

INNOVATION IN RURAL FINANCE IN TANZANIA

Prof. Samuel Wangwe
Principal Research Associate
Economic and Social Research Foundation

and

Director
Daima Associates Ltd
Dar es Salaam
e-mail:swangwe@esrf.or.tz

In collaboration with
Ms Moorine Lwakatare
Consultant
mlwakatare@esrf.or.tz

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1.0 Introduction

Economic reforms have been implemented in Tanzania since the mid-1980s which essentially entailed the shift from an administratively managed and public sector led economy to a market oriented and private sector led economy. Financial sector reforms were part of these broader economic reforms. Financial sector reforms took the form of decontrolling interest rates, restructuring existing public sector banks and allowing entry of private banks.

A successful financial sector reform was expected to generate a dynamic process involving substantial changes in the country's real activities of production, exchange (trade) and finance. Sustainability of the reforms was expected to result in financial deepening, increase in the range of financial products in order to better serve the needs of the economy and enhance transformation of the economy (urban as well as rural) so that production, exchange and other economic activities take place in different ways and in the context of new or reformed institutions.

Growth with economic transformation has at least two implications for the financial system:

First, new methods of production and trade require improved technology and infrastructure which exert new demands which may stimulate new changes in finance. Second, changes in the institutional structure may call for changes in the financial operations to match it. For instance, changes from public sector-led development to private sector-led development in a market economy would imply fundamental changes in the operations of financial intermediaries.

The design of the financial sector reforms was initiated with the establishment of the Presidential Commission of Enquiry into the Monetary and Banking System in 1988. The Commission was tasked to examine the banking sector and make recommendations on how to improve its overall performance to support economic growth. The commission recommended broad based financial sector reforms. The main aspects of the proposed reforms were enacted in the Banking and Financial Institutions Act (1991). The Act provided the legal framework which permitted major changes in the financial sector, notably, the entry of private banks into the market and vested Bank of Tanzania with its supervisory and regulatory role.

The Government took the initiative to restructure major banks and financial institutions, which included the restructuring and down sizing of the National Bank of

Commerce and the recapitalisation of the Co-operative and Rural Development Bank through selling of shares to the general public. With introduction of new banks competition has been enhanced, resulting into improvement of quality and quantity of financial services and products offered, at least in urban centres.

But despite this progress financial services to the rural population have been slow to develop. In some respects there has been a retreat of financial services to the rural areas as indicated by closures of several rural based bank branches during the restructuring program. The composition of financial services was changed as windows for rural finance in those banks were closed or considerably reduced even by those banks which were formerly devoted to rural financing (e.g CRDB).

The financial sector reforms are still in progress but there is increasing concern that the majority of the rural population which constitutes 70-80% of the population and comprise 90% of all the poor in Tanzania have not benefited from the financial reforms. They have largely been bypassed by these reforms. The need to enhance accessibility of financial services to the rural poor in Tanzania deserves high priority on the agenda of the on-going financial sector reforms. In recognition of the need for improving access to financial services by the rural population this conference has been organized to focus on "*The Future of Rural Finance in Tanzania*". It is envisaged that this conference will address the experience and lessons learned to date in the development of rural finance with a view to facilitating appropriate design of rural finance and develop sustainable financial services for the needs of rural population in Tanzania. The challenge is to be innovative in the design of rural finance options. In this context, the purpose of this paper is to review innovations and adaptations in rural finance and draw lessons which can contribute to the future policies and strategies for promoting rural finance.

The rest of this paper is organized as follows: Section 2 examines the historical developments in brief and the evolving policy framework in order to locate more appropriately the current status of rural finance in Tanzania. Section 3 addresses various experiences and lessons that can be drawn from rural financing practices to date. It identifies innovations in rural finance and their policy implications. Section 4 is the conclusion and recommendations.

2.0 Historical Developments and the Evolving Policy Framework

2.1 The concept of rural finance

Rural finance refers to the broad range of financial services, such as: savings, credit, payment transfers, leasing, insurance, etc provided by formal and informal financial services providers operating in rural financial markets.

Rural finance addresses the financial needs of the rural population, which form the majority of the Tanzanians. Like other types of financial services, rural finance is a facilitator rather than a creator of economic opportunities. Where economic opportunities already exist, access to credit facilities can contribute to faster and more extensive adoption of improved technology which is consistent with raising the level of productivity and therefore the level of incomes.

In Tanzania, agriculture has always been at the top of the agenda when it comes to discussing economic and developmental issues. With 60-70% of its population involved in agricultural production and living in poverty this initiative has been of particular importance. One approach that has been taken up to improve agricultural production is to disseminate new technologies such as improved seed varieties,

fertilizers, implements and chemicals. However, the cost of technology was identified as a major constraint to the adoption of improved production technologies. It is in this context that credit is a key element in modernization of agriculture. It can enable farmers to afford technology before they harvest and that way contribute to accelerating adoption of new technologies. Credit facilities are also an integral part of the process of commercialisation of the rural economy..

2.2 Developments in rural finance

For most of the period since the late 1960s and 1970s the Tanzanian financial sector was mainly government-owned with pervasive government interference in the financial system. Credit was directed on the basis of government priorities with little regard to credit-worthiness, and banks were convenient agents of fiscal policy.

Two institutions, the National Bank of Commerce (NBC) and the Cooperative and Rural Development Bank (CRDB) were dominant in providing rural financial services. NBC provided working capital and other short term finance to agriculture and other rural activities while CRDB provided development finance to rural development activities. These two institutions had virtual monopoly in their functional areas: Each institution was governed by its own stature and the Bank of Tanzania's (BOT) supervisory role had been limited. Finally, the environment in which the formal financial institutions operated was also regulated by the state.

Credit was allocated administratively by the BOT which established legal ceiling in bank lending and deposits in addition to regulating interest rules. In the prevailing environment, the financial sector's performance was very poor and savings mobilisation was neglected. Loans to cooperatives increased, and no pressure was applied on borrowers to repay their loans. The Government of Tanzania's (GOT) policies resulted in over-staffed and inefficient banks. These loan policies led in 1988 to 70% of NBC's loan portfolio to be in arrears and 95% of this was accounted for by parastatals and a substantial share by cooperatives. The Cooperative Rural Development Bank's (CRDB) rural sector loan portfolio was no better, with 66% of its loan portfolio in arrears as of end 1988. With a non-performing loan portfolio and unable to attract deposits, the formal financial sector was bankrupt, and dependent on financing from the GOT. In response to the difficult financial position, LART was established in 1991 as an institution which would specialize in the recovery of non-performing assets of banks and financial institutions in Tanzania with a view to rescuing public banks and financial institutions burdened with non-performing assets (NPAs). Most of the loans to the rural sector had been channelled through the cooperatives. In the recovery process, the experience of LART suggests that loan recovery from cooperative unions, where only 44% of the face value was recovered, has been most challenging followed by that from parastatals where 71% of the face value had been recovered by June 2002. The remaining work of loan recovery was hindered by the poor quality of collateral attached to the loans (mainly depicted by the absence of title deeds on land) and to litigations following appeals made by some NPA owners (LART. Annual Report, June 2002)

GOT reformed the financial sector in 1991 and established the Banking and Financial Institutions Act. Banks were restructured and some of them were privatised. Interest rates were liberalised, and financial operations were to be conducted on a more

commercial basis. Along with banking de-regulation, the Cooperative's Act of 1991 was passed which authorised the re-structuring of the Cooperative movement and permitted the establishment of the Savings and Credit Cooperatives (SACCOs). Non-Governmental Organisations (NGOs) also started micro-credit operations in Tanzania.

2.3 The Legal and Regulatory Framework

The Banking and Financial Institutions Act of 1991 vested powers on licensing, supervision and regulation of banks and financial institution on the BOT. These powers are further consolidated under the 1995 BOT Act. Hence, BOT are responsible for regulation and supervision of formal financial institutions, including community and cooperative banks. The legal and regulatory framework has now been extended to cover micro-finance activities. However, supervision and regulation of SACCOs is the responsibility of the Registrar for Cooperatives, who operates through the Regional and District Cooperative Departments. These Departments have very low capacity to undertake such tasks, part of the problem being that they are very much under-funded, and lack adequate facilitation to implement their functions satisfactorily. This has resulted in poor supervision, including weak accounting and monitoring. SCCULT, the umbrella organization for SACCOs, is currently grappling with this challenge.

2.4 The Policy Framework

The policy framework has been evolving at various levels. With the Tanzania Development Vision 2025 emphasising on the need to transform the economy from a predominantly agricultural one with low productivity to a semi industrial economy with modern rural sector, great emphasis is placed on the role of the private sector in stimulating economic growth and developing the rural areas. Thus, the promotion of income generating activities, development of a diverse and strong micro and small-scale enterprise sector, and diversifying the skill base through vocational training is an integral part of the strategy for achieving the vision.

Since development of rural finance is dependent on a variety of factors that cut across different sectors, the formulation of the Rural Development Policy and Strategy and the Agricultural Sector Development Strategy are an integral part of the overall policy framework for rural finance. The rural development strategy sees the need to diversify the structure of the economy with a view to reducing dependence on agriculture.

The National Micro-finance Policy covers all policy aspects related to the financial instruments and institutions relevant to rural finance. The policy is a framework that lays out the principles guiding the operations of the microfinance systems, as it covers the provision of financial services to households, small scale farmer and micro enterprises in urban and rural areas.

Cooperatives are a critical institution for facilitating rural finance. Therefore reference to the Cooperative Development Policy (2002) is in order. The new Cooperative Development Policy (2002) has repositioned government commitment to support cooperatives which are owned and managed by their members by creating a conducive environment for their development into competitive entities in the context of a market economy. The policy recognizes economic groups as important initiatives towards membership based cooperatives and emphasises business minded leadership in running the cooperatives. In the context of rural finance, the Cooperative

Development Policy (2002) supports the establishment of viable cooperative financial institutions. The policy aims to increase participation of marginalized groups in cooperatives and recognizes business groups and commits to assist these groups towards attainment of fully registered cooperatives. According to the policy, the government will encourage the formation of cooperative financial institutions in order to reactivate thrift and saving habits among members. In particular, the policy states that the government will encourage formation of SACCOs within the area of operation of primary societies and will provide technical assistance to the SACCOs. The policy continues to state that the government is committed to encourage and assist the establishment of cooperative banks.

3.0 Experiences, Innovations and Lessons in Rural Finance

Rural finance is provided by four categories of institutions: and banks (e.g. CRDB, NMB, KCB, Exim Bank), member based organizations and associations such as cooperatives (especially SACCOS and some cooperative unions), NGOs (e.g. PRIDE, MEDA, SEDA and FINCA), large companies financing through contract farming, , government and public sector institutions (e.g. SIDO, PTF, WDF, YDF, Local councils)

3.1 Banks Providing Rural Finance

Some banks within Tanzania have started providing financial services to a majority of the low-income population either directly or indirectly through linkages with NGOs or savings and credit institutions as a viable poverty reduction tool.

One bank that has taken up this initiative is Exim Bank. The bank is specializing in pre-export crop financing as well as trade and financial services to small and medium enterprises and has specifically been used as an agent for managing the agricultural inputs fund. Exim Bank has to its credit a financial tie-up with International Finance Corporation IFC, Washington) which is the commercial arm of the World Bank and PROPARGO, a French Financial Agency which is dedicated to private investment financing. The mission of IFC is to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives whereas PROPARGO tries to stimulate private sector investors and markets. IFC aims to try and do this through financing private sector investments, mobilizing capital in the international financial markets, helping clients improve social and environmental sustainability, and providing technical assistance and advice to governments and businesses.

In addition to this IFC also thrives on training local staff and management and by transferring best practice SME banking skills through a twinning arrangement with a top-tier. This benefits service delivery to the different sectors and diverse customer base it has which include; Development agencies, public sectors companies, NGOs, private sector businesses, parastatal organizations , Primary Cooperatives, etc.

With its 'out reach' strategy the bank hopes to reach vast areas in the country to fetch in more business opportunities.

Lessons that can be drawn from the experience of commercial banks like Exim Bank are as follows:

- Networking and forming linkages with international financial institutions can give access to best practices
- Security in rural areas is problematic in the absence of formal registration of assets that could function as collateral titles and even when they are registered their market value is low. There is need to innovatively search for alternative ways of managing to provide financial services without necessarily demanding physical collateral.
- Short term lending is not appropriate for most of production activities in the rural areas. Longer term credit is needed.
- Linking with intermediate institutions which are closer to the farmer clients reduces the cost of collecting and processing information about potential borrowers. Linkage to SACCOs and Community Banks has proved useful in cutting down administrative costs, enhancing loan recovery and improving reach without having to physically locate branches in all areas of operation.

3.2 Member-Based Organizations - SACCOs

The most dominant member-based organizations in Tanzania are the Savings and Credit Co-operative Societies. These Savings and Credit Cooperatives (SACCOS) are categorised into urban SACCOS and rural SACCOS. Of interest in the context of this paper are rural SACCOS.

Owing to the poor access of formal financial services in the rural areas, the formation of SACCOS was advocated and encouraged by the Government as one way of promoting access to financial services. The rural SACCOS, have a common bond in residences and associations. Members of these schemes usually reside in the same village, and rely on the same primary cooperative society for crop sales. Farmers under this scheme open a group share account with a convenient bank (e.g NMB, NBC, CRDB or any other bank) catering for their needs in the area. Crop sales are paid to farmers through this account. Special passbooks are provided in which all the necessary entries are recorded. The group share account is operated as a deposit account which earns interest. Members in these schemes are allowed to make withdrawals from the accounts. Members may be loaned amounts related to the size of their savings. Normally loans are paid during crop sales though repayments can be made anytime.

In SACCOS savings are linked to credit. The SACCOs have helped to address the bias that often prevails against individual borrowers who are located in rural areas which are sometimes not easy to reach. The SACCOs have functioned as a bridge between individual borrowers particularly small borrowers and the formal financial institutions. SACCOS have had a substantial role in the mobilisation and allocation of otherwise untapped resources. Like the formal financial institutions, SACCOS are found in both rural and urban areas. These societies are willing to offer even small sized loans to members which is something that the formal financial institutions will not do in view of the high costs of administration, and lengthy procedures involved in processing information before a decision is made to give out a loan. The high transaction costs, inadequate information and the associated perception of high risk associated with rural finance have limited the growth and development of rural financial services in the country. The financial institutions that have utilized the

knowledge and proximity of established institutions in the rural areas have tended to do better. Through SACCOS these institutions have extended credit to small borrowers in the rural areas some of which are otherwise not easily accessible. Unlike banks that experience low loan repayment rates from peasant borrowers, SACCOS loans have lower default rates. Borrowers know that the loans come from savings of the community. Community pressure, access to information and close follow up all have been combined to enhance access even without having to use conventional forms of collateral.

A number of rural schemes operate under a savings-first arrangement whereby potential borrowers have to pay cash deposit before they can apply to borrow a maximum of twice the amount they have saved with the programme, or at times the borrower would have to save up to 25% of the loan requested. Thus, loan size is linked to level of savings. With the high borrowing transaction costs associated with the loans, farmers who can deposit only small amount of money can hardly participate in the programmes. As such, linking the amount of loan to the level of savings, in trying to minimize risk costs, prevents poor people to enhance their credit worthiness by demonstrating their savings abilities to lenders. Thus the regulation limits access to loans by the poor farmers. Under these circumstances, pooling savings through institutional arrangements such as SACCOs helps to address this problem.

The case of the linkage between SACCOs and Kilimanjaro Community Development Bank (KCB) can be used here to draw useful lessons. With failures of rural financial institutions within the region the SACCOS together with the coffee marketing primary cooperatives and their unions joined up to form what is currently known as KCB. Having developed from the grassroots it has given the people of the region a sense of ownership and a belief that KCB represents the local community and has contributed to its sustainability. The bank has also strategically tapped into the coffee economy by providing farmers with direct deposit facilities for the proceeds earned from coffee sales, since the people of the region have a long history of community activities based around coffee economy.

By having a clear organisational structure, objectives, key tasks and restricting share holding to primary rural co-operative societies and particular SACCOS the bank has made considerable strides since its establishment.

Although the main focus of the bank is on rural development the bank has only managed to open its main office and customer service desk in Moshi town. But this has not deterred the bank from pursuing its main objective of reaching the rural areas. In this regard, it embarked on building links with SACCOS groups as part of its rural penetration agenda. The bank has taken up the effort to support capacity building through training, management and supervisory assistance to SACCOS.

Various factors explain the progress that KCB has made with the SACCOs that have links with the community bank. First, they have catered for a local and well known limited population. Second, they have taken up the promotion of thrift attitude towards saving as their primary task. Third, they have developed convenient savings products for low income small holders. Fourth, they have provided an assured source of credit as a secondary activity. Fifth, they have provided training opportunities to members as part of capacity building. Sixth, they have promoted efficient management of resources.

In contrast to the top down initiative used by past rural finance institutions which pumped large volumes of externally generated finances as credit, SACCOS have been cautious about lending and they have treated it as a secondary rather a primary or core activity during the formative stage . The main challenge that KCB and its SACCOS are facing is that of managing the transition from aid dependence towards sustainability.

Lessons to be drawn from the experience of SACCOS to date are as follows:

- Poor infrastructure poses a challenge to the spread of rural financial services by NGOs in the country
- The financial institutions that have utilized the knowledge and proximity of established institutions in the rural areas such as SACCOS have managed to enhance reach and loan recovery
- Unlike banks that experience low loan repayment rates from peasant borrowers, SACCOS loans have lower default rates. Borrowers know that the loans come from savings of the community. Community pressure, access to information and close follow up all have been combined to enhance access to credit even without having to use conventional forms of collateral.
- Building competence in SACCOS through capacity building initiatives deserves priority to enable these institutions operate more efficiently and competitively. SACCOS and community banks will need assistance in acquiring technical and managerial competence and institutional capacity building. However, the main challenge that these institutions will face is that of managing the transition from that kind of dependence towards sustainability.

3.3 NGOs as Providing Financial Services

Currently, NGO's are financing approximately 18,000 micro-entrepreneurs. The two largest programmes are run by Pride Africa, with 9,000 members and Juhudi ya Akina Mama Scheme managed by MEDA, with 4,000 members. Financial NGOs have been very instrumental in pushing the frontiers of financial services to the poor and remote areas although most of them have operated mainly in urban and semi-urban centres.

PRIDE Tanzania is one of the largest financial non governmental organization in Tanzania since it was founded in 1994 with a dedication to microfinance in . As part of a nation wide initiative for poverty reduction PRIDE Tanzania has been pursuing its objective of assisting micro entrepreneurs by providing loans and technical skills. However, there are indications that poor infrastructure poses a challenge to the spread of rural financial services in the country. For instance, the policy of PRIDE is that "branch offices must be placed in locations where there are basic infrastructure requirements to support both branch operating requirements and the relative comfort of PRIDE officers". This shows the true nature of a majority of organisations that claim to cater for the poor rural population. Because of its commercial orientation, PRIDE has a target group mainly comprising of the lower middle income and non-poor population.

PRIDE'S Loan Structure

	<i>Loan Size Tsh.</i>	<i>Duration Weeks</i>	<i>Weekly Payment</i>	<i>Total LIF*</i>	<i>Approximate Cumulative LIF</i>	<i>Cumulative LIF as % of total loan</i>
1	50,000	25	3,000	25,000	29,000	58
2	100,000	40	3,500	40,000	71,000	71
3	200,000	50	6,000	50,000	129,000	63
4	500,000	50	11,000	50,000	181,000	36
5	1,000,000	50	21,000	50,000	233,000	23
6	2,000,000	50	41,000	50,000	285,000	14

Note: LIF = Loan Insurance Fund

PRIDE'S PRODUCT FEATURES

Eligibility	Above age of 18, must own a business, must be in a group of five. Ten groups of five are organised into a Market Enterprise Group (MEC).
Procedures	Loan Application followed by 8 weeks training after which 2 group members get 1st loans, followed by 2 members after 4 weeks, followed by the Chairperson after another 4 weeks. Clients must make weekly contributions of Tsh. 1,000 to the LIF during the waiting period. Recently the procedures for loan release have been changed to 6:2:2.
Security	<ul style="list-style-type: none"> ◆ 1st guarantee is the group ◆ 2nd guarantee is the MEC ◆ 3rd guarantee is the Loan Insurance Fund (LIF)
Grace Period	◆ Nil grace period
Repayment	◆ 30 % interest flat. Weekly payments include contributions to LIF. Prepayments are accepted.
Repeat Loans	◆ Must follow the prescribed sequence of loan sizes. An interval of 2 weeks between loans.

FISEDA has adopted a marketing approach in helping in the establishment of Ward Banks and has been putting emphasis on training in order to ensure that the appropriate skills are acquired first. It has also put emphasis on performance monitoring on a weekly basis using ICT facilities (e.g the V-SAT facility that has been installed in Bunda). Monitoring of loan repayment is done very closely too. FISEDA has also excelled in innovatively designing a diversity of products (about 10) each tailored to the needs of specific communities. It has also been encouraging diversification into non-agricultural economic activities as a way of reducing vulnerability.

Elsewhere in the developing countries, micro-finance was launched by Non-Government Organisations and banks such as, Grammen Bank (Bangladesh, 1976), Kenyan Rural Enterprise Programme, Banco Solidario (Bolivia, 1992), Bank Ratyat Indonesia (BRI, 1984), among others. In these countries, the experiences show that, with new methods of lending, which included providing very small loans without

collateral at full cost interest rates that were repayable in frequent installments, the vast majority repaid on time.¹ Myriad benefits have been attributed to micro-finance programs. The Grameen Bank has been credited with addressing the structural determinants of poverty, economic and social status of women, and sources of vulnerability.

Lessons that can be learned from NGO-microfinance institutions include the following:

- Working through groups has helped to introduce peer pressure in loan recovery and in providing information about borrowers at low cost. Experience has shown that new and appropriate methods of lending, have been used which included providing very small loans without collateral at full cost interest rates that were repayable in frequent installments and that the vast majority repaid on time
- Staffing of the financial institutions needs to give weight to competence, incentives and monitoring performance on a continuous basis. Capacity building deserves high priority.
- Collaboration with foreign entities helps in starting up and building capacity that is needed initially. However, the challenge of reducing dependence and attaining sustainability is facing many NGO-MFIs.

3.4 Rural Financing through Contract Farming

By looking at large companies such as Tanzania Breweries Limited, and Dimon (T) Ltd based in Morogoro, we are able to have a clear picture of the way government and private traders finance agriculture through number of arrangements.

Dimon (T) Limited which is a tobacco leaf processing company is a supplier of tobacco to the Tanzania Cigarette Company (TCC) and deals directly with tobacco farmers through the already existing primary cooperative societies.

Dimon has learnt lessons from the collapse of a vast number of companies that have failed in the tobacco market due to outstanding debts. Instead of dealing with individual farmers the company tends to deal with the Primary cooperative society leaders who distribute the money paid in advance to farmers as a means for buying supply inputs such a seeds, fertilizers, equipment and other essential items. It is up to the leaders to keep within budget allocated to them. As an addition to funds for agricultural input, the company also supplies the farmers with a bag of maize seeds to encourage them to grow other crops i.e for every four bags of tobacco seeds given to the farmer a bag of maize is provided. This is a way of providing them with another source of income and for food sustainability.

Dimon claim that through dealing with the farmers as a society the farmers become credit worth, in the sense of a credit movement. If the society can guarantee to grow more then the input will also increases.

Repayment on the loans for agricultural input funds is done at various points; the first and second produces for the farmer are considered as the debt recovery phases whereby the farmer gets nothing for the produce. It is not until the third produce that the farmer gets paid.

¹ United Nations Development Programme, "Microfinance Essentials: A synthesis of lessons learned" Evaluation Office, No.3 December 1999

Tanzania Breweries Ltd has also learnt a valuable lesson in past years. The company had been in direct contact with the barley farmers by providing them with agricultural inputs but this proved problematic as the company made hefty loss from farmers selling on produces and seeds to their fellow farmers hence incurring a huge loss of 1.2 billion Tshs in a period of a year. From this the company decided to adopt another method of contract farming through the use of Cooperatives whereby members would have to apply for farm inputs and the company would provide the funds.

This method was beneficial to the company in so many ways as liability was mainly on the cooperatives rather than TBL. If there were a shortfall in the delivery of the goods/output either through theft or any form of misconduct by a member, the cooperative would have to pay the deficit.

Other than providing loans for agricultural inputs the company also provides the service of Agricultural Extension Officers to advise the farmers on various farming tactics and help with whatever problems they are facing with. Through the Cooperate Social Responsibility Funding Scheme money is set aside for rural development initiatives; 60% Schools, 20% Hospitals, 10% Water and Sanitation and 10% for other small projects within the community.

Lessons to be learned from credit arrangements contract farming are:

- Instead of dealing with individual farmers the contracting companies have learned that it works better when they deal with the Primary cooperative society leaders who distribute the money paid in advance to farmers to purchase inputs
- The companies providing loans for agricultural inputs have also learned that performance improves when complementary technical assistance is also provided. The companies have been providing extension services to advise the farmers on various farming methods and techniques to enhance productivity and incomes generated by the farmers.

3.5 *Agricultural Inputs Fund*

The Agricultural Inputs Credit Fund was established by government to extend credit for the purchase of agricultural inputs. The allocations of financial resources to this Fund has been rather unstable and below requirements. The Fund is supposed to be revolving and growing. However, the initial experience was that of low loan recovery rate. In response to that experience of losing money, the Fund has been innovative in working with other partners such as commercial banks (e.g Exim Bank) and community development banks as fund managers who are better placed to evaluate loan applications and monitor loan recovery. The Fund has also sought the help of the Savings and Credit Cooperative Union League of Tanzania (SCCULT) and specific SACCOs in the process of handling the funds. SCCULT lends to specific SACCOs who do on-lending to their members. The fund is channelled either directly to the farmers or indirectly by financing distributors of agricultural inputs. There are also District Agricultural Inputs Trust Funds such as Mufindi AITF and Mukuranga AITF which have been used for on-lending to their members.

Lessons to be drawn from this experience are:

- The use of these linkages essentially substitutes for collateral

- Working through SACCOs and Community Development Banks and other locally based institutions such as District Agricultural Inputs Trust Funds reduces the transaction costs of handling financial services largely because of easier access to information about their members and proximity to the places where the economic activities of their members are located. This facilitates follow up and monitoring of loan recovery.
- Strengthening SACCOs and improving marketing (making sure that farmers have a market and at reasonable prices) are supportive attributes for the development of rural finance. The SACCOs have to build the capacity to operate like businesses and must be staffed by entrepreneurial and knowledgeable leaders. Capacity building is essential for SACCOs to function competitively.

3.6 Savings mobilization

The potential for saving mobilization in the rural areas is substantial. The survey results showed that about 72% of grassroot associations actually saved and that over 80% of the respondents were willing to utilize the services of grassroot associations in order to access both credit and savings (K-REP, September, 1997).¹² It was found that 83% of the household indicated that at times they had surplus income they could save. The challenge is to provide for appropriate forms of instruments which are consistent with enhanced financial intermediation (VPO, 2000).

The common trend in grassroot associations have been instrumental in instilling a saving behaviour and provides an opportunity for promoting loan repayment based on pressure from peer monitoring as a substitute for conventional collateral. Group initiatives in various forms (e.g. self help groups) are becoming an innovative link between their members and banks and other providers of financial services. The groups take credit from the banks for on-lending to their members. This has become an innovative method of financial intermediation.

4.0 Conclusion and Recommendations

Rural finance has positive impact on household economic conditions

At household level in the rural areas it is often difficult to separate financial needs of enterprise/business households activities from other financial needs of individual households. This presents itself as a challenge for financial service providers to formulate appropriate instruments which can address both enterprise and individual household needs such as school fees and costs associated with health care. If these are not catered for then even the performance of enterprise activities can be affected. For instance, diversion of resources to other basic needs can reduce resources available for enterprise development thus disrupting their performance.

Experience has shown that availability of financing, even small amounts, has a very positive impact on the family's economic condition as it helps to unlock productive potential. Micro-finance facilities can provide a range of financial services including

² K-REP (1997) Demand for Rural Financial Services in Tanzania. Sept 1997

credit, savings, and insurance to poor enterprises and households, offers the potential for growth and helps safeguard poor households against extreme vulnerability. Loans, savings, and insurance help even out income fluctuations and maintain consumption levels during lean periods. Evidence from rural finance clients demonstrates that access to financial services enables poor people to increase their incomes, build assets, and reduce vulnerability. It also translates to better nutrition and improved health outcomes. These experiences suggest that providing affordable financial services to the rural population deserves high priority in development.

Direct interventions have failed

.Direct interventions in rural finance to stimulate growth and reduce poverty through a blend of targeted credit programmes, interest subsidies, and other government policies became widespread in the 1950s, when Keynesian economics inspired many governments to design fiscal interventions at the macroeconomic level. But these direct interventions have generally been disappointing and have tended to retard, rather than promote the development of financial services in rural areas.

The policies were based on serious misconceptions about the real challenges facing rural communities and were directed more toward the symptoms rather than the causes of inadequate rural financial intermediation.

Institutional and Policy Design Stands a better chance of success

A recent development in the provision of rural financial services (both savings and credit) have demonstrated that proper institutional design and adherence to appropriate policies pays off handsomely and have the potential to generate substantial achievements in terms of both sustainability and greater institutional outreach. There are an increasing numbers of successful micro-finance institutions that provide financial services in a sustainable manner. Various quantitative and qualitative studies indicate increases in income and assets and decrease in vulnerability of micro-finance clients.

Although the new approach focuses on income expansion and poverty reduction, the perceived challenges and ways of addressing them are strikingly different. The principal change involves promoting deep and efficient rural financial markets by creating a favourable policy environment, improving the legal and regulatory framework that supports rural financial markets, and addressing specific market failures in cost effective ways through well designed, self sustaining interventions. Successful rural finance institutions are all located near their clients; utilize lending technologies that are simple and inexpensive for both the client and lender and most include savings.

It has often been argued that the formal financial sector in most developing countries has failed to serve the rural communities due to collateral, credit rationing, preference for high-income clients and large loans, and bureaucratic and lengthy procedures of providing loan. On the other hand, the informal financial sector has also failed to help farmers due to monopolistic power, excessive high interest rates and exploitation through under valuation of collateral. (Rweyemamu et al, 2000). With continuous emphasis being placed on delivery of micro-finance services to the rural population, it is important to focus on semi-formal institutions that are filling the gaps left by both the informal and formal financial institutions supporting agricultural sector

development. These can form viable links between the formal financial institutions and the borrowers.

Improving the Environment for Rural Financial Services

The new approach continues to focus on income expansion and poverty reduction but makes the case for cost effective alternatives, such as increased investment in rural infrastructure or in human development, to reach these goals. Advocates of this approach propose that governments concentrate on establishing a favourable policy environment that facilitates the smooth functioning of rural financial markets while playing a more limited and efficient role in the direct provision of rural financial services. The factors that prevent rural financial markets from operating efficiently are recognized to be broader and include macroeconomic policies, weakly regulated financial sectors, institutional features (legal and regulatory), and specific constraints related to intermediation in rural areas. This approach sees the government's main task as creating a conducive environment for private intermediaries in rural financial markets.

Cost of transport and infrastructure

Transportation expenses tend to be high due to the fact that many borrowers are located at long distances from the loan offices. When the opportunity cost of labour in-terms of the work time lost is considered in the total borrower transaction cost computations, the loans tend to be very expensive to the borrowers as the total transaction costs amount to a substantial part of the loan received. This also poses a challenge to the providers of financial services as they find themselves spending considerable time visiting areas that are sometimes remotely located. Depending on the nature of the visits this could be done several times a week.

Numerous studies have shown that the provision of roads reduces transaction costs of inputs and outputs, leading to an increase in agricultural output, crop area and yield. Agricultural output itself is limited by inadequate off-farm, “upstream” and “down-stream” facilities. Better infrastructure can stimulate rural income by lowering the costs of trade with the country’s urban areas and foreign markets.

Infrastructure helps make the more remote rural areas part of a broader market, contributing to the marketization and profitability of agriculture. It also promotes information flows between communities and rural and urban areas, thus linking farmers to markets for goods, input supplies, and agricultural extension services. Electrification can improve access to information and networks. Thus, rural infrastructure plays a vital role in empowering people, connecting isolated communities and providing rural people with access to the political and decision-making entities.³

Partnership in promoting and developing rural finance

Micro-finance, thus offers the potential for sustainability and growth. Due to their demonstrated success in providing benefits to the poor, international donors and

³ The World Bank website

governments are more willing to support micro-finance institutions. Many governments have set up facilities that channel funds from multilateral agencies to Micro-finance Institutions. Micro-finance is not a panacea but an important intervention in reducing poverty especially in rural areas.⁴

Scaling up this successful approach will require partnership between civil society, government and its institutions and donors to provide seed resources for expansion of these services. Scaling up may also require commitment of grant resources to help offset the overhead cost associated with operating these facilities, as experiences has shown that even in the case of Grameen Bank, the pioneer in this field, the bank remains constrained by high expenses per unit transacted and relies on donors and socially conscious investors.⁵

Experience has shown that the development of rural finance requires action by several actors in the public, private as well as the civil society sectors. The public sector should work with the micro finance institutions through investing in infrastructure, market services and extension of the rural areas as a way of developing the agricultural sector.

It is suggested that governments, in partnership with NGOs and the private sector, particularly those involved in provision of agricultural inputs, marketing or agro-industry, with support from international donor agencies, establish Farmer Support Services (FSS) in rural areas to assist farmers in accessing credit that could be available through micro-finance facility, technical assistance available from government or NGOs, training –capacity building, marketing information including new standards for exports, and assistance with crop and product diversification. In fact, it is advisable that diversification be pursued beyond agriculture into non-farm activities in order to adequately address the challenges of seasonality and vulnerability.

Putting in place low cost and tailor-made delivery systems

- Innovative, low-cost delivery systems and mobile banking services.
- Innovative, and flexible loan terms and conditions adapted to social, economic and cultural circumstances. For example, all offer weekly or monthly repayment schedules tailored to the clients' cash flow.
- Control over administrative expenses and effective use of economies of scale.
- Where the volume of business is relatively small, mobile offices provide limited services to clients in outlying areas once or twice a week
- The small average size of loans and relatively high cost of legal procedures make foreclosure prohibitively expensive (although warranted in certain cases to achieve a demonstration effect). Thus the focus

⁴ www.cgap.org

⁵ Jonathan Murdoch, “The role of subsidies in microfinance: evidence from the Grameen Bank”, Journal of Development economics, April 1999, www.elsevier.com.

is on quality at entry and appropriate incentives for repayment.

Close monitoring including using established institutions in rural areas.

- Close monitoring of loan performance; high on-time collection rates and low loan losses.
- Applicants are prescreened based on readily available information (gathered from peers and from village leaders), and proposed investments are evaluated.
- Advanced management information system that facilitate effective planning, control and timely monitoring of loan repayments.
- Access to information through established institutions in the rural areas should enable shortening of the loan application process. Collateral is desirable but not mandatory. Loan delivery systems incorporate cost minimizing features. Most NGO- MFI have used a group lending approach which has helped to reduce the cost of loans administrations, enhance enforcement of loan recovery and substitute peer monitoring for collateral which most rural households do not have.

Management autonomy and incentive structures

A variety of mechanisms have enhanced the efficiency of these institutions, some of the important are:

- High degree of management autonomy in formulating operational policies.
- Policies that provide for staff accountability, investment in human capital, and rewards (monetary incentives and promotions) that are related to sound financial performance and sustainability. Staff incentives are linked to the performance of the loan portfolio, so clients are monitored more closely than is usual.
- Clients are given a substantial incentive to repay through both interest rebates and access to additional large loans contingent on timely repayment.
- Appropriate financial ratios for measuring a financial institution's performance should be designed and put in place. For instance, return on equity and return on assets has become more common in recent years. In addition, the use of the subsidy dependence index is recommended to evaluate those providers who depend on their access to subsidies.

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