



Determining the causes of HIGH loan default rates, A case study of citizenship economic empowerment commission (CEEC)

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Abstract

This study investigates the causes of high loan default rates at the Citizenship Economic Empowerment Commission (CEEC), focusing on lender-specific and borrower-specific factors, as well as potential measures to mitigate defaults. The research employs a qualitative approach, gathering insights from CEEC borrowers and stakeholders to understand the underlying challenges affecting loan repayment. Key findings indicate that loan defaults are driven by inadequate financial tracking systems, corruption in loan disbursement, weak loan recovery mechanisms, and borrower perceptions that CEEC loans are "government money" with no strict repayment obligations. Additionally, limited financial literacy and external economic challenges further exacerbate default rates. The study contributes both theoretically and practically to the field of microfinance and economic empowerment. Theoretically, it aligns with the Credit Risk Theory, the Theory of Micro-Loan Borrowing Rates and Defaults, and the Theory of Asymmetric Information, offering insights into how institutional weaknesses and borrower behavior influence loan performance. Practically, it provides actionable recommendations, including implementing robust financial tracking systems, enhancing loan recovery mechanisms, improving financial literacy training, and increasing transparency in loan disbursement. Despite its contributions, the study acknowledges limitations, such as reliance on qualitative data, which may restrict generalizability. It also highlights areas for future research, including exploring the role of technology in loan management and conducting comparative studies on government-funded microfinance institutions. The findings emphasize the need for a multi-faceted approach to strengthening financial oversight, borrower education, and institutional accountability to enhance loan repayment rates and ensure the sustainability of economic empowerment initiatives.

Keywords: Loan Default, Microfinance, Economic Empowerment, CEEC, Financial Literacy, Loan Recovery, Institutional Frameworks

Introduction

High default rates remain a critical concern for financial institutions worldwide, as they affect profitability, liquidity, and financial stability. Whether in traditional banks, non-financial banking institutions (NFBIs), or microfinance institutions (MFIs), loan defaults challenge the operational efficiency and sustainability of these organizations. Default rates have drawn increasing attention in recent years, especially in the context of global economic uncertainties and the evolving financial landscape. This chapter therefore introduces the study by outlining its background, problem statement, objectives, and research questions. It also highlights the significance of the study, defines its scope, and concludes with an outline of the dissertation's structure. In the banking sector, defaults are closely monitored as an indicator of financial health. Recent studies suggest that non-performing loans (NPLs) remain a persistent issue, particularly in developing economies. Scholars have highlighted the importance of effective regulatory frameworks and risk management practices in addressing high default rates (Alqahtani *et al.*, 2021)^[2]. The COVID-19 pandemic exacerbated these challenges, with many banks globally experiencing an uptick in loan defaults as borrowers struggled with economic disruptions (Biricik & Taylor, 2021)^[10]. Furthermore, empirical evidence suggests that loan defaults in banks can have a domino effect, creating systemic risks that extend beyond individual institutions (Bolarinwa & Adegbeye, 2020).

MFIs also continue to grapple with high default rates, although they have been instrumental in promoting financial inclusion, especially in underserved populations. Studies conducted post-2020 have indicated that these defaults can threaten the sustainability of MFIs, particularly those operating in volatile economic environments (Tambunan & Purba, 2021)^[46]. Given their unique clientele and relatively small loan sizes, MFIs face distinctive challenges in maintaining repayment levels. Similarly, NFBIs, such as cooperatives and credit unions, face rising default rates in various regions. These institutions operate outside the traditional banking sector and often lack access to the sophisticated credit risk management tools employed by banks. Research from recent years points to the increasing pressure on NFBIs to adapt their lending practices in response to global financial changes and emerging economic risks (Omondi *et al.*, 2022)^[39]. For many NFBIs, high default rates are linked to broader concerns about financial stability and institutional survival (Wagenaar *et al.*, 2021)^[47].

Macroeconomic factors have further compounded the challenges of managing high default rates across all types of financial institutions. Economic shocks, such as those caused by the COVID-19 pandemic, and ongoing market fluctuations have created an environment in which defaults are more likely to occur (BOZ, 2024). As such, maintaining financial stability and managing credit risk effectively have

become top priorities for institutions globally (Nasr & Saadaoui, 2020) ^[35].

Addressing the issue of high default rates remains crucial to ensuring the sustainability and growth of financial institutions. As these institutions navigate an increasingly complex and interconnected financial landscape, further research into the broader impact of defaults and mitigation strategies will continue to be of paramount importance.

The persistent issue of high loan default rates has been explored extensively in financial literature. This evolution reflects shifts in lending models, the development of risk assessment techniques, and changing socio-economic factors that influence borrower behaviour. Understanding these developments is crucial for addressing the contemporary challenge of high default rates.

The early literature on lending and default risk predominantly focused on assessing borrowers' capacity to repay loans through traditional risk factors such as collateral, income, and liquidity. Classical economic theories emphasized that aligning lending practices with borrower profiles was essential to mitigating default risk (Fisher, 1930 ^[18]; Keynes, 1936) ^[24]. These models, however, were more applicable to institutional lending, offering limited insights into the consumer credit landscape.

The gradual development of formal lending institutions further structured credit access, primarily through credit history and financial ratios to assess default risk. Despite this, predicting defaults remained a challenge, particularly as consumer lending expanded (Smith & Warner, 1979) ^[44].

The economic liberalization of the 1980s led to significant growth in consumer credit markets, including personal loans and credit cards, which exposed lenders to higher default risks. Merton's (1974) credit risk model marked a major shift by introducing probabilistic approaches to assessing defaults based on a borrower's equity volatility. This model laid the foundation for modern credit risk analysis and enabled a more precise calculation of default probabilities (Jagtiani & Lemieux, 2020) ^[21]. In parallel, Altman's (1968) Z-score became widely used to predict corporate defaults, offering a comprehensive framework for financial institutions. Despite these advancements, challenges in assessing the complex socio-economic factors influencing borrower defaults persisted.

The 1990s witnessed the rise of microfinance institutions (MFIs) in response to unmet credit needs in developing economies. Group lending models, as pioneered by the Grameen Bank, successfully mitigated default risks through peer pressure and joint liability mechanisms (Yunus, 1999) ^[48]. Empirical studies during this period showed that microfinance institutions achieved lower default rates compared to conventional banks, particularly in underserved markets (Armendáriz & Morduch, 2010) ^[4]. Despite initial success, microfinance later faced difficulties in maintaining low default rates as it scaled up operations. Key challenges included borrower-specific factors such as financial illiteracy and economic instability (Janda & Svarovská, 2021) ^[22]. These findings highlighted the complexities involved in providing credit to vulnerable populations and the need for adaptive credit models.

The 2008 financial crisis significantly influenced the study of loan defaults, particularly regarding systemic risks within the global lending system. The crisis revealed that widespread risky lending practices, particularly in subprime mortgage markets, led to mass defaults, triggering a global

economic recession (Acharya & Richardson, 2009) ^[1]. Post-crisis literature focused on macroeconomic factors like unemployment, interest rates, and inflation, which had substantial impacts on default rates (Gupta & Jain, 2021) ^[20]. In response, regulatory bodies introduced measures such as Basel III, which emphasized stricter lending standards and stronger capital reserves to prevent future crises (Basel Committee on Banking Supervision, 2011) ^[9]. Despite these efforts, default rates in many sectors remained high, revealing limitations in risk assessment models and highlighting the need for more comprehensive approaches to managing default risk.

Recent years have seen significant changes in the credit landscape, particularly with the rise of financial technology (Fintech). Digital lending platforms use advanced tools like machine learning and alternative data to assess creditworthiness, improving access to credit in underserved markets (Frost, 2020) ^[19]. However, while Fintech has widened credit access, it has also raised concerns about over-indebtedness and increased default rates, especially in emerging economies where regulations are less mature (Jagtiani & Lemieux, 2020) ^[21]. In addition, challenges such as high unemployment, and global crises like the COVID-19 pandemic continue to heighten default risks, particularly in developing countries (Mishra & Sharma, 2023) ^[28].

Zambia has experienced several instances where government-backed financial institutions or loan programs faced significant challenges due to high default rates, mismanagement, and economic instability. One notable example is the Development Bank of Zambia (DBZ), established in 1972 to promote long-term financing for sectors such as agriculture and small businesses. However, the bank struggled with high default rates due to poor loan monitoring, corruption, and political interference (Mwanza, 2020) ^[32]. Despite multiple recapitalization efforts, DBZ continued to face sustainability issues. Another example is the Zambia National Commercial Bank (Zanaco), founded in 1969 to support small businesses and agriculture. In the 1990s and early 2000s, Zanaco experienced high NPLs due to politically-influenced lending and poor credit management (Chanda, 2021) ^[12]. The bank's partial privatization in 2007 helped stabilize operations by improving its credit practices.

The Lima Bank, established in the 1980s to finance small-scale farmers, collapsed in the 1990s due to insolvency caused by high loan defaults. Farmers often defaulted on loans because of poor harvests, insufficient agricultural inputs, and low financial literacy (Ngoma, 2022) ^[36, 37]. Corruption and political interference also contributed to the bank's downfall. Similarly, the Cooperative Bank, which was created to support cooperative societies and small businesses, failed in the late 1990s. It faced significant repayment issues due to inadequate monitoring systems, corruption, and the perception of loans as grants (Phiri, 2023) ^[42]. Its collapse left many cooperative societies without access to critical financing.

Problem Statement

Loan default rates remain a major challenge for microfinance institutions and government-led economic empowerment programs globally (Smith, 2021; Johnson & Lee, 2020). In Zambia, the Citizens Economic Empowerment Commission (CEEC) has implemented a number of initiatives aimed at providing financial support to

various economic sectors, especially those involving small and medium enterprises (SMEs) (World Bank, 2023). Despite these efforts, the high rate of loan defaults has hindered the CEEC's mission of fostering economic growth and empowering citizens (Williams *et al.*, 2022). CEEC has had NPLs in amounts totaling K109, 567, 518 as of November 2021. This is according to the 2021 Auditor General's report (AGR) on accounts of parastatal bodies and other statutory institutions. The report has also revealed that some of the loans had remained static for periods ranging from two to four years. In addition, the commission failed to recover the collateral pledged as security for the loans disbursed (CEEC, 2021).

According to the 2023 AGR, NPLs at CEEC amounted to over K283 million. and the 2024 AGR found that NPLs remained high, ranging from 92% to 97%, with only 6% of loans performing against the set target of 10% (CEEC, 2024). Despite various reports highlighting the alarming rate of NPLs at CEEC, there is limited qualitative research that explores the underlying causes from both the lenders and borrowers' perspectives. Existing literature primarily focuses on quantitative analyses, such as financial ratios and NPL trends, but fails to adequately investigate behavioral, institutional, and socio-economic factors contributing to loan defaults. Additionally, prior studies have not sufficiently examined the effectiveness of CEEC's risk assessment, loan monitoring systems, and follow-up strategies in the Zambian context. By addressing these gaps, this study provides deeper insights into the root causes of loan defaults, offering practical recommendations to enhance CEEC's operational efficiency and policy framework.

Literature review

1. Previous Studies

Research on loan default rates has been an area of significant interest in financial and economic studies, particularly concerning microfinance institutions and government-supported loan programs. CEEC, which provides loans to small and medium enterprises, has faced challenges with high loan default rates. Understanding the factors contributing to these defaults is crucial for developing strategies to improve repayment and ensure the sustainability of empowerment programs.

Research has consistently shown that lender characteristics play a significant role in determining loan default rates. One major factor is inadequate credit risk assessment. Lenders often fail to conduct thorough evaluations of borrowers' creditworthiness due to limited resources or pressure to disburse loans quickly (Mwanza, 2020) ^[32]. Furthermore, weak loan monitoring systems prevent lenders from identifying early signs of financial distress among borrowers. Studies also highlight the impact of political interference, where loans are disbursed based on political connections rather than sound financial criteria (Chanda, 2021) ^[12].

Another critical issue is the lack of borrower education programs. Lenders frequently neglect to offer financial literacy training to borrowers, resulting in poor financial decision-making (Ngoma, 2022) ^[36, 37]. Additionally, corruption and nepotism in loan disbursement processes erode the credibility of lending institutions and contribute to high default rates (Phiri, 2023) ^[42]. Addressing these issues requires a comprehensive approach that emphasizes

transparency, enhanced credit assessment, and borrower education.

Financial literacy programs are another critical component. Educating borrowers on debt management, budgeting, and repayment obligations can foster a culture of responsible borrowing (Phiri, 2023) ^[42]. Additionally, lenders can introduce more flexible repayment terms to accommodate borrowers facing temporary financial difficulties. Establishing clear communication channels and reinforcing the consequences of loan default can also help shift borrower perceptions and improve repayment behavior (Lungu, 2024) ^[25].

By addressing the lender-specific and borrower-specific factors contributing to high loan default rates, as well as implementing targeted mitigation measures, lenders can reduce the prevalence of defaults. This literature review has synthesized relevant research to align with the research questions, providing a comprehensive overview of the factors at play and potential solutions. Moving forward, it is essential to adopt a multi-faceted approach that promotes financial literacy, transparency, and accountability across all levels of the lending process. Future research could explore the effectiveness of these measures in reducing default rates and improving loan program sustainability.

The World Bank (2021) highlights that banking systems in many developing nations continue to suffer due to a high percentage of subprime loans and risky credits. This issue is exacerbated by directed lending practices, which favor certain individuals or sectors, leading to the accumulation of bad loans. These non-performing loans (NPLs) strain financial institutions, leading to slowed economic development, particularly in low-income countries. Many state-owned banks in these regions suffer from low capital bases and high exposure to risk, making them vulnerable to collapse when borrowers default (World Bank, 2021).

Bank management plays a crucial role in internal factors that lead to NPLs, contributing to the instability of the banking sector in developing nations (Moussa, 2022). Additionally, according to Zhang *et al.* (2020), macroeconomic forces such as global economic cycles and domestic economic imbalances have been significant contributors to the rise of bank failures globally. These factors create liquidity pressures on local banks when international capital inflows are interrupted by unexpected global events, including wars or shifts in international policies (Davis & Gavin, 2021). As a result, local banks often attempt to call in loans or halt renewals, leading to forced asset sales and financial trouble for borrowers, which reduces the value of banks' collateral (Davis & Gavin, 2021).

Further supporting this notion, Enoch (2020) emphasizes that severe macroeconomic imbalances were a key factor in financial crises in Latin America, leading to high loan default rates. These crises were primarily driven by a combination of poor lending practices and economic instability. Similarly, Nakaso (2020) ^[34] found that Japan's financial crisis stemmed from an endogenous boom and bust cycle, where banks overextended credit to ventures with poor long-term prospects, driven by optimistic market conditions. This cycle ultimately led to widespread defaults as asset prices collapsed.

In the microfinance (MFI) sector, interest rates are a major factor in loan defaults. Xiang, Jia, and Huang (2019) observed that when interest rates are not appropriately

adjusted to the risk profiles of borrowers, default rates tend to increase. However, Kodongo and Kendi (2020) showed that implementing a graded scale for interest rate collection helped MFIs reduce loan defaults. This strategy allowed long-term, reliable borrowers to secure lower interest rates over time, which encouraged new borrowers to repay loans promptly in order to benefit from similar incentives (Kodongo & Kendi, 2020). As noted by Thuo and Juma (2021), the creation of such differentiated lending structures also helps MFIs meet both financial and social objectives by improving repayment rates while expanding outreach.

Van den Berg *et al.* (2020) found in a study in Mexico that MFI loan officers played a vital role in reducing default rates by maintaining close contact with borrower groups and providing financial management training. Loan officers were responsible for resolving conflicts and ensuring timely repayments, which contributed to better loan performance (van den Berg *et al.*, 2020). Conversely, Hossein (2020) identified political interference in Jamaica's MFI sector as a significant factor leading to loan defaults, where politically connected individuals saw loans as gifts and felt no obligation to repay.

Loan defaults can stem from institutional, client-based, or combined causes. Poor loan management practices, such as lax credit screening or inadequate enforcement of repayment policies, often lead to institution-based loan defaults (Siaw *et al.*, 2021; van den Berg *et al.*, 2020). On the other hand, client-based defaults are frequently driven by factors such as moral hazard, where borrowers feel less inclined to repay due to external influences or the perception of minimal consequences for default (Bylander, 2021; Presbitero & Rabellotti, 2019). In Nigeria, Siaw *et al.* (2021) found that implementing improved loan management systems significantly reduced default rates in MFIs, particularly when accompanied by borrower training programs.

In Sub-Saharan Africa, high loan default rates have been a persistent challenge for MFIs and other financial institutions. Morduch *et al.* (2020) conducted a regional study focusing on MFIs across East and West Africa, noting that poor economic conditions, such as high inflation rates and unemployment, directly contributed to higher default rates. Additionally, many borrowers in this region rely heavily on subsistence farming and small-scale trading, which are vulnerable to external shocks like climate change and global economic downturns, further exacerbating loan repayment difficulties.

Musau and Ngugi (2021) analyzed loan defaults in Kenya and Nigeria, finding that borrower-specific factors, such as over-indebtedness, lack of financial literacy, and inadequate business management skills, were key contributors to defaults. Their study also noted that financial institutions were struggling with implementing effective follow-up mechanisms and lacked the capacity for ongoing monitoring of borrowers' financial health. They recommend stronger financial education programs and improved risk assessment tools to help mitigate the rising default rates.

Another study by Lusambo and Phiri (2022) in Zambia and Tanzania examined the effects of regulatory frameworks on loan default rates in microfinance. They found that inconsistent regulation and oversight contributed to higher default rates as some MFIs were either too lenient with lending standards or did not have robust delinquency management strategies in place. Strengthening regulations

and building the capacity of MFIs was identified as a potential solution to address these challenges in the region.

2. Theoretical Framework – Theory of Micro-Loan Borrowing Rates and Defaults

The Theory of Micro-Loan Borrowing Rates and Defaults was developed by Stiglitz & Weiss (1981) and later expanded upon by Armendáriz & Morduch (2021) ^[4]. The theory explains that high borrowing rates, inadequate repayment structures, and limited borrower financial capacity contribute to increased loan defaults, particularly in microfinance institutions. It suggests that when lending rates are too high, borrowers with lower creditworthiness are more likely to take loans, increasing the risk of default. Additionally, the theory highlights the role of borrower behavior, business performance, and loan structuring in repayment outcomes. At CEEC, this theory is critical in assessing whether interest rates and loan conditions contribute to borrower defaults.

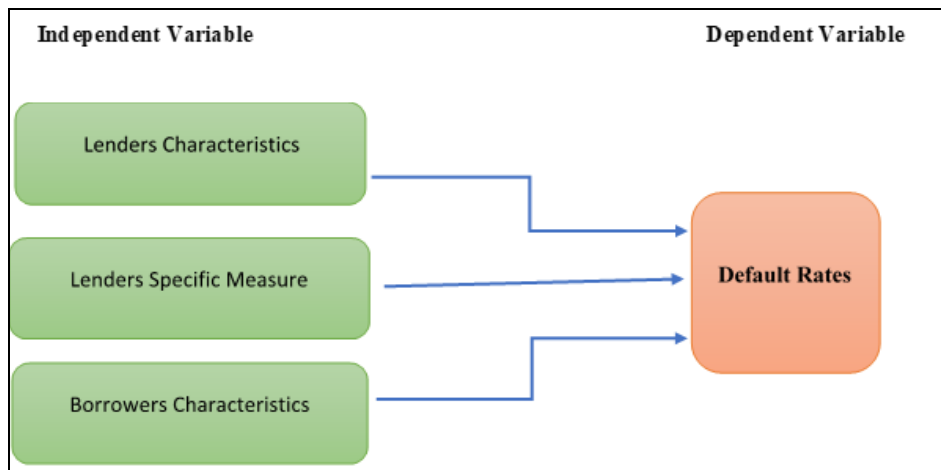
The study found that many CEEC borrowers struggled with loan repayment due to business challenges, limited profit margins, and inadequate financial planning. This aligns with empirical evidence, which shows that micro-loan recipients often face difficulties when repayment structures are rigid and not aligned with business cash flows (Beck & Cull, 2022; Zulu & Phiri, 2020) ^[41]. Zulu & Phiri (2020) ^[41] found that microfinance borrowers in Zambia frequently default due to high operational costs and poor business management, similar to CEEC's borrower challenges. Additionally, Banda (2019) emphasized that inadequate borrower training and limited financial literacy significantly impact loan repayment in Zambia's microfinance sector.

The essential utilization of this theory at CEEC lies in its ability to improve loan structuring, adjust interest rates based on borrower capacity, and introduce flexible repayment plans. The findings indicate that CEEC's one-size-fits-all loan terms do not accommodate the diverse financial situations of borrowers, leading to delayed payments or outright defaults. By applying this theory, CEEC can develop more borrower-friendly loan conditions, such as grace periods, flexible installment plans, and reduced interest rates for struggling businesses. As noted by Mwale & Chileshe (2021), customized loan structures in Zambia's microfinance sector have led to improved repayment rates and reduced defaults.

Currently, CEEC does not fully apply this theory, as evidenced by high default rates and borrower struggles with rigid repayment schedules. If integrated effectively, the theory could help CEEC structure loans in a way that aligns with borrowers' business cycles, reducing repayment stress and improving loan recovery rates (Tembo, 2022). Research by Tembo (2022) on Zambian micro-lenders suggests that aligning loan terms with business cash flows leads to higher repayment success. Therefore, adopting these principles could enhance CEEC's loan recovery mechanisms while fostering business sustainability among borrowers.

3. Conceptual Framework

Fig 2.1 The link between a researcher's variables is represented by a conceptual framework. Conceptual frameworks are often created using a literature analysis of previous studies on the topic and can be textual or visually presented.

Fig 2.1 Conceptual Framework

Source: Author(s) (2024)

Research methodology and design

This study employed a phenomenological research design to explore the lived experiences of CEEC loan borrowers and loan officers in understanding the causes of high loan default rates. Phenomenology is well-suited for this research as it seeks to uncover how individuals perceive and interpret their experiences regarding loan acquisition, utilization, and repayment (Smith & Johnson, 2021; Creswell & Poth, 2021). By focusing on CEEC borrowers within North mead and City Markets, this approach allowed for a deep exploration of borrower behaviors, institutional challenges, and socio-economic influences affecting repayment. The study utilized semi-structured interviews with borrowers who had received CEEC loans and key informant interviews with CEEC staff responsible for loan disbursement and monitoring (van Manen, 2021).

These interviews provided insights into borrower's motivations, challenges in repayment, and perceptions of CEEC's loan policies. Additionally, focus group discussion (FGDs) was conducted with marketeers who had taken out loans, allowing for collective reflections on shared challenges and repayment difficulties (Morgan, 2023; Smith, Flowers, & Larkin, 2020).

Data was analyzed using thematic analysis, where transcripts were systematically coded to identify recurring themes related to borrower financial behavior, loan repayment challenges, and institutional support mechanisms (Braun & Clarke, 2021). This iterative process ensured that emerging themes remained grounded in participants' lived experiences, contributing to a rich and nuanced understanding of the factors driving loan defaults at CEEC.

The population for this study consists of two distinct groups: borrowers and CEEC staff. The first group includes the 385 borrowers who received loans from CEEC (CEEC 2022), specifically those based in North mead and City Markets. These markets were selected due to their high concentration of marketeers who are recipients of the Marketeer Booster Loans (Saunders, Lewis, & Thornhill, 2021). The second group comprises 30 CEEC staff members involved in loan disbursement, monitoring, and recovery processes (CEEC 2023). These staff members are essential in understanding the institutional factors influencing loan defaults (Creswell & Poth, 2021).

A purposive sampling technique was used to select participants from both groups. For the borrower group,

individuals who had defaulted on their loans were specifically targeted to gain insights into the reasons behind loan defaults (Creswell & Poth, 2021). The sample size for borrowers was 25, chosen to ensure a rich and varied perspective on borrower behaviors and experiences. For the CEEC staff, a sample of 5 staff members was selected based on their roles and involvement in loan management. This approach allowed for a detailed exploration of the factors contributing to high loan default rates, ensuring that both borrower and staff experiences were adequately represented in the study (Bryman, 2021).

Findings

Lender-Specific Factors Contributing to High Default Rates

A major finding from this study is that CEEC lacks a robust financial tracking system, leading to inefficiencies in loan disbursement and monitoring. The absence of a proper monitoring mechanism has resulted in poor loan recovery rates, as evidenced by similar findings from Mwanza (2020)^[32], who emphasized the importance of financial tracking in ensuring accountability in microfinance institutions. Furthermore, cases of corruption were identified, where loans were granted based on personal connections rather than creditworthiness. This aligns with findings from Phiri (2020)^[41], who highlighted that political influence in loan disbursement often leads to poor repayment rates.

The Credit Risk Theory provides a relevant framework for understanding this issue, as it emphasizes the need for thorough risk assessment before issuing loans. Without a strong risk assessment mechanism, lenders are unable to accurately predict the repayment capabilities of borrowers, leading to higher default rates. Chanda (2020)^[13] noted that institutions with weak credit risk assessment models tend to experience higher loan defaults due to the inability to differentiate between creditworthy and non-creditworthy borrowers.

The Theory of Asymmetric Information further explains this phenomenon, as lenders at CEEC lack full transparency regarding borrowers' financial behaviors, making it difficult to determine who is likely to repay. Nakaso (2020)^[34] found that asymmetric information is a key contributor to loan defaults in government-backed financing schemes, as borrowers may misrepresent their financial standing when applying for loans. To address these issues, CEE should

implement real-time financial tracking systems and stricter due diligence measures in loan approvals. This would ensure that loans are disbursed based on merit rather than personal relationships, ultimately reducing default rates.

Borrower-Specific Factors Influencing Loan Repayment.

Another key finding of this study is that many borrowers perceive CEEC loans as "government money," leading to a lack of repayment commitment. This attitude is consistent with Musonda (2023), who found that borrowers often assume government-backed loans do not require repayment due to political rhetoric that portrays such programs as grants rather than financial obligations. Lungu (2024) ^[25] similarly highlighted that government loans often suffer from high default rates because borrowers believe there are no serious repercussions for non-repayment.

Financial literacy was also found to be a critical factor influencing loan repayment. Many borrowers lacked the necessary financial management skills to properly utilize loan funds and ensure timely repayment. This finding is supported by Mulenga (2020), who emphasized that financial literacy significantly impacts loan utilization and repayment behavior. The Organization for Economic Co-operation and Development (OECD, 2021) also stressed that financial education is crucial in reducing default rates, as well-informed borrowers are more likely to manage their finances effectively.

The Theory of Micro-Loan Borrowing Rates and Defaults supports this finding, suggesting that default rates are influenced by borrower behavior and perception. Ngoma (2022) ^[36, 37] argued that a borrower's perception of loan obligations plays a critical role in repayment decisions, with a strong correlation between financial literacy levels and default rates. The Theory of Asymmetric Information also applies, as borrowers with limited financial knowledge are more prone to adverse selection and moral hazard, where they take on loans without a clear plan for repayment.

To mitigate these challenges, CEEC should implement structured financial literacy programs for borrowers before loan disbursement. Educating borrowers on loan obligations, repayment structures, and financial management would significantly enhance repayment rates and reduce defaults.

Measures to Reduce Loan Defaults.

The study identified that improved borrower screening, enhanced financial education, and stricter enforcement of repayment policies are critical in reducing loan defaults. These findings align with World Bank (2020) recommendations, which emphasize the need for financial institutions to conduct thorough vetting of loan applicants to assess their repayment capabilities. Mwanza (2020) ^[32] also stressed that a rigorous screening process ensures that loans are granted only to creditworthy individuals, thereby minimizing default risks.

Financial education is another crucial factor in loan repayment, as noted by Mulenga (2020), who found that borrowers with higher financial literacy levels tend to have better loan repayment behaviors. OECD (2021) also reported that financial literacy programs contribute to improved loan performance in microfinance institutions by equipping borrowers with skills to manage debt effectively. The Credit Risk Theory supports these measures, as it underscores the importance of risk assessment and

mitigation strategies in lending. Lusambo (2020) noted that enforcing stricter lending policies, such as requiring collateral or personal guarantees, could improve repayment rates by increasing borrower accountability. Similarly, Nakaso (2020) ^[34] found that institutions with well-defined enforcement mechanisms tend to experience lower default rates due to the deterrent effect of penalties and legal consequences for non-repayment.

Given these findings, it is crucial for CEEC to adopt a multi-faceted approach, incorporating stringent lending policies, mandatory financial literacy training, and robust enforcement measures to ensure loan sustainability.

Conclusion

The findings of this study provide valuable insights into the persistent challenges surrounding loan default rates at CEEC. The study establishes that both lender- and borrower-specific factors play a crucial role in the high default rates observed. The lack of robust financial tracking mechanisms, corruption in loan disbursement, and weak loan recovery strategies hinder CEEC's ability to enforce repayment and sustain its loan programs effectively.

On the borrower side, misconceptions about CEEC loans being non-repayable, coupled with financial illiteracy and external economic pressures, significantly contribute to default rates. Many borrowers do not perceive repayment as a priority, which further exacerbates the problem. Additionally, the study highlights that insufficient follow-up and political interference further weaken the enforcement of loan repayment obligations.

The study concludes that addressing loan default rates at CEEC requires a multifaceted approach that strengthens institutional frameworks, enhances financial literacy among borrowers, and ensures greater transparency in loan disbursement and recovery processes. Without these interventions, the sustainability and effectiveness of CEEC's empowerment initiatives remain at risk. The next section outlines specific recommendations aimed at mitigating these challenges and improving loan repayment rates. This study makes significant contributions to both theoretical and practical aspects of microfinance and economic empowerment. The study enhances the understanding of loan default determinants in the context of government-funded microfinance programs by integrating insights from Credit Risk Theory, the Theory of Micro-Loan Borrowing Rates and Defaults, and the Theory of Asymmetric Information. It provides empirical evidence on how institutional inefficiencies and borrower perceptions influence repayment behaviors, thereby expanding existing literature on microfinance sustainability. The research highlights the need for policy-driven interventions to mitigate default risks in microfinance institutions, offering a framework for future academic studies on loan performance in similar contexts. The study provides actionable recommendations to CEEC and similar institutions on how to improve loan recovery, enhance financial literacy among borrowers, and reduce corruption in loan disbursement. It offers insights into the role of digital financial tracking systems and structured monitoring mechanisms in enhancing loan repayment rates. The study underscores the importance of borrower sensitization and institutional reforms to foster a culture of accountability in microfinance programs.

By bridging the gap between theory and practice, this research contributes to the ongoing discourse on sustainable microfinance operations and economic empowerment.

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