



The Relationship between Client Appraisal and Financial Sustainability among Microfinance Institutions in Tanzania

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Abstract; *The research aimed to investigate the degree to which client appraisal relate to financial sustainability among Microfinance Institutions in Tanzania. And aimed to test the hypothesis, H1: client appraisal has a statistically significant positive relationship with the financial sustainability of microfinance institutions. It was informed by Resource Based View theory. The research employed an explanatory research design. In total 291 Microfinance Institutions from Dodoma, Iringa and Shinyanga regions were visited for data collection. Semi-structured questionnaire in form of 5-point Likert scale was a tool for data collection, and analysed by descriptive (inferential) method. Research findings revealed a negative but statistically insignificant relationship between client appraisal and financial sustainability ($\beta = -0.196$, $p = 0.193$). This research findings implied that client appraisal practices, as currently implemented in various Microfinance Institutions in Tanzania did not significantly predict financial sustainability. It was generally concluded that research findings underscored the complexity of multi-layered nature of financial sustainability in Microfinance Institutions in Tanzania. Besides, and the requirement for context-specific strategies that could balance risk management with operational flexibility. The subsequent recommendations were made, first, Microfinance Institutions need to strengthen client appraisal frameworks using predictive analytics and digital tools to improve risk assessment accuracy and minimize default rates. Second, regular training is needed be offered to Microfinance Institutions staff in order to maintain consistency and precision in evaluation processes. Future longitudinal research is needed which should include other variables including, macroeconomic trends, regulatory impacts, and client-level outcomes to minimise the limitations of present research.*

Keywords: *Microfinance Institutions, Client appraisal, Financial sustainability, Path coefficient, Model fit*

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1. Introduction

The world has witnessed radical changes in microfinance services in the past two decades and developing countries have been no exception. As revealed in the Convergences (2019) report, there was a 9 percent global increase in microfinance services between 2012 and

2018. According to the 2018 report, borrower numbers increased by 6.3 million to 139.9 million, with a loan volume reaching USD 124.1 billion (Convergences, 2019), implying a 46 percent surge in borrowers and 56 percent increase in the number of Microfinance Institutions (MFIs) since 2012. The rapid increase in both MFIs and borrowers reflects not only heightened loan demand (Mtambie, 2016) but also a global rise in

loan delinquency (Convergences, 2019). Essentially, loan delinquency defined as a breach of loan repayment terms (Hwandi & Gama, 2015) is often linked to the minimal requirement for immovable collateral, which reduces borrowers' repayment incentives (Msuya, Izumida & Uchiyama, 2019).

The Convergences (2019) revealed that global loan delinquency grew from an average of 6.4 percent to 7 percent between 2009 and 2018. Countries such as China experienced the highest delinquency rates, ranging from 50 percent to 79.5 percent between 2012 and 2020 (Jia et al., 2016; Cui et al., 2018; Bu & Liao, 2020), whereas Europe recorded increased to 10 percent to 16 percent delinquency rates during COVID-19 (European Commission, 2020). The literature indicates that in Sub-Saharan Africa, loan delinquency stood above 5 percent exceeding the global benchmark of 3 percent (Shieler & Amu, 2018; Lyimo, 2019). It should be noted that high delinquency is a strong indicator of financial instability and potential bankruptcy in MFIs (Ogunsanwo, Abdulai & Abere, 2020).

Given the fact that lending is the main income-generating activity for Microfinance Institutions (MFIs) (Mori, Nyatori & Olomi, 2016), sound loan portfolio management is key for financial sustainability. Therefore, Microfinance Institutions (MFIs) need to prioritise the development of healthy lending and collection strategies. Efficient credit delivery and recovery mechanisms are seen as long-term solutions to delinquency, fostering timely loan repayment and improved institutional performance (Ngonyani & Mapesa, 2019). Strategies such as client follow-up and use of collection agencies (Boateng, 2018), and lending models including client profiling, project appraisal, and group lending (Mori et al., 2016; Kalu et al., 2018), can reduce delinquency rates. It is essential for MFIs to collect and analyse credit histories, borrowing patterns, and repayment behaviours (Kalu et al., 2018).

The recent research carried out by TICGL (2025) in Tanzania revealed that 49 percent of MFIs report default rates between 5 -10 percent, while 27 percent of the MFIs higher risks with rates exceeding more than 10 percent. The earlier research done by Charles (2022) in Tanzania showed that the higher interest rates impair MFIs' suitability as well as reduce financial inclusion.

Another research was done in Kenya by Alper, Clements, Hobdari, and Porcel (2019), investigating the impact of interest rate controls in Kenya introduced in September 2016. Research findings revealed that the law on interest rate controls has had negative effect of what was projected. That is, it led to a collapse of credit to micro, small, and medium enterprises. Additionally, it led to shrinking of the loan book of the small banks as well as reduced financial intermediation. It was recommended that adverse effects might chiefly be avoided if the ceiling was high enough to facilitate lending to higher risk borrowers.

Empirical evidence still consistently underscores the importance of effective client appraisal and selection in maintaining MFI financial sustainability. Edwin and Omagwa (2018) established a statistically significant positive relationship between client appraisal and financial performance, demonstrating that robust screening minimizes delinquency risks. Likewise, Ndiege et al. (2016) and Boateng (2018) found that the accuracy of client-based information directly determines repayment behaviour and institutional profitability.

Numerous research findings reveal contextual differences, for example, while Jefferson et al. (2019) observed that stringent screening practices in Europe significantly reduced loan losses, yet, Lyimo (2019) found limited effects in Tanzania, suggesting that client follow-up and monitoring may play a more decisive role in emerging markets. The researcher, Kalu et al. (2018) and Msuya et al. (2019) indicated that robust appraisal enhances repayment performance by aligning loan size and repayment capacity. Additionally, Ahmed and Malik (2015) depicted that credit terms and client appraisal had a significant and positive influence on loan performance. Nevertheless, their analyses were basically operational and lacked consideration of dynamic organizational factors such as learning and adaptation. This research investigated the relationship between client appraisal and financial sustainability for an approximate of 291 Microfinance Institutions (MFIs) in Tanzania.

1.1 Statement of the Problem

The financial sustainability of Microfinance Institutions is vital to expanding access to credit for low-income and underserved communities. However, persistent loan delinquency threatens this sustainability nationally and globally. While multiple studies (Makorere, 2014; Mosh, 2016; Ndiege et al., 2016; Msuya et al., 2019; Ngonyani & Mapesa, 2019; Lyimo, 2019) explored the determinants and consequences of loan delinquency, yet, majority have narrowly focused on operational factors such as client appraisal, credit terms, and internal controls. The studies have generally overlooked how organizational strategic capabilities, particularly the ability to sense, learn, and integrate affect the effectiveness of delinquency management and financial sustainability of Microfinance Institutions. Therefore, this study addressed both theoretical and empirical gaps by examining how dynamic capabilities moderate the relationship between loan delinquency management strategies (client appraisal, credit terms, and internal control) and financial sustainability among Tanzanian Microfinance Institutions.

1.2 Research Question

The main research question investigated was: to what degree does client appraisal relate to financial sustainability among 291 MFIs in Tanzania? The following hypothesis was used and tested: H1: Client

appraisal has a statistically significant positive relationship with the financial sustainability of microfinance institutions.

2. Literature Review

2.1 Theoretical review

The Resource Based View (RBV) theory proposed by Penrose (1959) and further developed by Barney (2001) informed this research. The theory emphasizes that a firm's resources are the primary drivers of its unique capabilities and competitive advantages. The Resource-Based View (RBV) theory posits that a firm's resources form the foundation of its dynamic capabilities, enabling firms to leverage these resources to achieve sustainable competitive advantage (Barney, 2001; Davis & DeWitt, 2021). This research contextualises the Resource-Based View (RBV) within Tanzanian microfinance, highlighting its underexplored role in explaining microfinance institutions' (MFIs) financial sustainability. It reveals that effective loan delinquency management strategies such as client appraisal, credit terms, and internal controls are not just operational tasks but also strategic resources that are valuable, rare, and hard to imitate, thus, providing MFIs with a competitive edge.

2.2 Empirical review

Zabolotnyy and Wasilewski (2019) denote that, financial sustainability of a for-profit firm such as Microfinance Institutions (MFIs) is the capability to generate value for owners and provide operational continuity, using an optimal combination of investments and sources of financing+. It is about the Micro financial stability to sustain resilience and soundness of a financial institution. That is, it involves managing risks, maintaining adequate capital and ensuring operational efficiency (Baltas & Liñares-Zegarra, 2024). Furthermore, risk management refers to mitigating credit liquidity, and various operational risks, while sustaining adequate capital to absorb losses. The regulation authority has the obligation to make sure that MFIs adhere to financial regulations and standards. In Tanzania, a number of policies and financial Acts have been put in place to ensure Micro financial stability, including Microfinance Act (2018), and the Microfinance Regulations (2019). The literature in Tanzania indicates that 49 percent of MFIs' default rates is between 5-10 percent, additionally, their operation costs are high, and face difficulty on accessing capital (TICGL, 2025). It is most likely that MFIs are not fulfilling one their main objectives, reducing income poverty, for instance, the resent research done by Mrindoko and Pastory (2022) in Iringa Municipality, Tanzania, revealed that majority of MFIs services had not improved micro and small entrepreneurs' income.

Empirical evidence consistently underscores the importance of effective client appraisal and selection in maintaining Microfinance Institutions (MFIs) financial sustainability. Edwin and Omagwa (2018) established a statistically significant positive relationship between client appraisal and financial performance, demonstrating that robust screening minimizes delinquency risks. Similarly, Ndiege et al. (2016) and Boateng (2018) found that the accuracy of client-based information directly determines repayment behaviour and institutional profitability.

More recent African studies, such as Ngonyani (2020) and Enoch, Arabo, and Digil (2021), emphasized that rigorous appraisals mitigate default risk but also noted the challenge of limited collateral among low-income borrowers. Both studies highlight the growing potential of digital technologies to improve appraisal accuracy through data analytics and mobile scoring tools, frontier yet underexplored in Tanzania. In summary, while previous studies affirm the significance of client appraisal in promoting sustainability, few have integrated the role of dynamic capabilities, specifically, how institutions learn and adapt appraisal strategies under changing market conditions. This study bridges that gap by testing the moderating effect of dynamic capabilities on the relationship between client appraisal and financial sustainability using structural equation modelling (SEM).

Comparative studies reveal contextual differences, that Whereas Jefferson et al. (2019) observed that rigorous screening practices in Europe significantly reduced loan losses, Lyimo (2019) found limited effects in Tanzania, suggesting that client follow-up and monitoring may play a more decisive role in emerging markets. Kalu et al. (2018) and Msuya et al. (2019) reported that vigorous appraisal enhances repayment performance by aligning loan size and repayment capacity, nevertheless, their analyses were mainly operational and lacked consideration of dynamic organizational factors such as learning and adaptation.

Earlier, Aliija and Muhangi (2015) carried out the research attempting to establish the effectiveness of loan appraisal process management on the credit performance of MFIs Fort portal Municipality in Western Uganda. Research findings indicated that the client appraisal was a feasible strategy for mitigating credit risk. Likewise, research findings indicated a strong relationship between credit performance of MFIs and client appraisal.

Moreover, Enoch, Arabo and Digil (2021) assessed the effects of credit management on financial performance on microfinance institutions in Adamawa State, Nigeria. The specific reason behind of doing this research was about challenges facing micro financial institutions due to growing incidence of loan defaults and consequence loan losses which results in their financial performance with huge failure to collect loans and advances. Research findings showed that client appraisal had a positive effect

on efficiency and productivity. That is, the research findings implied that client appraisal aids the microfinance banks to be effective, efficient and productive in credit management. Nevertheless, these findings were contrary to that of Gambo (2012) who indicated that client appraisal with regard to capability, gender and geographical location did not affect the credit management of microfinance banks.

3. Methodology

3.1 Research design

This study employed an explanatory research design to test the existence and strength of relationships among key variables and to validate a conceptual model explaining the relationship between client appraisal and financial sustainability among 291 MFIs in Tanzania. This design was chosen because it enables both the statistical testing of hypotheses and the exploration of institutional experiences, ensuring methodological complementarity and richer insights (Creswell & Plano Clark, 2018).

3.2 Population and sampling procedures

The target population for this study comprised all microfinance institutions (MFIs) operating in three regions of Tanzania namely, Dodoma was 325 MFIs; Iringa was 386 MFIs; and Shinyanga was 492 MFIs, in total were 1203 MFIs. Tanzania, estimated at 6,170 institutions (Magumula & Ndiege, 2019; Rabodiba, 2019). And The sample size was obtained by using Yamane (1967) formula. Yamane's formula provides accurate sample size, and it fits with the available parameter $N=1203$. It is expressed as:

$$n = \frac{N}{1 + N(e^2)}$$

Where;

n = Sample size

N = Total number of target population (1203)

e = Precision (5%)

$$n = 1203 / [1 + 1203(0.05)^2]$$

$$n = 291$$

Therefore, the sample size was 291 respondents.

3.2.1 Sampling techniques

The research employed a multistage sampling technique combining purposive and probability sampling methods. Initially, the regions of Dodoma, Iringa, and Shinyanga

were purposively selected based on their documented high rates of loan delinquency and the substantial presence of MFIs (Raphael & Mrema, 2017; Mpogole et al., 2021; Kasoga & Tegambwage, 2021). Within each selected region, two districts were purposively chosen due to their active microfinance sectors and loan delinquency challenges: Dodoma Urban and Bahi in Dodoma, Kahama and Shinyanga Urban in Shinyanga, and Mafinga and Iringa Urban in Iringa region.

3.3. Tools for data collection

Tools for data gathering was semi-structured questionnaire in form of 5-point Likert scale. Data on credit terms and loan collection strategies was collected using a semi structured questionnaire. Moreover, data for the construct, internal control, was collected based on the subsequent variables: timely release of loan/credit; borrower training and support services upon securing a loan, financial discipline, proper documentation, capital structure, loan insurance, number of borrowers per staff and follow-up of loan by visiting borrower's business premises. Last, but not least, the data on dependent variable, financial sustainability, data on Return on Equity, Return on Investment (ROI), Portfolio at Risk (PAR) and financial productivity was collected. Obtained data were analysed by using inferential statistical method.

3.4 Validity and Reliability

To ensure the face validity of the study, data collection tools was constructed and shared with university supervisors for constructive criticism and revised as was recommended. Content validity was achieved through questionnaire pre-testing by using expert judgment and in so doing, fellow PhD students, academic staff of Open University of Tanzania and from Ruaha Catholic University evaluated the tools and advise accordingly. Their opinions were used to improve the instruments. Moreover, pilot and triangulation were applied to ensure internal validity. A pilot study provided insights into the problem under study and its dimensions while triangulation provided a basis for validation and validation of results. On the other hand, the Cronbach's Alpha was computed to test the reliability of accrued data prior to analysis; this was to ensure that findings are trustworthy.

4. Results and Discussion

4.1 Results

To start with profile of respondents was given (Table 1)

Table 1: Profile of respondents

Variables		Number	Percent
Gender	Male	160	55
	Female	131	45
Age	18-25	26	8.9
	26-35	162	55.7
	36-45	72	24.7
	Above 46	31	10.7
Education	Certificate level	3	1.0
	Diploma level	73	25.1
	Degree level	126	43.3
	Masters level	75	25.8
	Other's qualifications	14	4.8
Business experience	Less than one year	191	53.5
	Between 1 and 5 years	92	25.8
	Between 6 and 10 years	60	16.8
	Over 10 years	14	3.9

Source: Field Data (2025)

The gender distribution shows a fairly balanced representation of males and females, with a slight predominance of male respondents. This diversity can help ensure that the study's findings are reflective of perspectives across genders. The majority of respondents fall within the 26-35 age range, indicating young to middle-aged demographic. This could suggest that the findings are most relevant to this age group, which may be the most active segment in microfinance activities. The education level of the respondents is high, the majority holding degrees or higher. This suggests that the respondents are well-educated, which could influence their understanding and implementation of financial sustainability strategies.

A significant proportion of respondents has less than one year's experience in business. This high representation of relatively inexperienced participants might indicate a need for more training and support in managing microfinance activities effectively.

The demographic characteristics of the respondents suggest a young, well-educated, and predominantly male participant base with varying levels of business experience. These attributes could influence the study's findings, particularly in understanding the nuances of how dynamic capability processes impact the financial sustainability of MFIs in Tanzania.

The findings from structural model assessment are presented in Table (2 and 3).

Table 2: Path coefficients

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values
CASF -> SI	-0.196	-0.133	0.150	1.303	0.193
CTS -> SI	-0.263	-0.293	0.062	4.222	0.000
IIC -> SI	0.128	0.146	0.071	1.798	0.072
EDS -> SI	0.026	0.021	0.081	0.321	0.748
EDL -> SI	0.010	0.039	0.062	0.163	0.870
EDI -> SI	0.157	0.139	0.058	2.727	0.006

Source: Field Data (2025)

Research Findings are given in Table 4.2. Findings of the relationship between client appraisal and financial sustainability among 291 MFIs in Tanzania and its hypothesis: H1: Client appraisal has a statistically significant positive relationship with the financial sustainability of microfinance institutions, is presented below.

The finding from structural model assessment presented in Table 4.3 show negative but insignificant path ($\beta = -0.196, p = 0.193$), for client appraisal, contradicting H1. This contrasts with studies linking rigorous client appraisal to reduced defaults (Karlan & Zinman, 2009) but aligns with critiques that excessive scrutiny may deter clients in low-income contexts (Morduch, 1999).

The Coefficient of Determination (R^2) value for financial sustainability (SI) is 0.218, with an adjusted R^2 of **0.175**. This indicates that approximately 21.8 percent of the variance in financial sustainability of Tanzanian microfinance institutions (MFIs) is explained by the combined effects of loan delinquency management strategies (client appraisal, credit terms, and internal

control) and dynamic capabilities (sensing, learning, integration). While this R^2 value may seem modest, it is common in social science research where human behaviour and organisational outcomes are influenced by multiple complex and often unmeasured factors (Hair et al., 2017).

Table 3: Model fit

	Saturated model	Estimated model
SRMR	0.075	0.075
d_ ULS	7.181	7.179
d_ G	2.011	2.011
Chi-square	2794.033	2793.912
NFI	0.773	0.773

Source: Field Data (2025)

The model fit demonstrates an acceptable fit with an SRMR of 0.075 (Table 4.3), indicating good

overall fit, though the NFI of 0.773 suggests moderate fit and room for improvement. The R-square value for financial sustainability (SI) is 0.218 (adjusted 0.175), showing the model explains about 22 percent of the variance, reflecting modest explanatory power. Effect size (f^2) analysis reveals that credit terms (CTS) and client appraisal (CASF) have small to moderate impacts on SI, while dynamic capabilities like learning (EDL) and sensing (EDS) show minimal direct effects.

4.2 Discussion

The findings revealed a negative but statistically insignificant relationship between client appraisal and financial sustainability ($\beta = -0.196$, $p = 0.193$). This implies that client appraisal practices, as currently implemented, do not significantly predict financial sustainability. This finding contradicts earlier evidence by Edwin and Omagwa (2018), who found that rigorous appraisal procedures reduce defaults and enhance profitability. Likewise, Ngonyani (2020) and Enoch, Arabo, and Digil (2021), found that the accuracy of client-based information directly determines repayment behaviour and institutional profitability. However, the present research aligns with Morduch (1999), who warned that overly stringent client vetting in low-income markets can deter qualified borrowers and restrict portfolio growth. Furthermore, the Resource Based View (RBV) theory proposed by Penrose (1959) puts emphasis by supporting that effective loan delinquency management strategies such as client appraisal, credit terms, and internal controls are not just operational tasks but also strategic resources that are valuable, rare, and hard to imitate, thus, providing MFIs with a competitive edge. Moreover, the research done in Uganda by Aliija and Muhangi (2015) indicated a strong relationship between credit performance of MFIs and client appraisal. Also, Enoch, Arabo and Digil (2021) in Nigeria found that client appraisal helped the microfinance banks to be effective, efficient and productive in credit management.

From the perspective of Dynamic Capabilities Theory by Teece (2007), this result suggests that MFIs may perform operational screening but lack the sensing capability to convert client information into adaptive decision-making. In other words, appraisal may exist as a static compliance function rather than a strategic learning process.

Therefore, the practical implication is that, MFIs need to modernize appraisal systems by incorporating digital risk profiling and predictive analytics, enabling managers to identify creditworthy clients more effectively while maintaining inclusion.

There were unexpected findings, that is, client appraisals were not significant, although widely assumed essential for performance, but it had no direct impact. This most likely stemmed from standardized but outdated appraisal processes or limited use of digital screening tools. The other strange finding was that, there was a negative influence of credit terms, contrary to expectations. Another interesting finding was that stricter terms reduced sustainability, possibly due to borrower fatigue, over-indebtedness, or limited financial literacy. These all-unexpected findings highlighted a contextual paradox, that is, control-oriented financial systems could undermine inclusivity and long-term stability in emerging markets, calling for more adaptive, client-centred approaches.

5. Conclusion and Recommendations

5.2 Conclusion

The research investigated the relationship between client appraisal and financial sustainability among 291 MFIs in Tanzania. Client appraisal among other factors showed no significant direct effects on sustainability, indicating that their influence may be indirect or context-dependent within Tanzanian MFIs. Therefore, the results underscore the complex, multifaceted nature of financial

sustainability in MFIs and the necessity for context-specific strategies that balance risk management with operational flexibility.

5.2. Recommendation

5.2.1 Practical recommendations

There should be enhancement of client appraisal systems. MFIs need to strengthen client appraisal frameworks using predictive analytics and digital tools to improve risk assessment accuracy and minimize default rates. Regular training should be provided to staff to maintain consistency and precision in evaluation processes.

5.2.2 Recommendation for further research

In the pursuit of this research, one limitation became apparent. In this study, the influence or effects of the given constructs on financial sustainability of microfinance institutions were analysed using the cross-section data that were available. The results from cross-section data, nevertheless, have limitations in giving a general and vigorous picture. In this regard, the influence of the given constructs on financial sustainability of microfinance institutions can be analyzed more effectively using longitudinal data. The longitudinal research should include other variables including, macroeconomic trends, regulatory impacts, and client-level outcomes would provide a more comprehensive understanding of financial sustainability in Micro Financial Institutions (MFIs).

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