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The Importance of Being Owned: Microfinance Institutions in Tanzania

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Non-governmental organisations operating in Tanzania and seeking to transform themselves into regulated microfinance institutions are currently facing the difficult task of establishing who the owners of their organisations are – a crucial factor that is limiting their ability to secure transformation and hence to get access to further funding. As an integral part of the Leverhulme-funded research project "Optimising the Dual Goals of Microfinance" this briefing paper presents preliminary results of field research undertaken in Tanzania during August 2009.[1] One of the major findings is that gaining access to equity capital is the primary concern of many of these organisations and hence identifying the best strategies to institute shareholding partnerships is paramount.

The focal microfinance institutions

Two main microfinance institutions were the focus of analysis during field research: PRIDE and SEDA, although others were also visited. PRIDE, which stands for Promotion of Rural Initiative and Development Enterprises, started its operations in January 1994 with its first branch and head office in Arusha. Now, the number of branches has expanded to 41 in 5 zones (Lake, Dodoma/central, Dar-es-Salaam/Coastal, Arusha and Mwanga).

The Small Enterprise Development Agency, SEDA, meanwhile, was initiated by World Vision Tanzania as a pilot project in 1995 in Arusha. At present, it makes loans through a network of three primary branches, i.e. Arusha, Moshi and Mwanza, and four field offices namely Shinyanga, Dodoma, Babati, Kahama.

The following reports observations mainly of the first microfinance institution. The main purpose of this initial visit to Tanzania was to help establish who the key partners of the focal microfinance institutions are and how and why their relationships change over time.

Key findings

Some main findings originating from an analysis of PRIDE evolution can be summarised in the following timeline:

[1] The research followed during fieldwork included semi-structured interviews with 43 key informants of microfinance institutions in Dar-es-Salaam and Arusha; and data collection of financial flows and institutional reports.

- 1994: A grant bilateral government agreement with Norway creates the programme. The Bank of Tanzania had representation at the Board of Directors.
- 2001: End of grant. Start of borrowing (first loans are small, e.g. SELF).
- 2005: New PRIDE loan products are introduced, e.g. individual loans, loans to SACCOs. As a proportion of total loans, group lending (the original product, for poorer clients) seems to be declining. If this is the case, there might be possible mission drift.
- 2006: New and larger borrowing from institutions.
- 2005: Transformation to regulated financial institution was supposed be completed.
- 2008: Government letter states that the original grant (revolving fund) belongs to PRIDE. This was a contentious issue that reflected the existing ambiguity with regard to institutional ownership i.e. was the owner the Government or was the institution private?
- 2008: Internal separation within the institution: PRIDE-NGO and MFC (PRIDE MFI). This marks an important strategic decision: the institution voluntarily decides to separate the operations that are purely financial from the ones that are non-financial. This is to signal to the country's regulators that the organisation can operate as a purely financial institution even before being awarded the licence.
- 2009: Expectation to become a regulated bank. Proposal to the Bank of Tanzania to get a licence.
- 2009: Ongoing negotiations to attract capital from investors in preparation for the transformation – mainly local but also international. Main challenge: to find the right shareholders to provide equity capital.

It is interesting to note the group lending methodology followed by the institution under study: credit officers only see customers at the branch when members meet – except when officers want to recruit customers or market products. Community people themselves assess potential group members to decide whether or not to accept them in their groups (e.g. issues of credit-worthiness, etc). Customers have to travel to branches to receive loans and to repay loans. Branches keep cash for these operations. Branches tend to be set up in places where there is a National Microfinance Bank (NMB) branch so that the branch can get cash from the NMB. In cases where there is no branch, the police escort PRIDE staff to transfer money to the branch.

A credit officer looks after 20 groups and then she/he is reassigned to a different set of groups. PRIDE states that there is a low turnover of credit officers.

In addition, compulsory savings are demanded from clients, which represent 10% of any type of loan. This is called a Loan Insurance Fund (LIF). One remarkable fact is that PRIDE on-lends the compulsory savings (LIF). In other words, LIF is another source of capital for the MFI. The institution has relatively effective Management Information System (MIS) but there is no connectivity to branches and little integration/reporting of information/data from branches to central office. However, a new MIS is being deployed.

Evolution of financial sources and partners

Based on Figure 1, some important observations can be derived:

i. Borrowing started in 2002. Before 2002, PRIDE operated with grants only.

ii. Breaking point in trend analysis of financial evolution is 2006.

iii. Marked difference in number of financial partners/lenders: During 2002-2005 there were two main financial partners, i.e. SELF, a government programme, and the National Microfinance Bank (NMB). From 2006 the number of financial partners has increased to eight who were active at different points in time. At June 2009, six financial partners are active, i.e. NMB, Stromme, Triodos, INCOFIN and Oxfam Novib.

iv. Stable relationship with two financial partners (NMB and Stromme), i.e. those present during 2002-2005.

v. In terms of borrowing amount: two main partners are INCOFIN (40% of total borrowing at June 2009) and NMB (28% of total). NMB lending to PRIDE has grown steadily over 2002-2009. INCOFIN lending is stable at US dollars (but in Tanzanian shillings appears as growing due to the fluctuation in exchange rate). INCOFIN is also an important partner because it is a potential shareholder of PRIDE-MFC.

vi. AFRICAP: Political influence (a Kenyan partner decided to stop lending to all PRIDE institutions in Africa).

vii. SELF: PRIDE decided to discontinue borrowing from SELF because the terms and conditions were onerous (i.e. too much reporting and target requirements).

viii. TRIODOS: Due to the current financial crisis, TRIODOS has changed the terms and conditions and requested PRIDE to pay off the debt before the originally agreed date.

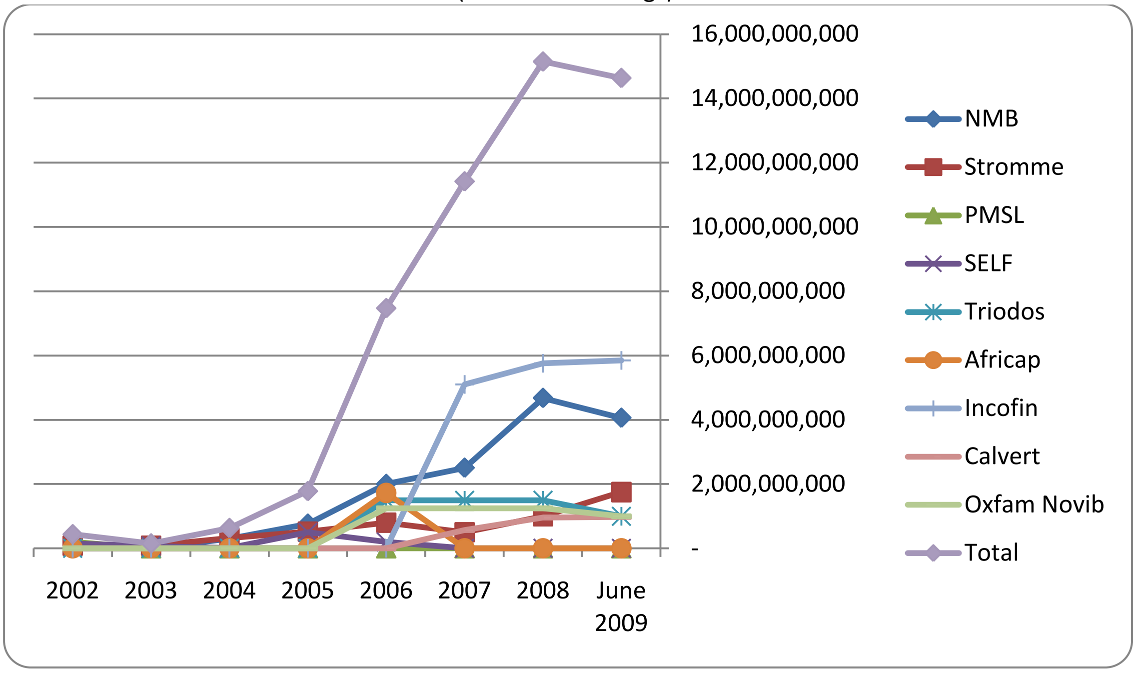
ix. INCOFIN and Calvert: These loans are denominated in US dollars. Bullet payments in both; i.e. the principal is paid at a pre-determined date. They are both hedged by a bank named Bank M.

x. Bank M is considered by PRIDE as a better partner compared to Standard Charter and other similar banks because Bank M provides quick service with less reporting.

xi. PRIDE is approaching new potential financial partners (locally and internationally).

xii. It seems that foreign borrowing is cheaper than borrowing from local institutions (But effective interest rates need to be calculated and compared).

Figure 1: PRIDE financial sources/partners
(Tanzanian shillings)



Source: Authors' field research, August 2009.

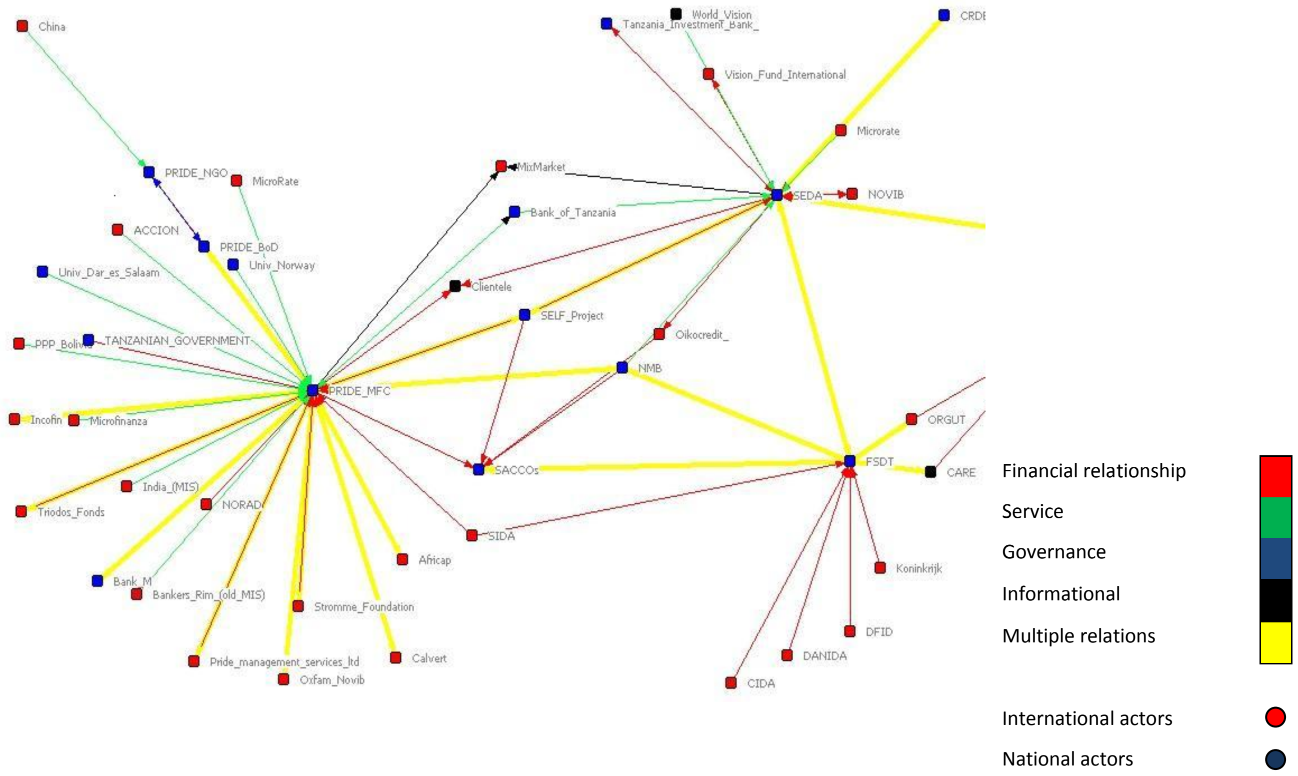
In sum, growth of lending to microfinance clientele is funded via borrowing but sustainability might be a question. Therefore, PRIDE needs to become a regulated MFI and hence be able to mobilise savings and raise shareholding equity. Social performance, meanwhile, is difficult to assess as there is no data collected by the institution. However, some indication can be derived from the mix of products offered by the MFI, i.e. if the proportion of group loans decreases in the mix of products (which means that individual lending of larger amounts increases), then this might be an indication of possible mission drift.

Financial, service and informational relationships

Figure 2 illustrates the most recent ego networks of PRIDE and SEDA and their common partners. It should be noted that these networks varied significantly over time – with very few shareholders involved in the early 1990s leading to larger numbers in recent years. The present network structure of June 2009 in figure 2 shows relationships based on financial, service and informational exchange.

Service networks in the case of PRIDE reflect relationships with the University of Dar-es-Salaam, the University of Norway, three risk rating agencies (namely ACCION, Microfinanza and MicroRate), a private consultancy from Bolivia and another one from China. Informational networks, on the other hand, are based on reporting relations with each lender (which can be annually or monthly). In this context, SELF was identified as the most onerous reporting in the past. Now, reporting is deemed to be similar across lenders.

Figure 2. Financial, service and informational relationships [2]



It is interesting to observe that the majority of PRIDE's financial partners are international actors while SEDA's partners are a mixture of international and national. There are a couple of common financial providers but the majority of them seem to be exclusive to the MFIs under study. In both cases, multiple relationships are maintained with key partners. A crucial microfinance actor in the country is the Financial Service Deepening Trust (FSDT) which in turn is formed by a consortium of five international donors. The FSDT is a firm supporter of MFIs in Tanzania but also, and perhaps more strongly, of informal microfinance initiatives that promote savings accumulation amongst low-income communities particularly in rural areas – an activity that is regarded as more related to poverty reduction than the provision of credit.

Conclusion and next steps

In general terms, Tanzania presents an incipient microfinance market where existing NGOs are struggling to survive in an evolving regulatory environment. Transformation to a regulated financial institution is the model followed by the two MFIs under study and hence determining who their shareholders are is an immediate priority. Preliminary analysis and network structures show that some key existing financial partners might be the most likely shareholders/owners of these new MFIs, given that local potential actors are few and less likely to be able to make significant investments in microfinance. More precise analysis will be undertaken in the next research activities.

[2] The types of relationships are: financial = loans and shares; services = capacity building and training; and informational = reports about the status of the MFI and its final clients.