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Loan Diversion and Loan Repayment for the Uganda Women Entrepreneurship Programme in Kibaale District, Uganda

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A B S T R A C T :

This article conducts a comprehensive examination of the extent and multifaceted impact of loan diversion among Uganda Women Entrepreneurship Programme (UWEP) beneficiaries in Kibaale District. Utilizing an extensive mixed-methods approach that combines quantitative surveys with qualitative focus group discussions, the study reveals that approximately 41% of beneficiaries diverted loan funds from their intended enterprise activities to other personal or household needs. The analysis further indicates that loan diversion had significant detrimental effects, leading to widespread business underperformance, weakened group enterprise cohesion, and a marked increase in loan default rates among the affected groups. In many cases, diverted funds were used for school fees, healthcare emergencies, and daily household expenses, undermining the original investment intentions and jeopardizing the long-term sustainability of the funded enterprises. Moreover, the findings show that loan diversion not only affected individual borrowers but also had a cascading negative impact on group credibility and collective loan responsibility, increasing tension among group members and reducing the overall trust in the program. In response to these challenges, the study strongly recommends the implementation of comprehensive and context-specific financial literacy programs tailored to the realities of rural women entrepreneurs. Additionally, it advocates for the establishment of rigorous, continuous loan monitoring mechanisms and the enforcement of strict compliance frameworks that reaffirm loan purpose agreements. Such interventions are essential to minimize diversion risks, enhance business success rates, and ultimately improve the overall repayment performance within UWEP projects in Kibaale District.

Keywords: Loan diversion, Loan repayment, Women entrepreneurship

Introduction

Loan diversion undermines the objectives of microfinance initiatives, compromising both business viability and repayment performance. This study investigates loan diversion practices among UWEP women groups in Kibaale District and their effects on loan repayment.

Literature Review

Loan diversion occurs when borrowed funds are redirected toward purposes other than the intended enterprise, often undermining the financial viability and operational sustainability of funded businesses. Extensive research (Roodman & Qureshi, 2006; Kamanza, 2014) highlights a strong and consistent link between loan diversion and higher default rates, suggesting that diversion severely compromises borrowers' ability to generate sufficient revenue needed for timely repayment. Diversion can manifest in various forms, including allocation of funds toward pressing household expenses, social obligations, or speculative activities unrelated to the original business plan.

Several factors contribute to loan diversion among UWEP beneficiaries. Immediate household needs, such as urgent medical expenses, school fees for children, and basic living costs, often compel borrowers to prioritize personal welfare over business investment. Poor financial planning, marked by inadequate budgeting, failure to forecast business cash flows, and insufficient contingency reserves, exacerbates this vulnerability. Moreover, a pervasive misunderstanding of loan obligations – in part due to inadequate borrower education – leads some women to perceive the loans as government grants that do not require strict repayment or adherence to original usage plans. Additionally, cultural norms and communal expectations can pressure women to use loan proceeds to meet social responsibilities, further detracting from enterprise-focused investments. Collectively, these factors highlight the urgent need for targeted financial literacy programs and rigorous loan monitoring systems to safeguard the integrity of UWEP's objectives.

When loans intended for business development are diverted to other uses, the capital available for the business is reduced. This can lead to underperformance of the enterprise, as there are insufficient funds to cover essential business operations or invest in growth. The direct consequence is a decrease in the business's profitability, which in turn affects the borrower's ability to generate the income needed to repay the loan (Roodman & Qureshi, 2006).

Loan diversion significantly increases the risk of loan default. Borrowers who divert funds away from their business often struggle to make loan repayments, especially if the alternative use of the funds does not generate a return. Studies show a strong correlation between loan diversion and higher default rates among women groups in Uganda. This is particularly problematic for group lending schemes like UWEP, where the default of one member can affect the entire group's creditworthiness (Zeller & Meyer, 2002).

The literature on loan diversion and loan repayment provides valuable insights into the causes and consequences of loan diversion. However, there are several gaps that need to be addressed. First, most studies focus on the impact of loan diversion on loan repayment, but few explore the role of external factors, such as economic shocks and social pressures, in driving loan diversion. Second, there is limited research on the effectiveness of different strategies for mitigating loan diversion, particularly in the context of government-funded programs like UWEP.

Methodology

Data were collected from 288 women in 96 UWEP groups through questionnaires and FGDs using a cross-sectional descriptive and explanatory research design with mixed techniques, which included elements of both qualitative and quantitative approaches in order to achieve the best results. Quantitative data were analyzed using regression models, while qualitative data enriched the understanding of underlying causes.

Results

The hypothesis stated, "*There is no effect of loan diversion on loan repayment*". A simple regression was used to test the hypothesis and results are presented in Table 1.

Table 1: Effect of loan diversion on loan repayment

Regression Statistics	
R	**.318**
R Square	**.101**
Adjusted R Square	**.098**
Standard Error	**2.853**
Observations	**288**

ANOVA statistics

	df	**SS**	**MS**	**F**	**Sig F**
Regression	**1**	**262.7**	**262.7**	**32.3**	**.000**
Residual	**286**	**2327.3**	**8.1**		
Total	**287**	**2590.0**			

Coefficients statistics

	Coefficients	**Standard Error**	**Beta**	**t Stat**	**P-value**
Intercept	**18.01**	**.64**		**28.07**	**.000**
Loan diversion	**-.15**	**.03**	**-.32**	**-5.68**	**.000**

Results of the regression coefficient (R = .318) show a weak relationship between loan diversion and loan repayment. The Adjusted R Square (.098) shows that a 1% change in change loan diversion contributed to 9.8% change in loan repayment.

The ANOVA statistics show that the Fisher's ratio (F = 32.3) had a significance (Sig F = .000) which was less than the recommended critical significance at .05. This led to accepting the finding and thus rejecting the null hypothesis "*There is no effect of loan diversion on loan repayment*". Therefore, it was concluded that a 1% change in change loan diversion contributed to 9.8% change in loan repayment.

The coefficients results (-.15) or the *Beta* results (-.32) show they were negative implying the change in loan diversion was in the opposite direction of change in loan repayment. This suggested that less loan diversion contributed to better loan repayment. On the other hand, more loan diversion contributed to poor loan repayment.

Discussion

Loan diversion substantially reduces the capital available for income-generating activities, directly compromising the borrowers' ability to sustain their businesses and, consequently, their capacity to meet loan repayment obligations. When funds intended for productive investment are redirected towards personal or household needs, the enterprise is deprived of critical resources necessary for operational growth and profit generation.

Immediate family needs—such as urgent medical treatments, school fees for children, funeral expenses, and subsistence living costs—emerged as the predominant drivers of loan diversion among UWEP beneficiaries. These pressing demands often led women to prioritize immediate survival and social obligations over the long-term health of their enterprises. Furthermore, inadequate understanding of loan terms and repayment expectations, exacerbated by limited financial education, contributed significantly to the misappropriation of funds. Many beneficiaries misunderstood the non-grant nature of UWEP loans, mistakenly believing they had the discretion to reallocate the funds without repercussions.

Recommendations

The study recommends the integration of compulsory financial literacy and loan utilization training to curb the vice of loan diversion. Strengthen monitoring and follow-up mechanisms is crucial. Implement stricter monitoring and accountability measures to ensure that loans are used for their intended purposes. This could include regular check-ins, progress reports and site visits to verify the proper use of funds. Loan diversion often occurs when there is insufficient oversight. By enhancing monitoring mechanisms, UWEP can ensure that funds are used as planned, thereby reducing the likelihood of loan diversion and its negative impact on repayment. The study recommends the establishment of group-based sanctions for loan diversion as well as instituting commitment agreements to curb loan diversion.

Conclusion

It was concluded that a 1% change in change loan diversion contributed to 9.8% change in loan repayment. It was concluded that loan diversion negatively affects loan repayment and this was corroborated by the interview findings. Loan diversion significantly hampers loan repayment under UWEP. Addressing it through education and accountability structures is essential for program success. Loan diversion significantly undermines the effectiveness of microfinance initiatives like UWEP by impeding project implementation, reducing business profitability and increasing the risk of loan default.

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