

# The Performance and Constraints of the Micro-Finance Institutions and Conditions for Poverty Reduction in Tanzania

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## **ABSTRACT**

The purpose of the thesis is to evaluate the performance and constraints of the micro-finance institutions and conditions for poverty reduction in Tanzania. In order to fulfil this purpose the authors have used institutional theory combined with traditional neo-classic micro theory. The National Poverty Eradication Strategy was formed in Tanzania in 1998 with a long-term objective of the government to reduce the poverty in the country. The objective more specific, was to reduce poverty with 50 per cent by the year of 2010 and eradicate poverty by the year of 2025. The authors have developed a number of factors for efficient micro-finances, if these conditions are met the micro-finances are presumed to be sustainable and useful. A field research survey will encompass interviews with micro-finance institutions in micro-finance non-governmental organisations, registered commercial banks, registered non bank financial institutions and other important influential organisations. The conclusion of thesis is that the micro-financing is a good tool for of reducing poverty, even if it is not completely efficient today. The micro-finance institutions have not succeeded in reaching out to the people in most need of the credits, the vulnerable poor. It is only the relatively poor already in business that are accepted as borrowers while new business starters, who are be in more need of financing support that are not accepted.

## SAMMANFATTNING

Syftet med uppsatsen är att utvärdera restriktioner och utförandet av mikrofinansinstitutioner och dess villkor för att minska fattigdomen i Tanzania. För denna utvärdering har institutionell teori kombinerad med traditionell neo-klassisk mikroteori använts. År 1998 utformades ”National Poverty Eradication Strategy” i Tanzania med ett mål för regeringen att minska fattigdomen i landet med 50 procent till år 2010 och att få den helt utrotad vid år 2025. Författarna har tagit fram ett antal faktorer som bör vara uppfyllda för att mikrokrediterna ska vara effektiva. Om dessa faktorer uppfylls innebär det att mikrokrediterna är hållbara och användbara för det tänkta syftet. En fältstudie har använts för att studera mikrofinans institutioner bland “micro-finance non-governmental organisations”, registrerade kommersiella banker och icke-registrerade kommersiella banker samt andra viktiga och inflytelserika organisationer. Slutsatserna i arbetet är mikrofinansiering är ett bra instrument för att minska fattigdomen, även om det inte är fullständigt effektivt i dag. Mikrofinansinstitutet har inte lyckats nå ut till de i störst behov av krediterna, de riktigt fattiga. Det är endast de relativt fattiga med redan existerande företag som är accepterade som låntagare medan nyföretagare, som är i större behov av finansiering inte är accepterade.

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## TABLE OF CONTENTS

<b>Chapter 1</b> .....	<b>1</b>
<b>INTRODUCTION</b> .....	<b>1</b>
1.1 Previous research .....	2
1.2 Objective .....	3
1.3 Methodology .....	3
1.4 Outline of the Thesis .....	5
<b>Chapter 2</b> .....	<b>6</b>
<b>MICRO-FINANCING IN TANZANIA</b> .....	<b>6</b>
2.1 The Purpose of Micro-finances .....	6
2.2 Currently Operating Financial Institutions in Tanzania .....	8
2.3 Group and Individual Lending .....	9
<b>Chapter 3</b> .....	<b>11</b>
<b>INTRODUCING TANZANIA</b> .....	<b>11</b>
<b>Chapter 4</b> .....	<b>14</b>
<b>THEORY</b> .....	<b>14</b>
4.1 The Importance of the Institutions .....	14
4.2 Factors for efficient micro-finances in Tanzania.....	16
<b>Chapter 5</b> .....	<b>18</b>
<b>THE SURVEY</b> .....	<b>18</b>
5.1 Findings of the Study .....	19
5.1.1 Demography .....	19
5.1.2 Loan Size and Conditions .....	20
5.1.3 Repayment .....	21
5.1.4 Advertisement.....	23
5.1.5 Pre-loan training .....	24
5.1.6 Use of the credits for poverty reduction .....	24
5.2 Fulfillment of the factors for efficient micro-finances in Tanzania .....	26
5.2.1 Incentives for repayment in order to disclose free-riding .....	26
5.2.2 Lending efficiency .....	27
5.2.3 Outreach to the poorest.....	27
<b>Chapter 6</b> .....	<b>28</b>
<b>CONCLUSIONS</b> .....	<b>28</b>
<b>REFERENCES</b> .....	<b>30</b>
<b>APPENDIX</b> .....	<b>33</b>

## ACRONYMS

BoT	Bank of Tanzania
MFI	Micro Finance Institutions
NPES	National Poverty Eradication Strategy
GDP	Gross Domestic Product
TAMFI	Tanzanian Associations of Micro-finance Institutions
NGO	Non Governmental Organisations
Sida	Swedish International Development Authority
Incofin	International Cooperation and Financing
SIDO	Small Industries Development Organisation

## **Chapter 1**

### **INTRODUCTION**

The most commonly used way to measure poverty is based on incomes or consumption levels. A person is considered poor if his or her consumption or income level falls below 1USD per day, a level necessary to meet basic needs. This minimum level is usually called the "poverty line" (The World Bank, 2003). As stated in the National Poverty Eradication Strategy (NPES) that was formed in Tanzania in 1998, the long-term objective of the government is to reduce poverty by 50 per cent by the year 2010 and eradicate poverty by the year 2025 (The United Republic of Tanzania, 2003a).

Micro-finance is the term used to refer to different methods for giving poor people access to financial services. More than twenty years experience of micro-financing around the world shows that poor people with little education are reliable borrowers who invest wisely and are willing to save if given the chance (Sida,1999).

The National Microfinance Policy (2000) of Tanzania states that establishing a basis for evolution of an efficient and effective micro financial system in the country that serves the low-income segment of the society will contribute to economic growth and poverty reduction. In developing countries, like Tanzania, the poorer sections of the population have little or no access to financial resources. Consequently, their participation in economic development is either limited or denied. Many specialised financial institutions created in the 1950s and 1960s were unable to meet the dual challenge of institutional and financial sustainability on the one hand, and outreach to large numbers of poor people on the other hand. Over more recent years, a variety of initiatives of micro-finance schemes have been undertaken, often combining financial and social intermediation in both urban and rural areas. Advances in financial intermediation and infrastructure, stimulated by the deregulation of the financial sectors and facilitated by

modern technology, have put the spotlight on participatory mechanisms for integrating the poor into the economic mainstream. The advances in financial intermediation include recent efforts to design and deliver very small loans to poor borrowers, both individuals and groups (Schneider,1997).

### **1.1 Previous research**

Earlier studies about micro-financing have evaluated whether micro-credit programs such as the popular Grameen Bank in Bangladesh reach the relatively poor and vulnerable in their operations. They found out that while micro-financing is successful at reaching the poor, it is less successful at reaching the vulnerable. The results also suggested that micro-financing is unsuccessful at reaching the group most prone to destitution, the vulnerable poor (Amin; Rai; Topa, 2003 ). The Grameen Bank is one of the first banks operating with micro-financing. The bank's initiative to uplift the socio-economic conditions of the rural poor in poor countries is not the first of its kind. During the past decades, several attempts have been made to alleviate rural poverty and expedite the pace of development in the country. However, most of these initiatives have come under government patronage (Wahid & Hsu,2000). Over the years the Grameen Bank has become a well-known financial institution that offers tiny loans to the poorest of the rural on a group lending basis. The definition of poor, that the Grameen Bank started to reach out to, were those who possessed less than half an acre of land of assets not exceeding the value of one acre of medium-quality land (Ibid.).

The study of the Grameen Bank has showed some positive results. Historically, the Grameen Bank has been able to recover 98 per cent of the principal including interests. Evidence suggests that the fast horizontal expansion of the bank has not diminished the loan recovery rate in any significant way. Other evidence shows that Grameen Bank is a marketing-oriented financial organization. The Bank targets a homogenous group of rural poor. In general, these people feel comfortable with petty loans and they invest the money in small business and trade such as small-scale poultry raising, cooking puffed rice, making bamboo stools, weaving floor mats with date-tree leaves, and paddy husking. Consequently, the Bank can rely on a degree of solidarity (Ibid.).

A study about the Grameen Bank (Hossain, 1993) have found that the Bank appeared to be quite effective in creating jobs. Some may argue that the sample size is not big enough to reflect the reality. Given that Grameen Bank is the youngest of the studied five programs, however, the fact that it stands second in job creation, may help to clarify the issue. Another study (Hossain, 1985) with Grameen Bank as a target, show that the bank experienced the second highest average per capita income rise. It is also generally believed that the Grameen Bank has significantly increased the productivity of its members. The micro-financing even helps the borrowers to improve their living and housing conditions.

Studies about micro-financing in Kenya (Kithinji, 2002), shows that the Kenyan government in the beginning of May 1999, recognized the importance of the micro-finance sector in the nation's financial community. In March the same year, an Association of Micro-Finance Institutions (AMFI), was formed, were a total of eleven large micro-finance institutions (MFIs) together served over 97 000 clients. Its mission is to develop a micro-finance industry and an institutional framework that serves poor and low-income people in Kenya. Its long-term objectives are to ensure that the micro-finance legislation is passed by parliament and to increase membership in the network among MFIs. Most Kenyan micro-credit programs have been slow to embrace more commercial practices and to make the transition to financial sustainability. With the increase of demand on these institutions to become financially, there has been a shift on emphasis from the very poor to the entrepreneurial poor. This shift has totally left out the very poor, which has defeated the initial goal of micro-finance for poverty alleviation.

## **1.2 Objective**

The main objective of the thesis is to evaluate the performance and constraints of the MFIs and the conditions for poverty reduction in Tanzania up to date.

## **1.3 Methodology**

The theoretical framework used in this study is traditional neo-classic micro theory combined with an institutional economics perspective. According to micro theory,

investments are needed in order for a higher consumption and a higher gross domestic product (GDP). To achieve this, the MFIs need to lend money in an effective way by means of clear rules and supervision. Studying institutional aspects of the Tanzanian micro-finance sector requires a methodology suitable for investigating the sets of rules that govern the actors involved. The study will examine how the institutions should work in order to fulfil this.

Interviews will be held with MFIs in micro-finance non-governmental organisations (NGOs), registered commercial banks, registered non bank financial institutions and other important influential organisations. The primary data will be collected through fieldwork interviews and some information obtained from the MFIs' data files will also be used. The MFIs selected are situated in Dar es Salaam, Zanzibar and Arusha region, since their head offices are located in these regions. The MFIs studied are all members of Tanzanian Association of Microfinance Institutions (TAMFI), a network of which the majority of the MFIs in Tanzania are members.

The main tool of data collection is a detailed structured questionnaire to be administrated at different levels and regions. Interviews will be held in order to study the performance of the micro-finances in Tanzania and also to find out if the conditions for poverty reduction are met. The questionnaire is mainly focused on the identified major issues and tasks. The questions are an instrument in order to find out if the objective of the thesis is fulfilled. The demography of the borrowers is the first thing that the authours want to know in order to get a hint of how the typical borrower looks like. A question about the average loan size is asked in order to get an overview of the lending system. By looking at how the MFIs uses advertisemet the authours will find out how they cover the tanzanian population. It is important that even the poorest with no access to modern media will be aware of the existence of the micro-finances. An important question that will be asked is if the loans are given to the ones with already existing businesses or if the loans also are given to the ones with little money and no existing businesses. The repayment is a good indicator in order to find out the performance of the credits. A good repayment rate indicates that the lending system works properly. With this the MFIs can get feedback that they are lending to the right

people. If the micro-finances work well, the credits will be a good help to reduce the poverty in Tanzania.

To complete the structured questionnaire, the authors have adapted the survey methodology depending on the type of MFI or organisation studied. Some MFIs have filled out the questionnaire themselves when interviews have been held with others, when more appropriate. The questions used are open ended with a purpose of evaluating the practice and performance of the MFIs with respect to their adequacy, constraints, achievements and prospects of serving the national objective of using credit as an instrument of alleviating poverty amongst the poor.

#### **1.4 Outline of the Thesis**

In chapter 2 a brief overview of the Tanzanian economy and the use of micro-finances is given. This is followed by chapter 3 and a more profound presentation of the country situation in Tanzania. Chapter 4 deals with the new institutional theories and refer to factors for efficient micro-finances in Tanzania. In chapter 5 there is at first a brief overview of the procedure of the survey and then it deals with the findings of the study.

The thesis ends in the conclusion part with a summary of the main findings of the study. The point of departure for the discussion in the conclusions is that changing the micro-finance sector is basically a matter for the Tanzanians themselves to handle, and our aim is by no means to provide ready-made solutions to the problems that currently besets the sector. Nevertheless, the report is aimed at contributing results and arguments useful for a wide circle within the micro-finance sector, and especially for those who are particularly interested in the future of the sector in Tanzania.

## **Chapter 2**

### **MICRO-FINANCING IN TANZANIA**

#### **2.1 The Purpose of Micro-finances**

About 80 per cent of the country's population live in rural areas where 70 per cent of Tanzania's national output is produced (African Rural and Agricultural Credit Association, 2003). Most of the people living in these areas are poor farmers and are the principal beneficiaries of micro-finance policy (Bank of Tanzania, 2001). The rural sector, like in many other African countries, has largely remained underdeveloped. Development of the rural sector is therefore central in Tanzania's strategy to increase national output and employment, and in its fight against poverty. (African Rural and Agricultural Credit Association, 2003). Experience from studies of micro-financing (Wahid & Hsu, 2000) shows that well designed micro-finance programmes can make a significant impact on the living conditions of the poor.

Here, micro-finance means small loans—approximately 17 USD to 9,600 USD amortised over short terms, most often six to twelve months. These micro loans can rotate, that is, after paying off one loan, the client becomes eligible for another.

Poor people in most countries have virtually no access to formal financial services. A small loan can help break the cycle of poverty when it is invested in an economic activity that generates increased earnings. Similarly, saving money in a safe place provides the poor a cushion against sudden shocks, such as illness or a bad harvest, which could easily push them into poverty. Greater access to financial services and increased incomes allow the poor people to invest in, for example, their childrens' future. They can also be able to seek health care services when needed, rather than to wait until an illness has reached crisis proportions (The World Bank, 2002).

It is understandable if there are many people who fear accessing these micro-credits for various reasons. Some small entrepreneurs may think that they never require a loan and some may fear the fact of being indebted. Some of the MFIs studied require that the clients save a certain amount each month in a special account. This is a way for the MFIs to have an extra security if the client is unable to pay one period and on the other hand to introduce saving traditions into the Tanzanians' lives. Tanzanians have little or no traditions of savings and might find it very hard to both save money and amortise the loans at the same time, since they lack experience of this.

The majority of Tanzanians have a very low income, and if they get access to financial services by means of lending and saving, it offers a lot. They get the possibility of managing scarce household and enterprise resources more efficient, they get protection against risks, provision for the future and taking advantage of investment opportunities, for economic returns. Financial services allow higher standards for the households of living to be achieved with the same resource base, while for enterprises and farmers, financial services can facilitate the pursuit of income growth (The United Republic of Tanzania, [2000]).

The most beneficial financial services for low-income people are the savings services. In order to protect themselves against periods of low income or specific emergencies and to cover large anticipated expenses, like school fees, it is necessary for nearly all the households to save. It is the same for enterprises, who also need to store the value they accumulate from their profits until they can invest them to earn higher return.

Savings in financial form provide funds for investment by others. Savings services can therefore have a very broad outreach and value. Credit services can allow enterprises and families to make some important investments sooner than without the micro-finance, and can also perform some of the same services as savings. The households use credit to meet consumption needs, particularly during periods when income flows are low. This can be for example during the off season before crops are harvested, and to make investments, such as housing improvements (The United Republic of Tanzania, [2000]).

Micro-finance addresses the financial needs of major sectors of the Tanzanian population. These micro-finance services are financial in nature. Materially, they differ from social welfare and resource transfer policies, although they can contribute to the reduction of poverty and improvement of income distribution (Ibid.). Most of the MFIs currently operating in Tanzania are either small and/or new.

## 2.2 Currently Operating Financial Institutions in Tanzania

A variety of licensed regulated and supervised financial institutions are currently operating in Tanzania. Included in this study are Registered Commercial Banks and Non-bank Financial Institutions. There are also a variety of financial institutions not regulated and supervised by BoT, these are the NGOs. NGOs are particularly important in reaching very poor or difficult-to-serve clients and in developing and testing innovative products and service delivery mechanisms. NGOs will not be subject to financial regulation and supervision as long as they do not accept voluntary deposits (The United Republic of Tanzania, [2000]).

A Registered Commercial Bank is a financial institution authorised to receive money on current account subject to withdrawal by cheque. (Bank of Tanzania, 2003a). Registered non bank financial institution is any person authorised by law or the bank to engage in banking business not involving the receipt of money on current account subject to withdrawal by cheque (Bank of Tanzania, 2003b).

*Table 2:1. Type of Financial Institution*

<b>MFI</b>	<b>Type of financial institution</b>
Akiba Commercial Bank Ltd.	Registered Commercial Bank
National Microfinance Bank	Registered Commercial Bank
Dar es Salaam Community Bank	Registered Non-bank Financial Institution
Tanzania Postal Bank	Registered Non-bank Financial Institution
FINCA Tanzania	Non Governmental Organisation
Incofin (T) Ltd.	Non Governmental Organisation
Presidential Trust Fund	Non Governmental Organisation
SIDO	Non Governmental Organisation
Swissaid Tanzania	Non Governmental Organisation

Most of the MFIs in Tanzania are young and need to grow. However, they are faced with a lack of management skills, equipment, insufficient knowledge on the local environment and weak networks needed for being sufficient MFIs. Five years ago, the term of micro-finance was hardly known in Tanzania. The micro-finance clients are small business people who own and manage an established on going enterprise, which can use the loans to expand their existing business line profitability.

### 2.3 Group and Individual Lending

In the case of group lending, a group of potential borrowers forms an association. The group itself guarantees the loan to the outside lender—it is responsible for the repayments. The idea is simple; by joining together, a group of small borrowers can reduce the costs of borrowing and gain access to financial services. The members are making sure they know the characters of the co-signing group members well so they are reliable future group members. Thus, the MFIs make use of the information “impacted” in the village or neighbourhood about who is reliable and capable borrower, getting villages to reveal this information in an incentive-compatible way. At the same time, implicit collateral is created by the pressure that members would be expected to place on each member in the group to repay loans.

*Table 2:2. Group and Individual Lending*

<b>MFI</b>	<b>Group/Individual</b>
Akiba Commercial Bank	Group
Dar es Salaam Community Bank	Group/Individual
FINCA Tanzania	Group
Incofin (T) Ltd.	Group
National Micro Finance Bank	Individual
Presidential Trust Fund	Group
SIDO	N/A
Swissaid Tanzania	Group
Tanzania Postal Bank	Group

Some MFIs only accept family members in the groups. This is also an incentive for the members not to free-ride, since you face a social risk of being disgraced, if you do not stand up to the standards set up by your family. The group formation creates the peer

pressure which in many cases lead to well behaved members but it can also create unpleasant argues within the groups and families which may lead to devastating endings.

### **Chapter 3**

## **INTRODUCING TANZANIA**

Tanzania is a country situated just south of the Equator with an estimated population of 33 million and a per capita GDP estimated at 251 USD in year 2001. About 50 per cent of the population are living below the poverty line (The United Republic of Tanzania, 2003b). A person is considered poor if his or her consumption or income level falls below 1USD per day, a level necessary to meet basic needs (The World Bank, 2003).

Between 1967 and 1992, all private banks were nationalized, but since then private banks, including branches of foreign-owned banks, have been allowed to open. The state-run Bank of Tanzania operates as the central bank; it manages the country's finances and issues the currency, the Tanzanian shilling. For administrative purposes, mainland Tanzania is divided into 20 regions. A commissioner who is appointed by the central government administers each region. At district, divisions, and ward levels, there are popularly elected councils with appointed executive officers. Since 1974, Dodoma has been the designated official capital of Tanzania, and it is centrally located on the mainland. However, Dar es Salaam remains the seat of most government administration, as well as being the largest city and port in the country (Encyclopaedia Britannica, 2003).

The president of Tanzania is the head of state and commander in chief of the armed forces. The cabinet of ministers is advisory to the president. Prior to 1995 it included two vice presidents; the Prime Minister, who is appointed by the president and acts as the leader of the cabinet, and the president of Zanzibar. Since the amendment to the constitution, which was approved in 1994 and took effect after the 1995 general election rescinded the stipulation that called for the president of Zanzibar to serve as a vice president (Ibid).

The population of Tanzania is characterised by many different ethnical groups. In 1987, there were 130 different African ethnical groups registered. These groups stand for 99 per cent of the population, and the remaining 1 per cent are Asian, European and Arabs. The population in Tanzania is geographically very uneven. The biggest part of the country is fairly thin occupied, but certain areas are crowded, like the Kilimanjaro region and the Lake Malawi. Average lifetime in Tanzania is 51 years for men and 53 years for women. In the year of 2001, 22 per cent of the population were living in the larger cities; Dar es Salaam with 2,4 million inhabitants, Mwanza with 291 000 inhabitants and Zanzibar town with 245 000 inhabitants (Bra Böcker, 2002).

The national language is Kiswahili and in the first seven years of primary education the language is used as the medium of instruction. The second official language is English and is commonly used by the government in official business. As well, most African Tanzanians speak their traditional tribal language (Encyclopaedia Britannica 2003).

In year 1999, Tanzania had approximately 35 per cent Muslim, 45 per cent Christian and 20 per cent of the population believing in other African domestic religions. Nevertheless, statistics indicate that there has been an increase of the Muslims and Christians previously. In the coast area Islam is the strongest religion, especially in Zanzibar and other islands (Bra Böcker, 2002).

The growth rate of the Tanzanian population is one of the highest in sub-Saharan Africa. Despite great improvements since the 1950s, the infant and child mortality rates remain high, but fertility is high as well. Nearly 50 per cent of Tanzanians are under the age of 15 years. Life expectancy, at about 53 years, is above average for the subcontinent (Encyclopaedia Britannica, 2003).

The industry in Tanzania is based on the processing of its agricultural goods and on import substitution - that is, the manufacture of products that were once purchased from abroad. The most important exports are coffee and cotton, but exports of tea, cashew nuts and tobacco are also substantial (Ibid).

The Tanzanian economy is overwhelmingly agrarian in nature. Over half of the GDP constitutes of agriculture and some 80 per cent of export earnings, and it provides a livelihood for about nine-tenths of the economically active population. The industry accounts for less than 10 per cent of the GDP and mining less than 1 per cent, whereas services, including public administration, produce approximately one-third of the GDP (Ibid).

## Chapter 4

### THEORY

Institutional theory is important to look upon when dealing with micro-finances. Both the formal and informal rules are of significance to see whether or not the micro-finances work properly. The rules in the community control the behaviour of the clients. The communities are built upon the institutional theories, and therefore these will work as a security for most of the clients, even if they do not know it. In the case of micro-financing, the rules of repayment within the groups are good examples of informal rules that exist. If the clients do not pay back the loan, they are affected by bad reputation and other people's thinking. These factors will most probably lead to higher repayment rates. The informal rules are important when the clients choose new members into their groups.

#### 4.1 The Importance of the Institutions

*“Institutions are the constraints that human beings impose on human interaction. They consist of formal rules (constitutions, statute law, regulations) and informal constraints (conventions, norms and self-enforced codes of conduct) and their enforcement characteristics. Those constraints define (together with the standard constraints of economics) the opportunity set in the economy.”*  
(North, D, [1993b]).

Institutions are the same thing as the rules of game in a community. The institutions help to reduce the insecure by giving structure to their daily basis. They give guidance to the teamwork between humans, so we know how to behave. The institutions give a structure for human co-operation. Different organisations like for example political parties, economic units and social units, affect the development of the institutions. Institutions are human creatures. The human creatures develop and change by people, because of that our theory has to begin with the individuals (North, D, [1993a]).

An organisation is a complex set of communications, power relationships and relationships of other kinds within a group of human beings pursuing one or more common goals. Internally to this organisation, information is produced and exchanged, and goals and attitudes are formed which influence its decisions and give predictability and uniformity to behaviour within it. In short, routines are established which create stable and reasonably sure expectations concerning behaviour internal to the organisation (Dallago, B, [1993]). An organisation is not an institution, even if you may think so, it is what happens within an institution that affects the organisation.

Organisations are not solely the entities which incorporate the institutions, defining and concretising their role in society and in the economy. They also perform an essential function in the formation, growth and change of the institutions. They are therefore the fundamental constitutive component of the economic system. This latter, in fact, is the set of all the major institutions in an economy which pursue, in a socially co-ordinated manner, the ends of economic activity. All these factors have an important part to play in the decision process, but what is decisive is the presence of authority relationships (Dallago, B, [1993]).

Political, legal, economic rules and contracts are all different formal rules and can complete and raise the efficiency at the informal restrictions. The formal restrictions can bring lower costs for information and supervision and through this enable solutions for a more complicated change. The informal rules come from information in the community and are a part of the heritage that we call culture. Informal restrictions are not only appendages to the formal rules, they are important themselves. The same formal rules and/or constitutions introduced in different communities give rise to different results. In interaction with other people on daily basis, apart from internal or external relations or in businesses, they all mainly consist of rules of behaviour and conventions. The difference between formal and informal restrictions is exceedingly fine. The long and uneven transition from unwritten traditions and customs to written laws have only had one direction, as we have developed from smaller to more compact societies of today (North, D, [1993a]). Formal rules, which are the rules that the clients act under, take a long time to change. These are already impressed upon the people and in the human

consciousnesses. The formal rules are important because they control the whole micro-finance sector.

In the study we have found both formal and informal rules. Among the clients within the groups studied, the informal rules are widely used. Group members have a vested interest in the success of the enterprise and therefore exert strong moral pressure on borrowing members to repay on time. There is a high risk of being frozen out if they are not having possibility to repay their share of the loan.

Institutional conditions must be economically sustainable. The formal restrictions must be fulfilled; the MFIs must lend enough capital and reach out to the poorest in order for poverty reduction. Informal restrictions, like exclusion and confiscation of personal and family members' belongings, must exist within the groups if the group members mismanage. Because of this, the informal restrictions lower the risk for free-riding.

#### **4.2 Factors for efficient micro-finances in Tanzania**

The development of the micro-finance industry is dependent on a number of factors and its success depends on the combined impact of the different stakeholder actions on those factors. The factors influencing micro-finance operations include economic opportunities, rural infrastructure, sectional development policy, demographic factors and social set-up. Others are financial infrastructure and institutional capacity of both the supply and demand side (Bank of Tanzania, [2001]). Using these conditions for assessing the institutions embedding the micro-finance sector of Tanzania is more a matter of discretion. Thus, in this report the listed criteria are looked upon as devices that indicate how ideal the micro-finance sector has developed in order to work as an efficient instrument for poverty reduction in the country. One should not expect that the Tanzanian micro-finance sector can—or ought to—be changed in accordance with any blueprint provided. Thus, we assume that a specific institutional configuration is conducive to a sustainable and useful Tanzanian micro-finance sector if the following conditions are met:

- Incentives for repayment must exist within the groups in order to disclose free-

riding syndromes from individuals.

- The lending must be at least as effective as the commercial lending, by means of interest rate, repayment rate and other necessary lending conditions.
- The lending must reach out to the poorest people in the country in order for the micro-finances to be an effective instrument for poverty reduction.

These factors are important in order to attain an efficient micro-finance lending. When the clients have opportunities to free-ride, the lending is inefficient. The free-riding affects the other clients, because if they notice that others can get away without any sanctions this creates incentives for the other clients to cheat and free-ride as well.

The interest rates that the MFIs charge have to be close to the interest rate for commercial lending. The MFIs must not make use of their position as lenders to poor people in need and charge exorbitant interest rates. The lack of experience from lending and saving makes it hard for the people to take a loan, save a part of it, invest a part of it and at the same time pay interest. It will most certainly take a while before the investing will generate a yield for the clients and their economy reaches a turning-point.

The lending must reach out to the poorest people in the country in order to reduce poverty. If the clients who already are in business get the loans, this will not help to reduce the poverty. Instead this will lead to higher cleft between the people that the authors call relatively poor and the vulnerably poor. The relatively poor are the people already in business and not the most vulnerabe ones in real need of micro-finances, if you compare them with the ones the authours call volnerably poor. If the very poor are being left out, the initial goal of micro-finances for poverty alleviation is defeated.

## **Chapter 5**

### **THE SURVEY**

Policy analysis involving social and financial analyses will be employed in this approach to answer the research questions. The current policies, instruments, constraints and achievements on micro-finance for the poor will thus be examined before identifying the proposed way forward towards increasing the access for poor to micro-credit facilities.

The questions in the survey are divided in four major sections with a total of 42 questions. The first section, A, covers basic institutional information, such as name and objective of the company, type of MFI and the date when the micro-finance operations started. Section B, is named Credit Facilitation and handles demography and method of application, while section C covers repayment of the credits. In section D, the authors ask the MFIs about their opinion on the use of micro credits for poverty reduction.

The study covers three different levels of micro-financing. To get an overview of the Tanzanian financial system, the authors begun by interviewing the decision makers, such as the Senior Finance Management Officer at the Ministry of Finance and the Acting Deputy Director at Bank of Tanzania. The next two levels are the ones handling the actual lending to the people and consist of Registered Commercial Banks, Registered Non Bank Financial Institutions and the NGOs. These institutions have different micro-finance expert that were targeted in the study. When doing the interviews, the authors had different methodologies for the different levels. For the larger institutions such as Ministry of Finance and Bank of Tanzania, a more overarching questionnaire was used, while a more detailed and structured questionnaire was used among the other institutions.

## 5.1 Findings of the Study

### 5.1.1 Demography

The average age of the clients in the study is 29 years and 72 per cent of them are women. The people who live in urban areas, 61 per cent, get the majority of the loans. The targets, of all the MFIs, are business already in existence, and they are all in the trade sector. The ones already running businesses can be considered relatively poor, not vulnerable poor since they already have a business and one can expect them to be above the poverty line, 1 USD per day. None of the MFI lends money to business starters. The survey has revealed that the MFIs do not consider new business starters as reliable borrowers since they do not have much experience from running businesses and do not have as much possessions to rely the security on. This is in one way understandable but it is here the basic idea, according to the NPES, with the micro-finance brakes down. The MFIs need to reach out to the vulnerable poor not only in the urban, but also in the rural areas.

*Table 5:1. Client Orientation*

<b>MFI</b>	<b>Average age of Clients</b>	<b>Urban</b>	<b>Rural</b>	<b>% Female Clients</b>
Akiba Commercial Bank	30 years	90%	10%	70%
Dar es Salaam Community Bank	25 years	100%	0%	93%
FINCA Tanzania	28 years	60%	40%	100%
Incofin	35 years	60%	40%	67%
National Micro Finance Bank	N/A	N/A	N/A	60%
Presidential Trust Fund	35 years	60%	40%	94%
SIDO	N/A	86%	14%	51%
Swissaid Tanzania	23 years	25%	75%	75%
Tanzania Postal Bank	N/A	5%	95%	72%
<b>Average</b>	<b>29 years</b>	<b>61%</b>	<b>39%</b>	<b>72%</b>

The majority of the MFIs have their clients in urban areas. The only two institutions that lend most of the money to rural areas are Swissaid Tanzania (75 per cent) and Tanzania Postal Bank (95 per cent). Probably these two MFIs are more active than the rest with advertising and travelling in the rural areas. All of the MFIs are situated in urban areas, so it takes a lot of engagement from the institutes to reach out to the vulnerably poor and the rural areas.

The state of the rural areas in Tanzania makes provision of financial services to those who live there and have a very difficult task. The physical infrastructure is poor, the markets are segmented, illiteracy rate is high and many other problems make it difficult to push the frontiers. This is one reason why many of the micro-finance institutions operate mainly in urban areas. Partly, for the same reasons, commercial banks are reluctant to provide services to the rural population (Bank of Tanzania, [2001]).

### 5.1.2 Loan Size and Conditions

The micro-finance institutions are granting small loans to licensed entrepreneurs which have the purpose of invigorating existing activities only. The loan varies from approximately 17<sup>1</sup> USD to 9,600 USD. The MFIs lend between 45-50 USD for first-time borrowers, except for Akiba Commercial Bank, that lends 17 USD, and FINCA Tanzania that lends 29 USD. These amounts may seem small to people in industrial countries, but as a matter of fact the loans are a good start to the clients in order for them to work their way out of poverty.

Many MFIs are young with an average of four of years experience dealing with micro-finances. SIDO is the only exception which has been in business for 30 years. This may be an indication that many MFIs lack experience in micro-financing and that the clients are young businesses whose owners have limited business experience and are in the first cycle of lending, which results in a moderate loan size.

*Table 5:2. Loan range*

<b>MFI</b>	<b>Lowest Loan</b>	<b>Highest Loan</b>
Akiba Commercial Bank	17 USD	9,607 USD
Dar es Salaam Community Bank	48 USD	2,402 USD
FINCA Tanzania	29 USD	2,402 USD
Incofin (T) Ltd.	96 USD	1,921 USD
National Micro Finance Bank	48 USD	3,362 USD
Presidential Trust Fund	48 USD	769 USD
SIDO	48 USD	480 USD
Swissaid Tanzania	48 USD	384 USD
Tanzania Postal Bank	48 USD	480 USD

Many of the studied MFIs were unable to answer the question about total disbursement. With the data from four of the MFIs, Dar es Salaam Community Bank, FINCA Tanzania, SIDO and Tanzania Postal Bank, the average disbursement per year in operation with micro-finance ended at approximately 48,300 USD.

### 5.1.3 Repayment

The repayment rate for the disbursed loans varies between 80 per cent and 100 per cent as at 31<sup>st</sup> May 2003 with an average of 92 per cent. Many of the group-lending MFIs have a very high repayment rate due to the group-pressure methodology used. The average of 92 per cent repayment in total seem to be surprisingly high since many MFIs are young and still in their first or second cycle of lending. It does not seem understandable how the relatively new MFIs with lack of experience can possess such a high repayment rate, in many cases close to 100 per cent when SIDO has 30 years of experience and considerable lower repayment rate than the other MFIs, 80 per cent.

*Table 5:3. Repayment rate*

<b>MFI</b>	<b>Repayment rate</b>
Akiba Commercial Bank	85%
Dar es Salaam Community Bank	100%
FINCA Tanzania	100%
Incofin (T) Ltd.	90%
National Micro Finance Bank	99.9%
Presidential Trust Fund	93%
SIDO	80%
Swissaid Tanzania	98%
Tanzania Postal Bank	85%
<b>Average</b>	<b>92%</b>

Sometimes the MFIs think it is necessary to contact relatives or sell assets belonging to the person that do not pay back. In some cases the group leader first tries to help the MFI by talking to the client unable to repay. If the person seems to continue not paying, he/she gets a letter of reminder, and if they still do not pay, they get sent to the court of law.

<sup>1</sup> 1USD=Tsh 1,040.95 as at 31<sup>st</sup> March 2003 (Bank of Tanzania, 2003e).

Most of the MFIs are only lending to groups and are using group pressure as incentive for repayment. In these cases the groups select the new members themselves. Some MFIs require that the members of the groups must be relatives. These MFIs think that family formations are more likely to have a higher repayment rate. This might be true, but the authors believe that the group lending to family formations most probably will lead to disputes and free-riding which affects the individual group member negatively. If one person within the group is not able to repay the loan, the other group members are responsible to repay that same amount. And then, if the group fails to repay the loan, the group savings are used to service the loan.

National Microfinance Bank is the only MFI that believe that group lending is ineffective and not a proper way of doing business. They only lend to individual Tanzanians and small businesses. In order to retrieve the same high repayment rate as the ones using group pressure, they are trying to building a brand with the message saying “You loan from our bank—and you pay back to us”. The credit officers use this motto in order to sustain the high repayment rate. It is very important that this motto is trustworthy so the clients know that they will be punished if they do not pay in time. If one client gets away with not repaying the loan given, the word is spread and the other clients think that they can do the same. They also have the opinion that donors as a source of funding, has the same effect on the people, and that savings are the best way to finance the lending.

One disadvantage with this type of lending is that people do not always fit together in groups. Tanzania Postal Bank lends to groups but circumvent this problem by not force the formation of the groups. One condition for group lending to work is that the group members must trust each other and know each other well, but not be members of the same family. A common thing for the MFIs is that they all believe in the importance of well known individuals in order to maintain a high repayment rate.

National Micro Finance Bank, Swissaid Tanzania and Tanzania Postal Bank require savings from the clients in order to get loans, this can be seen as a problem since the majority of the Tanzanians cannot afford to save and do not have a savings culture. This

can therefore be a problem since the Tanzanians do not have any experience from saving.

Official statistics suggest that savings rates are low at macro and micro levels. However, there are indications that the national savings rate has been improving from a negative 12 per cent in the 1990s to about 10 per cent in 2001/2002. (Semboja, H.H, [2003]).

#### 5.1.4 Advertisement

Various promotion materials such as television, radio, Internet, brochures, posters, flyers and public meetings have been used by the MFIs, aiming at educating the targeted groups on availability of credit facilities and ways of accessing it. A lot of people in Tanzania do not have access to television, radio, newspapers et cetera. This is the one reason why the authors believe that it is very important for the MFIs to be sure of using the right kind of media for outreach to the poorest regions in the country, where the people who are in real need of the credits live.

*Table 5:4. Advertisement Used by the MFIs*

<b>MFI</b>	<b>Advertisement</b>
Akiba Commercial Bank	Radio/Newspaper
Dar es Salaam Community Bank	Radio/Newspaper/Public Meetings
FINCA Tanzania	Newspaper/Word of Mouth
Incofin (T) Ltd.	No Advertisement
National Micro Finance Bank	n/a
Presidential Trust Fund	Public Meetings/Brochures
SIDO	Radio/TV/Newspaper/Internet/Visits
Swissaid Tanzania	Radio/TV/Brochures/Visits
Tanzania Postal Bank	Public Meetings

Only two of the studied MFIs use television as advertisement tool. Because nearly all of the clients are poor people, they might not have a television, and therefore it can be a waste of time to use this advertisement tool. The most efficient and cheapest way is the word of mouth. The clients who take the loan probably have relatives or friends that also are interested in taking a loan, so it is good to talk a lot about it. Another good way

to advertise is the radio. Even if not all clients might have radios, you can find it at many public places.

#### 5.1.5 Pre-loan training

Training in credit management is compulsory to equip borrowers on technicalities of credit handling, administrating and responsibilities attached to credit given. The training also aims to learn the MFIs' procedures on repayment, savings and risks so the clients are well prepared.

Many of the pre-loan training classes are based on talking and discussions since most of the clients do not know how to write.

*Table 5:5. Pre-loan training*

<b>MFI</b>	<b>Pre-loan training</b>
Akiba Commercial Bank	Yes
Dar es Salaam Community Bank	Yes
FINCA Tanzania	Yes
Incofin (T) Ltd.	Yes
National Micro Finance Bank	No
Presidential Trust Fund	Yes
SIDO	Yes
Swissaid Tanzania	Yes
Tanzania Postal Bank	No

Nearly all the MFIs studied use pre-loan training. It is good for the clients to get an insight on how the procedures with the micro-finance work before they get the real loan. The clients can also get to know other people who take loans and support each other. It is also important to know the procedure with the repayment, so they are prepared and know how to plan for the loan. For the MFIs it is good with the pro-loan training so they can sort out which of the clients that are really interested.

#### 5.1.6 Use of the credits for poverty reduction

All the MFIs studied believe that the credits have improved their clients in their businesses by the ability to disburse bigger volume of loans and by providing loans

which make the clients engaged in ventures hence generate income. They also believe that the credits have created more employment opportunities due to an increase in sales which has led to that additional staff have been necessary in some cases. By issuing more loans to borrowers and by broaden the products and services offered they believe that they can reduce the incidence of poverty in one society. Generally, the MFIs studied believe that the objective of lowering the poverty is met because as time goes by more and more people are being self employed because of the capital money they receive from the MFIs' capital facilities. The credits have stimulated household savings for the clients, since the repayment in many cases is done weekly and the clients are forced to save. The forcing by some MFIs are to enable the clients to repay the loan. In these cases, the clients are stimulated not only to save for repayment, but also for other household development activities.

To lower the poverty, the MFIs studied have some suggestions. One is to enhance the availability of credit funds to small and medium enterprisers. You can also facilitate availability of market ends for micro enterprises through trainings, exhibitions, advocacy and information. Another suggestion is to intensify credit-management training to the micro-entrepreneurs that borrow the money. If more funds are secured for the MFIs, then it will issue more loan to borrowers and in that way reduce the incidence of poverty in the society. If the savings and repayment go as expected, then more people will be self-employed in small and medium scale economic ventures.

Some of the MFIs have discovered problems while working with the micro-credits. For example, there are high costs on training and consulting credit administrating that should be followed up. There is also unreliability of assets/properties usually offered to secure offered loans when it comes to realization of the respective assets. Something that influences the micro-financing is the competition. It intensifies the availability of the loans to the clients. Costs that are rising, are those connected to when the MFIs are reaching out to the rural areas. When most of the MFIs are fairly new on the market, they have little facilities, and therefore have to use their own cars and sometimes the community busses. The current clients have little experience in borrowing and repaying to the extent that they do turn investment into household consumption instead.

## 5.2 Fulfillment of the factors for efficient micro-finances in Tanzania

The development of the micro-finance industry is dependent on a number of factors, more briefly discussed in section 4.2, and its success depends partly on the listed criteria that are looked upon in this study. The criterions are devices that indicate how close to an ideal poverty-reducing instrument the micro-finance sector has developed. The study has revealed useful information in order for the authors to conclude whether or not the listed criteria are fulfilled or not.

*Table 5:6. Fulfilment of the factors for efficient micro-finances in Tanzania*

<b>Critereon</b>	<b>Grade of Achievement</b>	<b>Authors' Comments</b>
Incentives for Repayment	Yes	Incentives for repayment is high according to the study. The free-riding syndrome seem to be small since the lending in many cases are to groups where group pressure exist.
The lending must be as least as effective as the commercial lending	Partly	According to the study, the repayment rate is extremely high and the MFIs charge an interest rate approximately 10 per cent higher than the commercial banks in Tanzania do.
The lending must reach out to the poorest people in the country	Partly	The study shows that even if about 80 per cent of the country's population live in rural areas where 70 per cent of Tanzania's national output is produced, the MFIs concentrate their lending to urban areas like Dar es Salaam and its surrounding areas.

### 5.2.1 Incentives for repayment in order to disclose free-riding

Incentives for repayment must exist within the groups in order to disclose free-riding syndromes from individual. The free-riding syndrome seems to be small according to the MFIs. One reason for this is that the lending in many cases is to groups where they carefully choose their co-members and have confidence in the new members which can be seen as an incentive for repayment. If the members chosen in to the groups are careful and behave well, they can get another loan; this might be one reason to the high repayment rate. This argument is true, but still the repayment rate that the MFIs stated, seem to be too high in the reality. Even if there are not much free-riding, there is probably more than the MFIs believe.

### 5.2.2 Lending efficiency

The lending must be at least as effective as the commercial lending, by means of interest rate, repayment rate and other necessary lending conditions.

Weighted average interest rate of commercial banks in Tanzania lies between 12-25 per cent per annum (Bank of Tanzania, 2003d) while the MFI studied charge an interest of 20-30 per cent per annum. FINCA Tanzania believes that by reaching scale they will be able to reduce pricing. The costs of making a small loan are higher in percentage terms than the costs of making a larger loan. The percentage cost of making micro loans is higher than the interest rate that commercial banks charge, because clients generally have no credit history, no collateral, are frequently illiterate and often live in remote areas (The World Bank, [2002]). According to the study, major part of the micro-finance clients do not live in rural areas and therefore these arguments are not defensible. The study also shows that the repayment rate is extremely high which would imply that the repayment-condition is fulfilled. The authors are doubtful to the high numbers revealed in the study and believe that the real repayment percentages are somewhat lower.

### 5.2.3 Outreach to the poorest

The lending must reach out to the poorest people in the country in order for the micro-finances to be an effective instrument for poverty reduction. The study shows that even if about 80 per cent of the country's population live in rural areas where 70 per cent of Tanzania's national output is produced, the MFIs concentrate their lending to urban areas like Dar es Salaam and its surrounding areas. Support to the rural financial services sector in Tanzania should be considered very essential and is a critical ingredient in the rural development agenda.

## **Chapter 6**

### **CONCLUSIONS**

Involvement of commercial banks in financing the low-income population in Tanzania is crucial if we are to attain the necessary scale for poverty eradication. The commercial banks have more favorable interest rates comparing to the MFIs studied. If the commercial banks start dealing with micro-finances and are able to sustain the interest rate they charge on “normal” lending, this would result in competition on the market and therefore lower the interest rates charged by the MFIs studied.

People already in business are accepted as borrowers while new business starters are not accepted. A person is considered poor if his or her consumption or income level falls below 1USD per day and it is not probable that the ones given the credits, people with businesses already in existence, fulfill this criterion. In order to reach the poverty goal stated in the NPES the micro-finance institutions need to reach out not only to the relatively poor but also to the vulnerable in their operations.

One factor for efficient micro-financing is to have low free-riding. The authors believe that this statement is partly fulfilled. Since the authors are doubtful to the repayment rate that the MFIs stated, there are a possibility that the free-riding syndrome is little higher than the MFIs experience it to be. Despite this, the incentive to repay is higher than the incentive for free-riding. Non-relative formations should be the most effective ones for individual repayment incentives.

The findings of the study suggest that Tanzanian micro-financing is successful at reaching the relatively poor while it is less successful at reaching the vulnerable poor. Despite the goals by the government not reached, this is a good start of reaching the poverty goal.

When looking at some earlier studies about micro-financing, the authors partly support with the other results. According to the Grameen Bank, everything has become better with the micro-financing. There seem to be no problems at all. Comparing with the study made in Kenya, our results are more analogous with those results. The micro-financing is good, but it does not help to reduce the poverty as much as believed.

In the case of micro-finance there is no fixed prescription for all countries. We need to learn as we walk to be flexible and to be heavily decentralized to be able to be as close to the clients as possible.

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**APPENDIX**

**A STUDY OF MICRO FINANCE INSTITUTIONS IN TANZANIA**

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Time start \_\_\_\_\_ Date \_\_\_\_\_

**A. INSTITUTIONAL INFORMATION**

**A1. Name of company** \_\_\_\_\_

**A2. Name and title of respondent** \_\_\_\_\_

**A3. Telephone number** \_\_\_\_\_

**A4. E-mail address** \_\_\_\_\_

**A5. City** \_\_\_\_\_

**A6. Year of establishment** \_\_\_\_\_

**A7. Number of Employees [M/F]:** M \_\_\_\_\_ F \_\_\_\_\_

**A8. Objective of the company** \_\_\_\_\_

**A9. Type of MFI**

- International NGO     Indigenous NGO     Community- Based Organization
- Village Bank     Savings and Credit Associations     Parastatal Organization
- Government Organization     Savings and Credit Cooperative Societies

**A10. Sources of funding** \_\_\_\_\_

**A11. Date when micro-finance operations started:** \_\_\_\_\_

**A12. What is the main purpose of micro credits?** \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**B. CREDIT FACILITATION**

**B1. Average age of the clients** \_\_\_\_\_

**B2. Gender**  
\_\_\_\_\_ % women \_\_\_\_\_ % men

**B3. Where do the clients live?**  
\_\_\_\_\_ % urban areas \_\_\_\_\_ % rural areas

**B4. What is your target?**  
 Business starters  
 Businesses already in existence

**B5. Which sector has had most applicants?** \_\_\_\_\_

**B6. Which sector has been given the majority of the credits?** \_\_\_\_\_

**B7. Method of application** \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**B8. Handling time of the applications**

Minimum \_\_\_\_\_ days  
Average \_\_\_\_\_ days  
Maximum \_\_\_\_\_ days

**B9. Are credits given to clients already in debt?**

Yes  No

On what basis do you make your decision? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

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**B10. How many applicants have you had?**

1998 \_\_\_\_\_

1999 \_\_\_\_\_

2000 \_\_\_\_\_

2001 \_\_\_\_\_

2002 \_\_\_\_\_

Total \_\_\_\_\_

**B11. How many turndowns have you had?**

1998 \_\_\_\_\_

1999 \_\_\_\_\_

2000 \_\_\_\_\_

2001 \_\_\_\_\_

2002 \_\_\_\_\_

Total \_\_\_\_\_

**B12. What is the main reason why you turn down an application? \_\_\_\_\_**

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**B13. Loan size**

Smallest \_\_\_\_\_ TSH

Average \_\_\_\_\_ TSH

Largest \_\_\_\_\_ TSH

**B14. Planned amount of credits**

1998 \_\_\_\_\_ TSH

1999 \_\_\_\_\_ TSH

2000 \_\_\_\_\_ TSH

2001 \_\_\_\_\_ TSH

2002 \_\_\_\_\_ TSH

**B15. Disbursed amount of credits**

1998 \_\_\_\_\_ TSH

1999 \_\_\_\_\_ TSH

2000 \_\_\_\_\_ TSH

2001 \_\_\_\_\_ TSH

2002 \_\_\_\_\_ TSH

**B16. What is the interest rate of the credits?**

\_\_\_\_\_ %

**B17. On what basis do you make decisions about the expiration date of the credit?**

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**B18. Do you have any pre-loan training for the clients?**

Yes

No

If yes, how does it work? \_\_\_\_\_

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**C7. What are the costs in term of structures?**

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**D. USE OF CREDIT FOR POVERTY REDUCTION**

**D1. What has been the impact of your credit on the following social-economic issues?**

D1.1. Have the credits introduced/improved your clients in their business?

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D1.2 Have the credits created more employment opportunities? \_\_\_\_\_

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D1.3 Have the credits generated a higher disposable income for the clients?

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D1.4 Have the credits stimulated household savings? \_\_\_\_\_

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D1.5 Are your clients prepared/willing to deposit their money within your organisation? \_\_\_\_\_

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**D2. How should you work to lower the poverty?** \_\_\_\_\_

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**D3. Comment on the performance of your organisation**

D3.1 General performance \_\_\_\_\_

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