

**Escape the low-growth trap?
Microfinance in Tanzania**

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Tanzania is a small-sized economy, with a large portion of the population below the poverty line of \$2 a day, particularly in rural areas. Finscope 2009, a national survey, provides evidence that 56% of the population has no access to financial services, a proportion that has slightly grown over the last few years. The main reasons given by respondents for not having loans, bank accounts or savings are practical obstacles (especially geographical distance), costs and lack of information – thereby suggesting that there is a large unmet demand for “accessible” financial services.

Microfinance has endeavoured to address these needs, devising solutions to provide the poorer segments of the population with credit and – to a lesser extent – insurance, leasing and transfers. However, the Tanzanian microfinance market is still tiny, young, and dominated by a small number of major organisations; it is mostly active in Dar es Salaam and Arusha, with limited penetration in rural areas. What are, then, the barriers to its growth, and what steps can be taken to overcome them?

Our study of microfinance in Tanzania, now at the end of its second year, addresses these concerns by widening its perspective, from case studies of individual microfinance institutions (MFIs) to the whole set of actors and stakeholders that operate in the field. More precisely, we adopt a network approach that places emphasis on the structure of inter-organisational partnerships that relate MFIs to relevant stakeholders, funders, and regulators; by so doing, we aim to bring to light systemic issues and to identify suitable policy responses.

A sparse network: inefficiencies and donor dependence

To assess challenges and opportunities in Tanzanian microfinance, it must be acknowledged that its operations do not depend on MFIs alone but on the whole network of partnerships and relationships that exist between poor clients and the MFIs that provide financial services to them; between MFIs and their funders, be they multilateral institutions, donor governments, non-governmental organisations (NGOs), for-profit companies, banks or cooperatives; between MFIs and regulators. The resulting structure is intrinsically complex, consisting of many layers and involving multiple actors.

To shed light on the intricacies of the system, we have mapped the complete network of “wholesale” relationships through which MFIs based in Tanzania obtain credit from various institutions and organisations in order to support their activities. We have built an original database of lending relationships for 2006-2008, with 19 MFIs and 26 wholesale lenders. The database has been built from multiple sources, primarily audited financial statements and ratings of MFIs, which are verified by accredited third parties and are therefore highly reliable. Complementary information has been obtained from the website of TAMFI (Tanzania Association of Microfinance Institutions), a national network of microfinance actors; MixMarket, an international web-based data service; annual reports and web sites of MFIs. Finally, qualitative insight has been obtained through fieldwork, with a series of interviews performed by the authors with Tanzanian MFIs and other stakeholders in 2010 and 2011.

The majority of MFIs have the legal status of NGOs; examples include BRAC, FINCA, SEDA, YOSEFO, and others. Together with them, community banks and even some commercial banks also operate in the microfinance market, for instance Access Bank, Akiba Commercial Bank, and Mbinga Community Bank. Notice that some of these banks are active both in the retail and the wholesale markets: for example, Akiba primarily provides retail micro-loans to final clients but has also once lent wholesale to Tujjenge, a MFI-NGO.

Figure 1 represents the wholesale lending network for Tanzania in 2008. MFIs are represented as grey circles and lenders as black or white squares; a tie between a square and a circle corresponds to a lending relationship. Black nodes are banks and white nodes are other types of lenders (NGOs, government agencies, multi-lateral institutions, apexes and specialised microfinance funders). The size of round nodes (MFIs) is proportional to their number of lenders and, conversely, the size of square nodes (wholesale lenders) is proportional to the number of their MFI borrowers in the country.

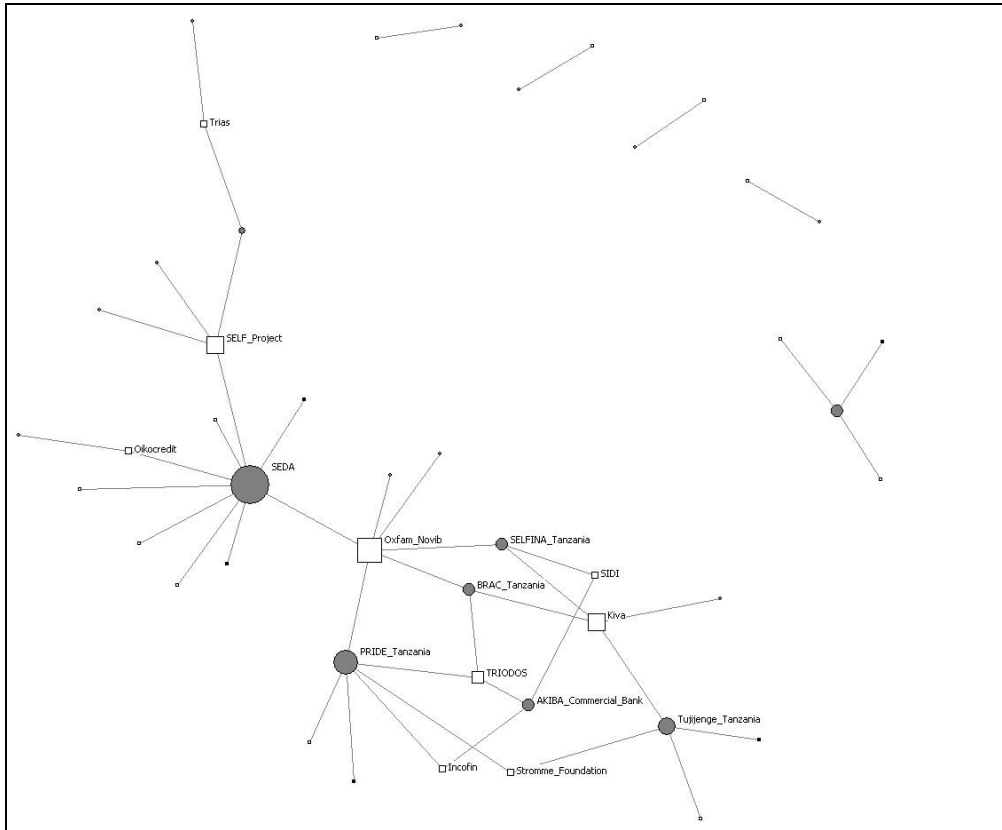


Figure 1 : The network of wholesale lending relationships for microfinance in Tanzania.

This is a non-cohesive, sparse network with small components and star-shaped sets of ties, representing MFIs that share few or no lenders. It suggests that MFIs have few lenders and tend to be dissimilar from other MFIs in terms of their patterns of debt relationships.

Multiple reasons explain this finding. To some extent, lack of cohesiveness is due to the small size of the market and the fact that some MFIs are local subsidiaries of large international parent organisations (BRAC, FINCA) that are sometimes their unique or principal funders. More importantly, it can be said that lending ties constitute only a limited part of the funding channelled to Tanzanian MFIs, which remain largely dependent on donations. Indeed MixMarket data for 2008 show that on average, Tanzanian MFIs operate at a loss, with negative return on assets, and operational self-sufficiency below 100%. MFIs in the country often face solvability or liquidity issues, and company crises are a common occurrence even for some of the larger institutions; SEDA is a recent case in point. Funders are responsive to this situation: for example the Financial Sector Deepening Trust (FSDT), established by five foreign governmental donors in collaboration with the Bank of Tanzania, offers both wholesale loans and grants; while it tends to encourage the former, it resorts to the latter for start-up or weaker MFIs. Donations are also provided by a number of international non-profit organisations such as Five Talents, Stromme Foundation, Swiss Contact, TRIAS, and World Vision. It must be acknowledged, however, that some of the larger Tanzanian MFIs have undertaken major efforts to achieve financial sustainability, and may in future set the example for others to follow. PRIDE attained operational self-sufficiency in 2001 and has always maintained it afterwards, with a positive return on assets. YOSEFO is also sustainable and relies primarily on commercial loans to sustain its microfinance operations, while it uses grants only for capacity-building and other supporting activities.

Another reason explaining the sparseness of the above network is that it does not include the large portion of microfinance activities that is undertaken by the so-called Savings and Credit Cooperatives (SACCOs). These institutions are very numerous (over 3500 in the whole country), of very small size and sometimes limited durability, more prevalent in rural areas. Major issues are their lack of accountability and their low reporting and performance standards (Triodos Facet 2007; EIU 2010; interviews with stakeholders 2011). They are supervised by the Ministry of Cooperatives and Marketing, but rules are only weakly enforced. The Finscope 2009 survey reveals further inefficiencies, with 50% more savers than borrowers in SACCOs, thereby suggesting that many of them have surplus money and do not put it to its best use, despite a large unmet demand. For all these reasons, SACCOs are extremely difficult to map and have not been represented individually in Figure 1, which only includes their three main associations in the country. These are the government-sponsored SCCULT and two private associations, Usawa Kilimanjaro and Dunduliza; the latter comprises more than 50 SACCOs and receives funding from various institutions including FSDT, and technical assistance from Développement International Desjardins (DID) of Canada. In principle, SACCOs should rely primarily on members' savings to provide retail loans but it is not always the case, and many of them also borrow from banks and other financial institutions. The main provider of loans to SACCOs is CRDB, a commercial bank, but others are also active in this area, notably the National Microfinance Bank, a wholesale lender to MFIs, and to a much lesser extent MFIs themselves, in particular Akiba (with three SACCO borrowers at the moment) and PRIDE. These institutions often rely on SACCOs to lower the cost of reaching out more remote populations, generally located in rural areas and difficult to access.

Because they do not take part in the wholesale lending market, informal providers of financial services have not been represented in Figure 1 either. These include ROSCAs (Rotating Savings and Credit Associations), ASCAs (Accumulating Savings and Credit Associations), money-lenders, and personal relationships with family and friends. Though use of these sources is currently declining, they are still widespread in the country and particularly relevant for savings (Finscope 2009).

To summarize, the unsatisfactory efficiency of a system that largely consists of low-performing institutions (both SACCOs and some MFIs-NGOs) limits its capacity to attract funding from commercial sources, and slows down the growth process that would be necessary to meet the country's vast unmet demand for financial services. Banks tend to be more competitive but find obstacles in the limited productivity of the MFIs-NGOs and SACCOs with which they partner to expand their services to difficult-to-reach populations.

Regulatory weaknesses and a need for capacity building

One reason explaining the incapacity of many MFIs-NGOs to achieve financial sustainability as well as their difficulty in accessing commercial loans rather than donor funding is the lack of sound regulatory requirements in terms of financial accounting and reporting standards. MFIs-NGOs are required by law to register as companies, but are otherwise unregulated and unsupervised. Self-regulation is also lacking. Few Tanzanian MFIs report to MixMarket (13 across all dates) and, even among those that do, only a sub-sample update their financial data regularly. The practice of obtaining ratings from external agencies is infrequent; one reason for this is that there are no rating companies based in Tanzania. Few rating scores have been

obtained from international rating agencies specialised in microfinance, notably MicroRate (PTF 2005 and 2007; FINCA 2004; PRIDE 2004), and MicroFinanza Rating (MuCoBa 2007). Collective initiatives to promote self-regulation have been conspicuously absent too. TAMFI, the Tanzania Association of Microfinance Institutions, has been inactive for long; only in summer 2010 has it been renewed, merging with the Coalition of Tanzania Microfinance Practitioners and Service Providers, a parallel industry network, and appointing a new board of directors. Although promotion of best practices is among its goals, no detailed plan of action has been agreed upon so far, not least because of limited funding.

Improvements in transparency and quality of information shared would require MFIs to upgrade to a regulated form. Such a transformation would also authorise them to take deposits from the public, thereby providing them with an additional source of funding. In passing, this would be another, much-demanded service that they might offer to their final clients, who now rely primarily on informal providers (Finscope 2009). Regulated financial institutions, supervised by the Bank of Tanzania, include banks, non-bank financial institutions, Micro-Finance Companies (MFCs) and Financial Cooperatives (FICOs). The required minimum core capitalization is different for each type but always relatively high; and reporting and accounting requirements are stringent for all regulated forms, often vastly exceeding the technical capabilities of MFIs in the country (Ellis 2007). As a result, only PRIDE Tanzania, initially created as a NGO, has obtained a licence to operate as MFC (2008); and no FICO has been licensed so far. It must be mentioned, however, that some other organisations are currently in the process of preparing to apply for a licence (YOSEFO for instance); PRIDE itself plans to further upgrade to bank status.

One difficulty for many MFIs willing to transform into regulated financial institutions is ownership. Originally created in a state-owned and -controlled system, they have never undergone a formal process of privatisation so that the extent to which they are private or belong to the government is often unclear. While this ambiguity has few repercussions on the operations of NGOs, it becomes a major challenge for transformation, in that the Bank of Tanzania requires clear-cut information on ownership of supervised institutions.

Other difficulties reported by some organisations are insufficient capacity and training, which raise issues especially at the level of middle management and induce a relatively high staff turnover. As a result, the position and role of leaders tend to be reinforced and the process of renewal at the top slows down, thereby hindering innovation at all levels – in managerial, reporting and accounting practices. Another consequence is a tendency to maintain existing funding ties rather than renewing –therefore missing opportunities for the creation of new, potentially more advantageous ties, or the destruction of less favourable ones.

In sum, regulatory gaps and limits in the availability of resources at the system level appear as main factors underlying the inefficiency and fragility of the Tanzanian microfinance system, despite a potentially large demand for financial services, and despite continuing flows of donor funding.

Conclusions and recommendations

To conclude, our study points to the need of two types of measures:

- 1) The Tanzanian authorities should revise the national microfinance policy and financial markets regulation to address the problems that have emerged so far. In particular, it is important to:
 - Lower the minimum capital requirements for MFCs, or establish a step-wise procedure for MFIs to entry this category more gradually;
 - Devise a process allowing a clear definition of ownership rights for MFIs. One possibly solution might involve the creation of a MFC formally separate from the original NGO, the former being in charge of microfinance operations, the latter of supporting services (training, capacity building, and any social initiatives the organisation might be involved in).

- 2) Donors should provide more resources in support of initiatives aiming at strengthening the industry at national level, rather than offering grants to individual MFIs. This could involve:
 - Support MFIs' coordination and self-organisation through TAMFI, to promote good practices, communication and networking with potential investors;
 - Provide seed funding for MFIs to obtain rating scores, promoting a better understanding of the benefits of being rated (as has been done with The Rating Fund, a joint donor initiative currently targeting Latin America and the Caribbean). This may also include initiating MFIs to Social Rating, a recently introduced service that aims to assess the capacity of a MFI to pursue its poverty reduction mission.
 - Provide funding for capacity building, especially at middle-management level, with focus on improvement of accounting and reporting practices.

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