

**MICROFINANCE OUTREACH AND FINANCIAL
SUSTAINABILITY: A CASE OF SELECTED MFI'S IN
TANZANIA**

**MICROFINANCE OUTREACH AND FINANCIAL
SUSTAINABILITY: A CASE OF SELECTED MFI'S IN
TANZANIA**

**By
Irene Gomba**

**A Dissertation Submitted in Partial Fulfilment of the Requirements for Award
of Master of Science in Accounting and Finance (Msc A&F) of Mzumbe
University.**

2013

CERTIFICATION

We the undersigned, certify that we have read and hereby recommend for acceptance by Mzumbe University a dissertation entitled “Microfinance Outreach and Financial Sustainability in partial fulfilment of the requirements of the award of Masters of Science in Accounting and Finance (MSc A&F) of Mzumbe University.

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DEDICATION

I dedicate this piece of work to my dearly loved young sisters Christine Gomba and Jacqueline Gomba as challenge for them to achieve more in their career succession.

LIST OF ABBREVIATION

ASDS	-	Agricultural Sector Development strategy
BOT	-	Bank of Tanzania
COSOP	-	Tanzania country Strategic Opportunity Paper
CRDB	-	Cooperative and Rural Development Bank
LGRP	-	Local Government reform Program
MFI	-	Microfinance Institutions
NBC	-	National Bank of Commerce
NGO	-	Non-Government Organizations
NMP	-	National Microfinance Policy
NPES	-	National Poverty Eradication Strategy
NSGRP	-	National Strategy Growth and Reduction of Poverty
PRSP	-	Poverty Reduction Strategy Paper
RDS	-	rural Development Strategy
TAS	-	Tanzania Assistant strategy
TPPA	-	Tanzania Participatory Poverty Assessment

ABSTRACT

The objective of the study was to find out the effect of microfinance outreach on their profitability using some microfinance institutions in Tanzania as cases for the study. Tanzania was selected because, the country enjoys peace, political stability and also it is gifted with huge natural resources but the majority of its people especial the rural population lives in absolute poverty.

The study used data of nine (9) microfinance institutions in Tanzania. The data was obtained from Microfinance Information eXchange (MIX) market. Data analysis was conducted using three simple regression models. Specifically, the study wanted to determine first, the effects of number of active borrowers on cost per borrower. Second, was to determine the effects of cost per borrower on the microfinance profitability. Finally, the study was set to determine the overall effect of number of active borrowers on the profitability of microfinance institutions.

It was found that, the number of active borrowers is negatively related with the cost per borrower; the cost per borrower is positively related with the operational self-sufficiency; and the number of active borrowers is positively related with the operational self-sufficiency. That is, the increase in number of active borrowers results into decrease in the cost per borrower which in turn leads into increased profitability. Thus generally, the study concludes that the number of active borrowers has a positive influence on the profitability of microfinance institutions.

Based on the study findings, the study recommends that in order for the microfinance institutions in the country to be profitable, they should ensure that they increase the number of active borrowers.

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CHAPTER ONE

INTRODUCTION

1.1 Background Information

Microfinance refers to the provision of a broad range of financial services such as savings, loans, money transfers, and insurance to poor and low-income households and for small-scale businesses (Armendariz & Morduch 2005). Currently, there is a wide range of institutions that are involved in providing microfinance services to low income groups. These include cooperative societies, local and international Non-Governmental Organisations (NGOs), commercial banks and development banks.

Traditionally microfinance has been seen to essentially provide small amounts of loans to those without access to formal financial institutions especially banks, this is termed microcredit. It is also a tool or market based strategy for poverty reduction and empowerment of women, helping the poor and managing to make profits at the same time, free of the heavy subsidies that brought down large state banks (Armendariz & Morduch 2005).

Micro credit and microfinance are relatively new terms, first coming to prominence in the 1970s, according to Robinson (2001). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidised rural credit programmes. These often resulted in high loan default, high losses and an inability to reach poor rural households (Robinson, 2001).

The importance of microfinance was reinforced with the launch of the Micro credit Summit in 1997. The Summit aims to reach 175 million of the world's poorest families, especially the women of those families, with credit for the self-employed and other financial and business services, by the end of 2015 (Micro credit Summit, 2005). More recently, the UN declared 2005 as the International Year of Micro credit.

Since then, the approach to poor finance developed within the international community, including the World Bank, emphasizing the importance of creating sustainable financial institutions providing a range of financial services that are based on client demand. The approach offers the opportunity to make a lasting contribution to reduction of poverty, because people need financial services on a permanent basis to manage their financial affairs including the growth of their economic activities.

Therefore, MFIs should be strong financially (that is have good financial performance) if they are to be able to reach a larger target market of the poor in society. In other words how well MFIs will help alleviate poverty depends on their financial performance. However, the financial performance also depends on the level of microfinance outreach. Thus this study is meant to explain how the outreach affects profitability of microfinance institutions in Tanzania.

1.2 Statement of the Problem

In developing countries, informal institutions especially microfinance institutions (MFIs) are becoming more and more important in poverty reduction strategies and the potential to reach a large number of those excluded from the formal financial sector should not be underestimated. MFIs that provide financial services to the poor according to Makina and Malobola (2004) include nongovernmental organizations (NGOs), rural banks, credit unions and commercial banks. There has been an increase in the number of institutions and their clientele, with most of them having poverty reduction as part of their main objectives. This is why there is the need to evaluate their financial performance and how it impacts their outreach.

Case studies on best practice in microfinance which began in the 1980's such as the Grammen Bank, BRAC and ASA in Bangladesh and BancoSol in Bolivia offer a wealth of experience in the literature of microfinance for comparative and performance assessment. But due to the limited nature of the background information for most MFIs these best practices must be adapted to suit each institution's circumstances taking into account their political and economic environment (Moll 2004; Armendariz and Morduch 2005).

Current thinking on the objectives of microfinance all seem to centre on financial sustainability and how this impacts on serving low income groups. These objectives influence the day to day operations of MFIs with a tradeoff between the objectives of poverty reduction and financial sustainability. Financial sustainability as suggested by Moll (2004) leads to MFIs focusing on the less poor who are better known, need larger loans and are in a better position not to default in repayment. This is what leads to exclusion of the very poor to microfinance services which they need. Concentrating on the poor or low income group makes it difficult to achieve sustainability as there is lack of information about the new client's repayment abilities and risks of defaults. Balancing these objectives is difficult as one must be sacrificed for the other. The result of which objective is being pursued reflects in the institutions annual financial statements.

It must be iterated that as a development agent focused on serving low income groups, MFIs should be financially stable if their goal of reaching the poor is to be achieved.

The Tanzania government is determining to stay the course of economic and social reforms and maintain improved macroeconomic stability. Real GDP is expected to reach the average growth rate of 6-8 percent per annum between 2005/06 and 2009/10. Domestic revenue mobilization effort will be accelerated and external support utilized to increase the capacity for steady growth. Projections for 2005/06-2009/10 assume improvements in the productivity of agriculture and other productive and economic service sectors, tourism and mining and a strategic trade regime fostering international competitiveness, promoting private sector development and implementation of policies in respect of the Small and Medium Enterprises (SMEs), micro -finance and cooperatives.(URT,2005)

According to World Bank, World Development Report 2000/2001. Attacking Poverty, evidence generated over the last 20 years in various parts of the world conclusively indicates that the availability of well – designed financial services can

significantly improve the incomes and drastically reduce the poverty levels of the poor in both rural and urban areas.

Tanzania enjoys peace, political stability and is also gifted with huge natural resources but the majority of its people especially the rural population live in absolute poverty. According to the Household Budget Survey of 2003/04 the proportion of the population below the national food poverty is 18.7 per cent and that below the national basic needs poverty line is 35.7 percent. Poverty remains overwhelmingly high in rural areas where 87 percent of the poor population lives and is highest among households who depend on agriculture (source: Tanzania Participatory Poverty Assessment (TPPA) 2003/04). In a similar note PRSP report points out thus “poverty is largely a rural phenomenon, in the rural areas, incomes are lower and poverty is more widespread and deeper than in the urban centers”(PRSP,2000,P.6)

In comparison between men and women the PRSP reports that women represent 51 percent of the population and head 14 percent of the households and the results from household surveys show that women-headed households are not necessarily poorer than male-headed households. For more clarification the report make example of 1991/1992 HBS reports which shows a poverty incidence level of 45 percent for female -headed households, and 49 percent for male-headed households (PRSP 2000).

Despite of the fact that, many studies have been attempted to explain the relationships between outreach and financial profitability as dual goals of microfinance, there are few studies which have been documented on the effects of outreach on microfinance profitability, just few studies have been conducted in Tanzania. This study therefore is meant to fill this knowledge gap.

1.3 Research Objectives

The main objective of this study was to find out the effect of microfinance outreach on their profitability. Specifically, the study was set to meet the following objectives:

- (i.) To examine the effect of number of active borrowers on cost per borrower.
- (ii.) To examine the effect of cost per borrower on microfinance profitability.
- (iii.) To examine the effect of number of active borrowers on microfinance profitability

1.4 Significance of the Study

The output of this study will add to the few existing literature of on how the microfinance institutions affect the financial performance of MFIs in Tanzania. The significance of this study lies not only on the academic excellence but also on the practical usefulness of its findings. The findings of this study are significant in that, MFIs thinking of becoming sustainable should also think of how to improve their outreach. It will also act as a motivation for further studies on the applicability of the results of this study in other countries.

1.5 Research Question

The main research question was, does the increase in the number of borrowers decrease the cost per borrower and increase the operational self-sufficiency of microfinance institutions in Tanzania? Specific research questions were:

- (i.) What is the effect of number of active borrowers on microfinance profitability?
- (ii.) Does the increase in number of active borrowers reduce the cost per borrower?
- (iii.) What is the effect of number of active borrowers on microfinance profitability?

1.6 Limitations and of the Study

The main limitation of the research was regarding the sample of this study. The study used the data consisting only 9 MFIs in Tanzania. This is due to the fact that most of MFIs do not provide their information on MIX market. MIX market is self-reported and only MFIs that are interested in providing information for donors are reporting. The observation and conclusions were therefore based on the information that was accessed.

Furthermore is about research methodology used. Due to less number of observations I used several simple regression models to analyse my data. Thus it was not possible to determine partial effect of each variable as it would be in the multiple regression. Lastly is about time frame required for completion of this research work.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This main theoretical chapter will give insight into several concepts and phenomena in microfinance, financial performance and outreach, particularly in the developing countries. It also gives some empirical findings on microfinance performance. The literature review aims at finding the gap between what other authors have explained theoretically and empirically and what has not been explained regarding the restrictions facilitating MFIs in Tanzania. This paper begins to address the theoretical literature review and then the empirical literature will also be presented.

2.2 Theoretical Literature Review

The theoretical part of this chapter focuses on definition of microfinance, the role of Microfinance Institutions in the economy, Characteristics of Microfinance Institutions, indicators of financial performance, indicators of outreach and the relationship between financial performance and outreach.

Poverty is the main challenge and fundamental issue in economic development in Tanzania. The government is committed to address this challenge in consultation with key stakeholders in the economy, especially the private sector, civil society, Non Government Organizations and other development partners. There is increasing number of households, which are not only absolutely poor but also live far below subsistence level.

The government of Tanzania both past and present have focused on ignorance, disease and poverty reduction as the main aim of their development strategy. This began in 1961 with medium and long term development plans.

Macroeconomic and sector policies associated with various reform measures were formulated by the government. These policies, strategies and reforms are aimed

primarily at attaining the Tanzanian's development vision 2025 of achieving a "sustainable socioeconomic development by the year 2025" (URT, P.14).

The government prepared the National Poverty Eradication Strategy (NPES) in 1998 to provide a framework to guide poverty eradication initiatives in the country. According to URT (2002) the implementation of NPES is predicted to reduce poverty by 50 per cent by the year 2010, and eliminate absolutely poverty by 2025.

The NPES was translated into a medium term strategy for poverty reduction known as the Poverty Reduction Strategy Paper (PRSP) in 2000. The PRSP was prepared in the context of the Highly Indebted Poor Country initiatives (HIPC) process. The focus of PRSP is to reduce income poverty, improving human capabilities, survival and social well-being, and containing extreme vulnerability among the poor (URT, 2002).

The review of the PRSP in 2004 culminated into the establishment of the National Strategy Growth and Reduction of Poverty (NSGRP). The NSGRP is the second national organizing framework for poverty reduction and promotion of social inclusion. It emphasizes growth and poverty reduction at the centre of the country's development agenda. It represents a more comprehensive approach to poverty reduction than the PRSP.

Thus, NSGRP builds on the PRSP and integrates components of the country's existing overall and sector strategies and policies by giving poverty more of a focus. Unlike its predecessor, NSGRP place emphasis on priority outcomes and results rather than focusing on priority sectors as were the case with the PRSP. Furthermore, it recognizes the contribution of every sector, includes cross cutting issues such as governance and communications (URT, 2005).

The Tanzania development vision 2025 outlines the goals of sustainable live hoods and sustained economic growth. Consequently, the development of the country's Microfinance Institutions (MFIs) is defined in various policies and strategies that

include; the National Microfinance Police 2000, Small and Medium Enterprises Development Strategy 2003, and Cooperative Development Policy 2002. It is out of these policies that the legal and regulatory framework for the financial sector was developed.

2.2.1 The Role of Microfinance Institutions in the Economy

Microfinance programs focus on expanding local economic activities and improving the standard of living of their clients by providing financial services needed to establish small businesses. In a similar note Shannon *et al* point out thus “the primary goal of most Microfinance Institutions (MFIs) is to improve the economic status of poorer segment of the population”. (Doocy *et al* 2005,p.79). They further clarified the concept by stating that micro enterprise programs have a unique opportunity to impact the economic, social and general well- being of the households (Doocy *et al* 2005).

Moll (2004,p.16) indicates that “microfinance is enjoying enormous support from governments, development agencies and nongovernmental agencies”. The reasons are different and many, with the term microfinance being linked to the relationship between finance and development by way of outreach. One such reason as suggested by Robinson (2001) distinguishes between two views: poverty lending or credit for target group and financial system. Different approaches influence policies that shape the environment of MFIs and the services they provide. Using the first of Robinson’s views the target group is the poor or those who lack capital to undertake enterprises that can lead to development, such as market women, farmers and small scale business owners. This is in line with international attention on poverty eradication (Moll 2004).

This ties in with the financial system or “pushing the financial frontier” approach, which sees low income groups as economic units that make daily decisions about production, consumption and resources based on conditions characterized by; seasonality, uncertainty about future consumption and production requirements, and low income levels (Moll 2004).

Since the 1990's microfinance institutions have evolved as a form of development tool for both the economy and the people whose lives are affected. This is intended to be of immense help to those who find themselves within the lower income group in society. On the same track Arsyad underscores the point when he says: "One of the objectives of microfinance is serving the financial needs of the poor and those who find themselves excluded from the formal financial sector. This has the added aim of reducing poverty, creating employments and helping the disadvantaged in the community". (Arsyad 2005, p.392)

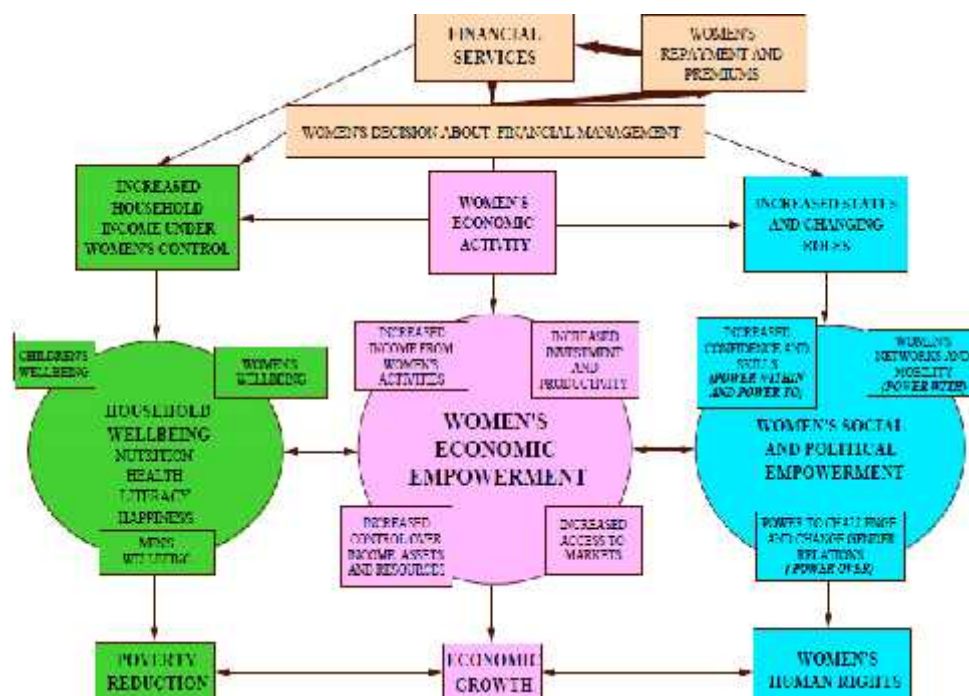
Microfinance facilitate growth in income and assets; it offers entrepreneurs ways to invest in the expansion of their businesses through working capital or fixed asset loans, without the usual collateral required by banks (Campion, A. *et al* 2009). Maes and Foose (2006) further clarify the concept by stating that MFIs is promoting income-generating activities such as poultry rearing and teaching member's relevant technical skills.

Microfinance, according to Campion, A. *et al* (2009) can reduce barriers to effective financial and business management, through training and education. Microfinance can provide a good opportunity to provide low-cost education services needed by the poor, if only to improve their performance as microfinance clients. This is especially true for village banking and related delivery systems that bring large groups of relatively poor clients together in regular meetings.(Dunford 2002). He added that good non for-mal adult education techniques can be used effectively at the regular meetings to promote changes in personal behaviour and in child-care practices and also to promote awareness of and confidence in whatever good quality health services are available locally. Such education technologies can also improve business skills that enable clients to put their loans to more productive use and generate more profit and savings.

Campion, A. *et al* (2009) argue that microfinance can play an important role in increasing self-confidence or strengthening social networks, empowering clients to seek the changes they need in their lives. According to Mayoux (2006) increase

women’s access to microfinance services can lead to women’s economic empowerment, increased well-being for women and their families and wider social and political empowerment. She more emphases that “ Microfinance services and groups involving men also have potential to question and significantly change men's attitudes and behaviours as an essential component of achieving gender Equality. Gender equality and women’s empowerment in turn are essential and integral components of pro-poor development and civil society strengthening.” (Mayoux,2006,p.1). For further supporting the point on how microfinance can reach and empower women, Mayoux made an interesting figure as can be seen below.

Figure 2.1: Gender equality and Women’s Empowerment



Source: Adopted from (Mayoux,2006 p.4)

Simanowitz and Brody (2004, p.1) state, “Microfinance is a key strategy in reaching the MDGs and in building global financial systems that meet the needs of the most poor people.” Littlefield,*et al* (2003,p.2) state “microfinance is a critical contextual factor with strong impact on the achievements of the MDGs...microfinance is unique

among development interventions: it can deliver social benefits on an ongoing, permanent basis and on a large scale”. Referring to various case studies, they show how microfinance has played a role in eradicating poverty, promoting education, improving health and empowering women (Littlefield *et al* ,2003).

In developing countries, informal institutions especially microfinance institutions (MFIs) are becoming more and more important in poverty reduction strategies and the potential to reach a large number of those excluded from the formal financial sector should not be underestimated. MFIs that provide financial services to the poor according to Makina and Malobola (2004) include nongovernmental organizations (NGOs), rural banks, credit unions and commercial banks. There have been an increase in the number of institutions and their clientele, with most of them having poverty reduction as part of their main objectives. This is why there is the need to evaluate their financial performance and how it impacts their outreach.

Case studies on best practice in microfinance which began in the 1980’s such as the Grammen Bank, BRAC and ASA in Bangladesh and BancoSol in Bolivia offer a wealth of experience in the literature of microfinance for comparative and performance assessment. But due to the limited nature of the background information for most MFIs these best practices must be adapted to suit each institution’s circumstances taking into account their political and economic environment (Moll 2004; Armendariz and Morduch 2005).

Current thinking on the objectives of microfinance all seem to centre on financial sustainability and how this impacts on serving low income groups. These objectives influence the day to day operations of MFIs with a tradeoff between the objectives of poverty reduction and financial sustainability. Financial sustainability as suggested by Moll (2004) leads to MFIs focusing on the less poor who are better known, need larger loans and are in a better position not to default in repayment. This is what leads to exclusion of the very poor to microfinance services which they need. Concentrating on the poor or low income group makes it difficult to achieve sustainability as there is lack of information about the new client’s repayment

abilities and risks of defaults. Balancing these objectives is difficult as one must be sacrificed for the other. The result of which objective is being pursued reflects in the institutions annual financial statements.

It must be iterated that as a development agent focused on serving low income groups, MFIs should be financially stable if their goal of reaching the poor is to be achieved.

2.2.2 Microfinance in Tanzania

Financial sector reform in Tanzania began with the Economic Recovery Programme of 1986. The Banking and Financial Institutions Act (1991), Cooperative Societies Act 1991 and Bank of Tanzania were amended and permitted entry of private banks into the financial market and subsequently led to restructuring of all Government of Tanzania's major banks and financial institutions. This included the downsizing and privatizing of the National Bank of Commerce and Cooperative and Rural Development Bank (CRDB). Banks were required to operate on a commercial basis. In addition, prudential norms for operations and the provisioning requirements for non-performing assets out of the profits were introduced, and regulatory functions of Bank of Tanzania (BoT) intensified.

According to CIDA *et al* (2003) while a combination of macro-economic stabilization and a financial sector reform process started in early nineties have laid the basic foundations for the development of sound financial sector, this has not resulted in significantly improved access to financial services by the low income people. Despite some of the gains from these reforms – liberalized interest and exchange rates, a relatively fluctuating Tanzanian Shilling, liberalized access to credit among others – the Government is acutely aware of the limitation of the traditional banking sector's ability to mobilize and capture savings from and extend credit to poor people in rural areas. As a case in point, the 1991 financial sector reforms compelled the National Bank of Commerce to close down its 77 branches located in various rural districts Countrywide. This further aggravated the situation of inadequate availability of financial services to the rural poor.

The rural population which has a weak financial resource base is in dire need of financial services that cater for its unique circumstances. The traditional banking sector is unable to answer the needs of the poor rural populace because it perceives provision of Credit in the rural sector; a very risky business, collateral requirements are not easily attainable by the rural poor and are operationally and administratively costly.

From the foregoing one can safely conclude that the traditional banking sector is therefore not adequately equipped besides being reluctant to provide financial services to the rural poor.

There is therefore a need for either financial institutions specializing in micro-finance services to step up to the challenge and provide specialized financial services to the low income groups or the poor organize themselves into savings and credit associations or financial cooperatives to address this need.

In July, 1998, IFAD, in close collaboration with the government of Tanzania and potential beneficiaries, prepared a Tanzania Country Strategic Opportunities Paper (COSOP) to clarify preferential areas for future interventions by the fund. The COSOP supports the ongoing government of Tanzania process of policy reform and restructuring of the public sector which aims to reverse the national economic and social declining trends of the past.

Key features of the reform process are: the introduction of an open and liberal economic policy regime, redefinition of the role of government to that of a facilitator, regulator and policy setter of the development process, decentralization of administration power to the districts and communities and the development of microfinance services as a major instrument in an overall effort to alleviate poverty. The role of Bank of Tanzania toward microfinance institutions is “to develop a policy, legal and regulatory framework, guide the development of the sector, coordinate Government intervention and interface with other stakeholders in the

field, monitor performance of the sector and disseminate relevant information to the public” www.bot-tz.org/MFI

The government policy from the strategic vision 2025, through the National Poverty Eradication Strategy (NPES) and Tanzania assistance Strategy (TAS) to the Poverty Reduction Strategy Paper (PRSP), the Local Government Reform Programme (LGRP), Rural development Strategy (RDS) and the Agricultural Sector Development Strategy (ASDS) as mentioned early sees pro-poor, private sector led, economic growth as key to long- term sustained poverty reduction. All these documents emphasize the critical role to be played by the financial services.

In an endeavor to rationalize the development of a strong microfinance sector, the government of Tanzania has developed and adopted a Rural and Micro Finance Policy covering all aspects of Micro Finance Institutions (MFIs) development through registration, governance, supervision and inspection. The National Microfinance policy (NMP) responding to these higher level policy demands, articulates the government’s vision for the development of pro- poor finance in Tanzania as follows:

“... Achieving widespread access to microfinance throughout the country, made possible by institutions operating on commercial principles. A wide range of institutions will be involved in the provision of services, including specialized and non- specialized banks, non- bank financial institutions, rural community banks, cooperative banks, SACCOS, and NGOs. Some providers will focus on credit, some on savings and others on both. Microfinance will be integrated with the mainstream financial system with the flexibility that ensures that their special features are not compromised. The institutions will use a variety of methodologies, each adopted for its particular Market niche. Competition will ensure that service providers operate efficiently and provide high quality services.

The system as a whole will provide financial intermediation without necessarily relying on injections of external donor or Government funds. Subsidies will no longer be needed, except perhaps for organizations pushing the frontiers of the system out to the most remote or poorest clients” (URT, 2000, p.8)

The rationale behind the need for Microfinance is that for the majority of Tanzanians , whose income are very low , access to financial services offers the possibility of managing scarce household and enterprise resources more efficiently, protection against risks, provision for the future, and taking advantage of the investment opportunities for economic returns .

Below is the status of Microfinance Institutions in Tanzania according to Tanzania microfinance institutions directory (2005).

Summary: Regional Distribution of MFIs in Tanzania

	Banks	Non-governmental Organizations (NGOs)	Financial Service Associations	Government Programs/Schemes	Savings and Credit Cooperative Societies (SACCOS)	Savings and Credit Associations (SACAs)	Community Based Organizations (CBOs)	Total
TANZANIA MAINLAND								
Arusha Region	-	8	-	-	68	1	-	77
Coast Region	-	-	-	11	33	-	1	50
Dar es Salaam Region	4	5	-	5	175	-	-	189
Dodoma Region	-	4	-	6	83	1	1	100
Iringa Region	1	2	-	-	100	-	-	103
Kagera Region	1	7	-	10	97	-	1	116
Kigoma Region	-	2	-	8	25	-	1	34
Kilimanjaro Region	1	-	-	-	92	1	-	94
Lindi Region	-	-	-	-	22	-	-	22
Manyara Region	-	-	-	-	50	-	-	50
Mara Region	-	1	-	10	99	-	1	111
Mbeya Region	-	1	-	-	160	39	2	190
Morogoro Region	-	1	-	11	87	-	-	94
Mtwara Region	-	1	-	-	41	1	-	43
Mwanza Region	-	4	1	14	207	-	1	227
Ndava Region	-	3	-	-	22	10	-	35
Njombe Region	1	-	-	-	47	1	-	44
Shinyanga Region	-	4	-	10	45	-	29	80
Singida Region	-	2	-	7	46	-	5	61
Tabora Region	-	6	-	13	17	-	2	30
Tanga Region	-	2	-	-	39	-	-	41
Sub-total	8	53	1	105	1,553	48	45	1813

ZANZIBAR

North Pemba Region	-	-	-	-	5	-	-	5
South Pemba Region	-	-	-	-	17	-	-	17
North Unguja Region	-	-	-	-	6	-	-	6
South Unguja Region	-	-	-	-	24	-	-	24
Urban West Region	-	4	-	-	30	-	-	34
Sub-total	0	4	0	0	52	0	0	86
Grand Total	8	57	1	105	1,635	48	45	1,899

Source: Tanzania Microfinance Institutions Directory (2005, p. iii)

www.bot-tz.org/MFI/Documents/Directory

2.2.3 Financial Performance

Financial performance has no definite definition, but simply put it refers to the ability of a company to generate new resources from its daily operations, over a given time period (Atrill & McLaney 2004). Some of microfinance financial performance indicators are discussed below;

Financial Profitability

Profitability is the ability of an organisation to generate earnings and make a profit and provides an insight into the degree of success of the owners' investments (Atrill and McLaney 2004). A company's profitability can be assessed in relation to its level of sales, asset levels (ROA) or invested capital (ROE).

Indicators of financial profitability according to Rosenberg (2009) are: Return on assets (ROA), reflects that organization's ability to deploy its assets profitably.

Return on equity (ROE), measures the returns produced on the owner's investment. The financial self-sufficiency ratio (FSS) indicates the institution's ability to operate without ongoing subsidy, including soft loans and grants, and operational self-sufficiency (OSS) ratio, indicates the institution's ability to operate without subsidy and without drawing down capital to pay for operating expenses. Unlike the financial self-sufficiency ratio, the OSS is not adjusted.

Loan Repayment (Portfolio Quality)

Rosenberg (2009, p.1) defines loan repayment as "how well is the lender collecting its loan". Loan collection has proved to be a strong proxy for general management competence, long experience with evaluating microfinance projects has shown that very few successful projects have bad repayment and very unsuccessful projects have good repayment (Rosenberg 2009). The loan portfolio is a MFIs' most important asset.

According to Lafourcade *et al* (2006, p.3) portfolio quality "reflects the risk of loan delinquency and determines future revenue and an institution's ability to increase outreach and serve existing clients". The standard international measure of portfolio quality in banking is portfolio at risk (PAR) beyond a specified number of days:

PAR (x days) = outstanding principal balance of all

Loans past due more than x days

Outstanding principal balance of all loans

Or loans at risk (LAR)

$$\text{LAR (x days)} = \frac{\text{number of loans more than x days late}}{\text{Total number of outstanding loans}}$$

Source: Rosenberg (2009, p.6).

The number of days (x) used varies, in microfinance 30 days is a common breakpoint.

Rosenberg (2009) argues that, it is useful when reporting PAR or LAR to include a description of the MFI's write-off policy. On commenting Rosenberg (2009, p.7) says "repayment of an MFI's loans is a crucial indicator of performance, poor collection of micro-loans is almost always traceable to management and system weaknesses". By insisting on loan collection he added that "the strongest repayment incentive for uncollateralized micro-loans is probably not peer pressure, but the clients' desire to preserve their future access to a loan service that they and their families find very useful: thus, healthy repayment rates are a strong signal that the loans are of real value to the clients" (2009, p.8).

Efficiency

Rosenberg (2009, p.1) define efficiency as "how well does the MFI control its operating expenses". In the same idea, Atrill and McLaney (2004, p.149) define efficiency "is how well various resources are managed by an institution". While Balkenhol (2007, p.9) relates efficiency with quantities and costs of inputs and outputs, "a firm is efficient if it maximizes the quantity/price of an output for given quantities/prices of inputs; alternatively it is efficient if for a given quantity/price of output it operates with the least quantity or least costs of inputs".

Two main indicators recommended by (CGAP 2006) to measure whether a retail microfinance provider is cost effective are: Operating expense ratio (OER) and cost per client (or loan). Operating Expense Ratio (OER) allows a quick comparison between an MFI's portfolio yield with its personnel and administrative expenses, how much it earns on loan versus how much it spends to make them and monitor them. According to Rosenberg (2009), its substantial drawback is to make an MFI

doing small loans look worse than an MFI doing large loans, even if both are efficiently managed.

Cost per Client (or loan), shows how much it costs the retail financial service provider to serve each client. Because it does not penalize MFIs making smaller loans, cost per client is a better efficiency ratio for comparing institutions (Rosenberg 2009). He added that if one wishes to benchmark an MFI's cost per client against similar MFIs in other countries, the ratio should be expressed as a percentage of per capita GNI, which is used as a rough proxy for local labour costs.

Poverty-focused MFIs are not avoiding pricing their services so as to cover their costs: MFIs that focus on the very poor and engage in very small transactions particularly tend to set their interest rates relatively high; compared to average MFIs they also tend to have the highest staff productivity in their respective regions and delivery techniques and compressed staff pay (Christen, 2000). In terms of allocative and technical efficiency they seem to operate already fairly close to their efficiency frontier. They appear to have pushed managerial efficiency to the limit and few options remain to obtain full financial sustainability, other than raising the average loan size (Balkenhol, 2007).

Productivity

Often measured in terms of borrowed per staff member, productivity is a combination of outreach and efficiency. Productive MFIs maximize services with minimal resources, including staff and funds (Lafourcade *et al*, 2006).

Financial Viability

Financial viability is the ability of the institution to cover its costs with revenue earned. The indicators used are operational and financial sustainability (Lidgerwood 1999). Operational sustainability is the MFI's ability to generate enough revenue to cover its direct costs while financial sustainability is the institution's ability to earn enough revenue to all costs.

Leverage

Leverage or gearing ratio measures the extent to which an organization is financed from sources that need a fixed return whether debt or equity. This is when a business is financed in part by borrowings (debt) and in part by shareholders (equity) and is calculated as debt to equity ratio. Leverage reflects the structure of an MFI's capital and how sufficient it is. According to Ledgerwood (1999) sufficient capital affects the MFI's financial sustainability as depositors are confident in the institution's ability to continue providing them with the level of services they get (length of outreach).

2.2.4 Relationship between Financial Performance and Outreach

Most MFIs initially did not either measure how much their services impact on the financially vulnerable in society or how they could improve such services to increase financial sustainability of both the clients and themselves in the medium to long term. To them their ability to provide loans and the ability of the poor to repay them was enough proof that income levels of their clients have been increased, as if this was not so the clients would not have been able to pay back what they owe within the approved timeframe set. But financial performance does not imply a positive change in people's lives as indicated by (Makina and Malobola, 2004 and Simanowitz, 2003).

Hartarska (2005) argues that microfinance institutions can be evaluated based upon the sector's double objective, namely reaching as much clients as possible and still obtaining operational self-profitability.

For MFIs to be beneficial to the poor in terms of depth and breadth of outreach, they should be financially stable, as without the required financial resources they cannot provide the services the poor need. However, without the poor (MFI clients) these MFIs may not exist. The microfinance outreach is therefore important in attaining financial sustainability. As Navajaas et al (2000) has commented, MFI outreach and their profitability depend on each other.

2.2.5 Assessment Tools

Impact assessment aim to answer the question of whether a project leads to change that is different from what would have happened without the intervention, or whether the program increases the probability of that change. According to Yaron (1997), there are two major schools of thought that are prominent in impact assessment of microfinance programs. The first one purely focuses on the organization or company and its operation. This approach focuses on institutional outreach and its sustainability. The assumption is that if both outreach and sustainability have been enhanced, then the intervention is judged to have a beneficial impact as it has widened the financial market, which in turn extends the choice of people looking for credit and saving services.

The second approach is the one, which focuses on the intended target groups or clients. This is the one that seeks to assess impact at household, enterprise, individual and community levels. In the case of microfinance impact assessment, one needs to conceptualize how microfinance leads to changes and what changes are reasonable to expect given the services provided. More specifically, impact is measured in terms of outreach and sustainability of MFI, and it is believed that if both are achieved then the program is beneficial as stated by Yaron (1997). In addition, impact can also be measured at different levels of the economy. Therefore, models have to be identified, several performance assessment techniques have been developed by CGAP (2001) in the 1990's. The important ones according to Arsyad (2004, p.397-401) are as follows:

ACCION; this method evaluates American commercial lending institutions and uses the CAMEL methodology. CAMEL is the acronym for Capital adequacy, Asset quality, Management, Earnings and Liquidity and uses a rating from 0-5 or D to AAA. An MFI below 2 is a lender; one between 2-3 has fundamental weaknesses that need correcting. ACCION's purpose is to strengthen management.

WOCCU (world council of credit unions) uses Protection, Effective financial structure, Asset quality, Rate of return and Costs, Liquidity and Signs of growth.

(PEARLS) to assess financial performance and is a set of 45 ratios grouped into six areas of financial performance that evaluate and monitor financial stability of credit unions. These areas are protection, effective financial structure, asset quality, rates of return and costs, liquidity and signs of growth. It does not address management.

Planet Rating a non-profit organization uses Governance and decision making process, Information and management tools, Risk analysis and control, assets including loan portfolio, Funding (equity and liabilities) and Efficiency and profitability (GIRAFE) to assess performance and has 26 indicators grouped into 6 areas of risk. These are governance and decision making process, information and management tools, risk analysis and control, assets including loan portfolio, funding (equity and liabilities), and efficiency and profitability. The focus here is on management not risk.

Micro Rate focuses on how risks affect an MFI's creditworthiness. The main parts of this methodology are: First, identify key risks and drivers, second, compare MFIs performances for benchmarking and lastly make information available to the market. The key evaluation factors are efficiency, asset quality, growth and profitability.

All four methods assess performance, but are suited to different geographical contexts, for example CAMEL and Micro Rate are best suited to Latin American countries and performance indicators used will depend on operations of the institutions concerned. The technique chosen must be useful to the MFI in terms of both internal management and external parties. Internal management will need productivity and efficiency, financial viability, profitability, leverage and capital adequacy ratios and outreach (Ledger wood 1999). Therefore, for this study regression analysis will be used to determine the relationship between financial performance and outreach.

2.2.6 Financial Sustainability and Performance

Managers of microfinance intervention as suggested by Johnson and Rogaly (1997) need to know how well the MFI is performing in financial terms. To begin with it is

of great importance to produce financial statements at the right time, because if it is produced late it cannot give a true reflection of the organisation's position. Also the financial statements must be analysed to produce information about the performance, which can be used to further improve that performance.

MFIs are tools intended to be of immense benefit to low-income people. According to Ledgerwood (1999) the main goals of MFIs are to serve the financial needs of the unserved and encourage the development of new businesses that is to reduce poverty. For positive impacts of MFIs on the poor to be achieved and sustained the MFIs must have a good financial performance.

According to Johnson & Rogaly (1997) financial sustainability of an MFI can be identified at three levels; First, subsidy, dependent the costs of the organisation are funded through grants and donor subsidies. Second, operational efficiency, non-financial costs of operation (salary and administrative costs) are covered by revenue (interests of loans and fees). Lastly, self-sufficiency and profitability, the organisation generates positive returns on assets (inflation adjusted) and covers financial costs of operation. That is on-lending capital is raised through loans and income is enough to cover loan costs.

At the moment ways of achieving financial sustainability is a subject of debate among microfinance practitioners as it not only assures the existence of MFIs but also promises financial services on a long lasting basis to the poor in society. Emphasis according to Johnson and Rogaly (1997, p.61) has been placed on "MFIs reaching a large number of users, so that economies of scale can be made and the cost of serving numerous small transactions starts to fall".

Financial performance of MFIs should be taken as an alternative indicator of positive change. If an MFI is increasing the outreach of its services to a large number and indicators of financial sustainability are improving then the impact of the MFI can be seen to be positive.

2.2.7 Social Performance (Outreach)

Another emerging debate in Microfinance Institutions services is the question of outreach. Outreach is a key factor in the process of market development and integration. Millan and Zeller (2008) mention three importance of social performance measurement as: First to encourage MFIs to be more mindful in maintaining their social mission, second to allow MFIs to demonstrate social performance, transparency and credibility to donors/investors leading to reallocation of funds towards socially oriented MFIs, and lastly to enable MFIs to demonstrate to stakeholders that their social mission is not lost in the pursuit of financial targets.

Outreach according to Rosenberg (2001 & 2009) is the number of clients or accounts that are active at a given point in time (breadth) and the level of poverty of these clients (depth). According to Schreiner (2002) outreach indicators can be used as indicators of the impact of MFIs on economic development: in this case outreach, even though they do not give a full assessment of the impact. Nevertheless these indicators can serve as quantifiable proxies of the extent to which the MFI is providing social benefits for the poor.

2.2.8 Indicators of outreach

According to Schreiner (2002) outreach has six aspects: worth to clients, cost to clients, depth, breadth, length and scope. Together these give the net social benefits of an MFI to its clients and will be discussed in turn.

Worth to Clients

Worth is defined as willingness of clients to pay and based “on the terms of the financial contract, tastes, constraints and opportunities of clients” (Schreiner 2002, p.3). The worth of a loan for instance increases as terms of the contract are matched closely to borrower demand. Worth of deposits increases with interest rates as the contract is “less restrictive”. Most economic models as suggested by Schreiner assume that worth to clients is the increase in profits in a clients business with or without access to microfinance. But microfinance can improve welfare of the poor even if it does not increase their profits; therefore an increase in profits is just a small

part of total worth. All microfinance does is help the poor “diversify their sources of income” (Schreiner 2002)

It is difficult to measure worth as it depends in part on subjective gain from a financial contract and also it is difficult to know what could have happened if the client did not have access to microfinance services. Repeat purchases could therefore be used as the simplest and straightforward measure of worth (Woller and Schreiner 2000). Customer satisfaction can be used as an indicator of worth.

Cost to Clients

This is the “sum of price costs and transaction costs” (Schreiner 2002,p.4). Price costs are direct cash payments for fees and interest. They are revenue for the MFI and the best measure is internal rate of returns, which is the interest rate that makes the present value of cash flow of the financial contract zero for the client. Transaction costs are non price costs for both non cash opportunity costs (example time to apply for a loan) and indirect cash expenses for transport, documents, food and taxes for using the financial contracts. These costs are not revenue to the MFI and are estimated from survey data on distance, time and money needed to use a financial service (Schreiner 2002). He more explains that, costs to clients are not either cost of supply or cost to society. Cost of supply is opportunity cost of resources used by the MFI. Cost to society includes cost to client, cost of supply and costs borne by non clients (such as being pushed out of the market by MFI clients) (2002).

Worth less cost according to Schreiner is net gain, which is increase in welfare due to microfinance. Net gain is measured as the difference in cost between getting from the current lender and getting it from another MFI. If loans cannot be obtained from another lender then net gain becomes willingness to pay. It is easier to check sign of net gain than size, as clients will not enter into any contract if they do not expect a positive net gain (Schreiner 2002).

Depth

Depth is the “value society attaches to net gain of a client” or simply put it is the social value of net gain. That is preference of society to who the client is example male or female, child or adult. Measuring depth directly through wealth is difficult rather indirect measures like sex (preference for women), location (rural), education (less), ethnicity (minority) and access to public services can be used. If poverty is used as an index of measurement then the percentage below the poverty line will be a good indicator of depth (Woller and Schreiner 2000).

The commonest proxy for depth is size of loan. Size has five dimensions: amount disbursed, term to maturity, amount of installments, time between installments and average amount outstanding in relation to purchasing power (Woller and Schreiner 2000).

Small amounts, shorter times and more installments imply greater depth that is very poor clients (Schreiner 2002). Deep outreach increases social benefits and also social costs, as per unit cost of supply are increased.

Rosenberg (2009, p.4) defines outreach depth as “client poverty level”. Rosenberg (2009) argues that microfinance projects have poverty reduction as an explicit objective, and are thus expected to reach poor clients. He agrees that there are various techniques for measuring client poverty levels and no widespread agreement on any one of them. Due to that he suggests the formula below to be used to report the poverty level of loan or savings clients at a point in time:

Average Outstanding Balance = Gross amount of loans or savings outstanding.

Number of active clients or accounts.

This indicator is often shown as a percentage of per capita Gross National Income (GNI):

Average outstanding loans or savings balance

GNI per capita

Source: Rosenberg (2009, p.4)

Rosenberg (2009) argues that expressing average balance as a percentage of GNI per capita allows for a comparison of how deeply MFIs from different countries reach down in their own national income distribution. He further the concept by stating that some MFIs regard an average outstanding loan balance below 20 percent of per capita GNI as a rough indication that clients are very poor but the Microfinance Exchange (MIX) classifies lenders as being MFIs if their average outstanding loan balance is not above 250 percent of per capita GNI (Rosenberg, 2009).

According to Rosenberg, “average outstanding balance is roughly related to client poverty, because better off clients tend to be uninterested in smaller loans or deposit account but the correlation between account balances and poverty is far from precise”. (2009, p.4).

In connection to depth of outreach (client poverty level) MIX (2009) encourages the MFIs that want to update their profile on mix market can add report on three indicators of poverty measurement, Poor and very Poor clients at entry, Clients in poverty and clients out of poverty.

Poor and Very Poor Clients At Entry

In order to assess the poverty levels of the clients, according to MIX (2009,p.4) “ an MFI should use the poverty line most appropriate, this indicator assesses the poverty line(s) and poverty tool(s) used to estimate the percentage of entering/recently joined clients who are below and in the bottom 50% of the poverty line”.

Clients in Poverty

Measuring a clients’ poverty status at entry and tracking this status over time is an important indicator that MFIs use to evaluate clients’ well being. “This indicator assesses the estimated percentage of clients who joined the institution 3 or 5 years ago and who remain below the poverty line” (MIX, 2009, P.4).

Clients out of Poverty

MIX (2009) explains that by using appropriate poverty assessment tools and tracking the same sample of client's overtime, an MFI can assess whether clients move out of poverty. "This indicator assesses the percentage of active clients who were 'poor' when they joined the institution 3 or 5 years ago and who are estimated to have move out of poverty". (MIX, 2009, P.4)

Breadth

According to Schreiner (2002, p.2), this refers to "the number of clients of an MFI". Breadth is of great importance because of "budget constraints" that is the wants and needs of the poor exceed resources available to them. Breadth depends on level of donations or financial resource implying that how much MFI have at their disposal determines the number of people they can reach and help (Schreiner 2002).

According to Rosenberg, breadth of outreach is the number of clients or accounts that are active at a given point of time these include borrowers, depositors, and other clients who are currently accessing any financial services (Rosenberg, 2009).

In a similar note Luzzi and Weber (2006, p.14) point out that "the number of active clients is a direct measure of breadth of outreach". They further clarify the concept by stating that having more clients (with possibly small loans) also implies higher costs per client, which is detrimental to financial performance (2006).

The report of Microfinance Information eXchange (MIX) (2009) splits more on breadth of outreach to be reported, which are geographic outreach, women outreach and client outreach.

Geographic Outreach

According to MIX (2009, p.3) "assesses the number of clients reached in the different geographical areas and in the areas below the national average level of development. It also assesses the ability of the MFI to serve clients in those areas where no other financial services are provided".

Women Outreach

“If an MFI has women as its target market, then any initiative in place needs to be reflected in the number of women clients actually reached. This indicator assesses the number of women clients (borrowers and savers) reached by the MFI” (MIX, 2009, p.4).

Client Outreach

MIX (2009, p.4) comment that “outreach is determined by the types and numbers of clients, reached with micro financial services”. This indicator assesses the ability of the MFI to reach its target market and clients outreach by lending methodology.

Length

Schreiner (2002, p.10) define length of outreach as “the time frame of the supply of microfinance services or the number of years of service”. If society cares about the future of the poor then length is important. Since future time is part of length, length is difficult to measure. Profits of the MFI can be used as a measure of length if donations are used and not guaranteed, as profits are an indicator of the MFIs ability to buy resources and to survive if any donations they receive should cease (Schreiner 2002).

But profits are not enough for length and neither are donations. Experienced managers, consistent incentives structure and a board of directors with a mission to constantly improve services to the poor goes a long way in helping an MFI have a great length as BancoSol has (Schreiner 2002).Also indicators of financial performance as indicated above, according to Woller and Schreiner (2000) such as return on assets, return on equity and profit margin can be used as indicators of length.

Scope

Schreiner (2002, p.11) define scope of outreach as “the number of types of financial contracts supplied”. Between products scope is loans and savings services. Within a product scope refers to loans made to groups and individuals, it could also mean

contracts with different terms. Any MFI like BancoSol with a variety of loan terms and savings services has a lot of scope as indicated by Schreiner (2002). The number of different types of loan, savings, insurance and other products offered broken down by product lines or product types can be used as indicators of scope (Woller and Schreiner 2000).

From the above discussion it is realized that outreach is the social value of net gain to clients, based on the number of clients. Funders that want to monitor the social performance of their projects will usually want to track more than just outreach. Several groups are working to propose and test additional indicators that measure social performance more directly. But there is as yet no consensus on any small subset of those social indicators that should be reported by every retailer.

Therefore, for this study we are going to use number of active borrowers as indicator of outreach since is the most indicator which have been agreed with most of Microfinance Institutions as recommended in Good Practice Guidelines for Funders of Microfinance (CGAP,2006).

2.2.9 The Concept Microfinance Performance

Performance means differently to different people. Management scientists, for example, regard performance as the degree to which execution has met the set standards and giving feedback to concerned parties for corrective measures. Marketers on the other hand regard performance both quantitatively and qualitatively. They regard quantitative measures of performance as sales revenue, sales revenue per goods/service/person, inventory turnover, while qualitative measures include skills, actual sales Vs targets (Lancaster and Massingham, 1993)

Accountants regard performance as measures relating to how good a firm is achieving set standards in operations, and in most cases it is regarded as profitability. A firm with high performance standards means a firm with high profitability (Martz and Usry, 1980; Francis, 1987). Yet economists regard performance in terms of efficiency where they argue that efficiency of a competitive market results in

efficient production i.e. as a consequence of the free entry of firms, prices will be driven down to equality with average cost at the minimum point on the long run average cost curve of each firm (Bell and Todaro, 1985)

For Microfinance Institutions performance is regarded in term of financial sustainability and outreach. For most MFIs, dual goals exist. One goal is to contribute to development. This involves reaching more clients and poorer population strata, the main outreach "frontiers" of microfinance (Helms, 2006; Johnson et al., 2006). The second goal is to do this in a way that achieves financial sustainability and independence from donors.

This study intends to employ quantitative measures of performance, particularly to Measure the impact of MFIs financial to outreach. Funding agencies' microfinance interventions produce better results when design, reporting, and monitoring focus explicitly on the key measures of microfinance performance that are measured and reported regularly. The more transparent the results, the more likely funders are to learn from successes and failures and to take corrective actions when needed.

I therefore take the core indicators recommended in Good Practice Guidelines for Funders of Microfinance (CGAP 2006). These are three indicators of financial performance: Financial sustainability (Profitability), portfolio quality, and efficiency. Social performance (breadth of outreach) number of active clients will be the key dependent variable of outreach.

2.3 Empirical Literature Review

Different studies in different disciplines used different approaches to assess impact. Cull *et al.* (2007) examine financial performance and outreach in a large comparative study based on a new extensive data set of 124 microfinance institutions in 49 countries. The authors explicitly explore whether there is empirical evidence for a trade-off between the depth of outreach and financial self-sufficiency (FSS). They examine this issue by examining whether more profitability is associated with a lower depth of outreach to the poor, and whether there is a deliberate move away

from serving poor clients to wealthier clients in order to achieve higher financial sustainability (mission drift).

A special feature of the study by Cull *et al.* is that an explicit distinction has been made between three types of microfinance institutions lending models, i.e. group lending systems, village banking, and individual-based lending. The study suggests that individual-based microfinance institutions seem to perform better in terms of profitability, but the fraction of poor borrowers and female borrowers in the loan portfolio is lower than for group-based institutions. The study also suggests that individual-based microfinance institutions, especially if they grow larger, focus increasingly on wealthier clients (mission drift), whereas this is less so for the group-based microfinance institutions.

On the whole, they concluded their results suggesting that institutional design and orientation matters importantly in considering trade-offs in microfinance. The results underscore the need to better understand how contracts function using detailed micro data.

This study aims to add to the small amount of empirical evidence on the relationship between financial performance and outreach to the poor of microfinance institutions. However, there are several differences. First, my study is much only in Tanzania. Second, I consider more recent years into consideration. Then I take number of active borrowers (outreach) as dependent variable. Whereas Cull *et al.* focus on explaining financial sustainability by running some linear regressions with e.g. Financial Self- Sufficiency (FSS) as the dependent variable. Most importantly, I examine whether financial indicators have a positive or negative relationship with outreach of microfinance institutions.

Even though operations of microfinance institutions in Tanzania are recent phenomenon, studies have been undertaken on different aspects including impacts of the performance of MFIs. Study done by Chijoriga (2000), on the overview of Microfinance institutions' performance in the context of Tanzania. In her study

Chijoriga evaluated the performance and financial sustainability of MFIs in Tanzania, in terms of the overall institutional and organisational strength, client outreach, and operational and financial performance. In the study, 28 MFIs and 194 MSEs were randomly selected and visited in Dar es Salaam, Arusha, Morogoro, Mbeya and Zanzibar regions.

She found out that, despite growing numbers of clients of microfinance institutions, with women as the majority, overall performance of microfinance institutions in Tanzania with few exceptions is poor. Unclear mission statements, donor dependence and inadequate management and accounting practices were some of the shortcomings diagnosed. Chijoriga argues for a clear separation of commercial and anti-poverty objectives. “Microfinance institutions should clearly distinguish between poverty alleviation which is a development focus and profit making which is a commercial focus” (Chijoriga, 2000, p.16). Chijoriga also remarks that microfinance institutions frequently ignore equal gender relations with the result that in some cases women’s dependence on husbands or other family members is exacerbated. In conclusion, Chijoriga pointed to low population density, poor infrastructures and low household income levels as constraints to MFI’s performance.

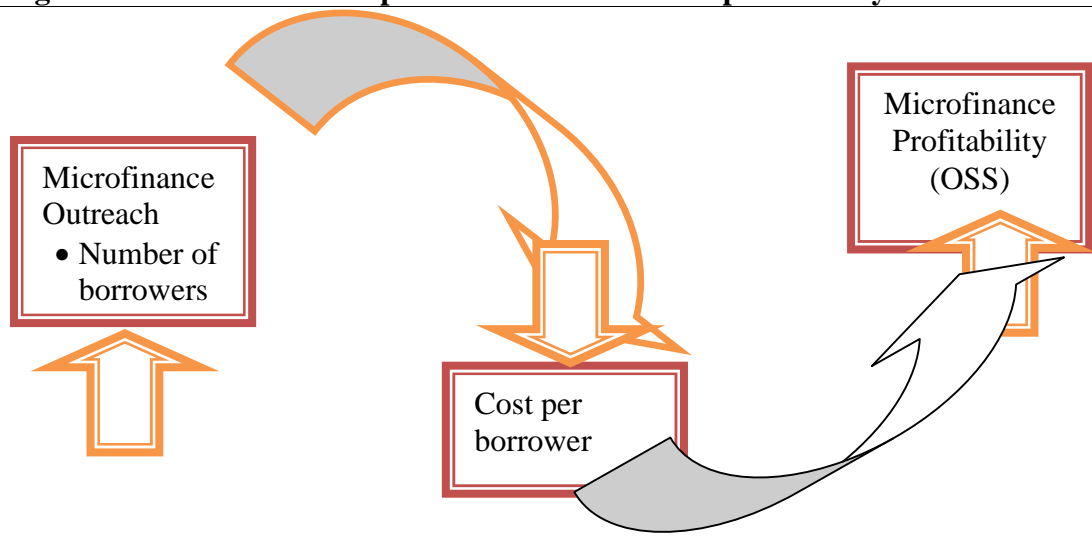
Other study done by Rweyemamu *et al* (2003) assessed the performance and constraints facing, semi-formal Microfinance Institutions currently providing credit in Mbeya and Mwanza regions (Tanzania). The primary data, which were supplemented by secondary data, were collected through a formal survey of 222 farmers participating in the Agricultural Development Program in Mbozi and the Mwanza Women Development Association in Ukerewe. They found out that, the interest rates were a significant barrier to the borrowing decision. Borrowers also cited problems with lengthy credit procurement procedures and the amount of disbursed being inadequate. On the side of institutions, the study observed that both credit programs experienced poor repayment rates, especially in the early years of operation, with farmers citing poor crop yield, low producer prices and untimely acquisition of loans as reasons for non-payment.

Kuzilwa (2002) examined the role of credit in generating entrepreneurial activities in Tanzania. He used qualitative case studies with a sample survey of businesses that gained access to credit from Tanzania government financial source. He found that, the output of enterprise increased following the access to the credit. It was further observed that the enterprise whose owners received business training and advice, performed better than those who did not receive training. He recommended that an environment should be created where informal and semi-informal financial institutions can continue to be easily accessed by micro and small businesses.

2.4 Conceptual Framework

Basing on the reviewed literature in this study we see that outreach could influence the profitability of microfinance institutions. Our assumption/hypothesis is that, as outreach increases, cost per borrower decreases. As a result, microfinance profitability (operational self-sufficiency) increases. The following conceptual framework shows diagrammatically the relationship between outreach and financial sustainability. In this diagram, cost per borrower as a dependent variable depends on the number of active borrowers. Thus the number of active borrowers is considered in step one as an independent variable. In the second step, the cost per borrower is considered to be an independent variable that affects the profitability of microfinance institutions. Profitability here is a dependent variable. Details are provided in the section 3.3 methods of data analysis.

Figure 2.2: The Relationship between Outreach and profitability



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides the methodologies and techniques that were geared towards the assessment of microfinance outreach and financial sustainability in Tanzania, the effect which were used in the data collection during this study. It spells out the research style, hypothesis, the analytical techniques to be used, data sources and collection methods.

3.2 Research design

Given the nature of the research question for this study; does microfinance outreach affect its profitability as measured by operational self-sufficiency? The research philosophy used to this study is positivistic paradigm. This approach was deemed appropriate because the study deduces the hypotheses based upon the theories of impact of microfinance outreach on their profitability in literature and then using analysis tools to derive the findings from data sample microfinance institutions in Tanzania. This is consistent with Collis and Hussey (2003, p.56) who argue that the “normal process under positivistic paradigm is to study the literature to establish an appropriate theory and construct a hypothesis”.

In addition, the financial indicators of microfinance were used to determine whether there is any relationship with outreach, which is something that would be concluded based on the establishing hypotheses. This type of study Collis and Hussey (2003) suggested positivist paradigm to be used, they comment that, positivistic paradigm explanation consists of establishing causal relationship between the variables by establishing causal laws and linking them to a deductive or integrate theory. Saunders *et al*, (2007) further clarified the concept by stating that the deductive approach develops a theory or hypothesis, and designs a research strategy in order to prove it. Therefore, the first step is to deduce a hypothesis, which needs to be a testable proposition between two or more variables. Then, it is necessary to indicate

how these variables will be measured. After that, the hypothesis is tested to confirm or modify it (Saunders *et al*, 2007).

Moreover, this study agrees with positivist paradigm assumptions. For example, it concurs with ontological assumptions, which argue that the nature of reality is objective and singular apart from the researcher. Therefore, mainly quantitative data are collected. In a similar note Collis and Hussey point out thus: “a positivistic paradigm the data collect will be mainly quantitative data because measurement is an essential element of the research process under this paradigm” (Collis and Hussey, 2003, p.57).

3.3 Hypothesis

This study tests the following hypothesis:

As outreach increases, cost per borrower decreases, and profitability (operational self-sufficiency) increases.

3.4 Methods of Analysis

Quantitative data analysis was used and more specifically step-wise simple regression models. With these type of data, the regression models were found more appropriate as they predicts the changes in the dependent variable in response to changes in the independent variables. Dependent variable used is the operational self-sufficiency (profitability) while independent variables number of borrowers and the cost per borrower. Ghauri and Gronhaug (2005) support such type of research to use regression models to explain the cause and effect among two or more variables.

The study regressed the operational self-sufficiency on number of active borrowers and costs per borrower. In the first regression, number of active borrowers is an independent variable to determine cost per borrower. In the second regression, we regress profitability on cost per borrower. In the third and last regression, profitability (oss) is regressed on number of active borrowers. The general regression model is as follows:

$$Y = a + + b + e$$

Where; Y =dependent variable, which are cost per borrower, in model (1), and operational self-sufficiency in model (2) and (3); C_b = is an independent variable. That is, number of active borrowers in model (1), and Cost per borrower (CB) and Number of active borrowers in model (2) and (3) respectively. a = Constant; β = Coefficients for the respective explanatory variables, which measures how a change in the independent variables affects the changes in the dependent variable; and e = an error term representing all factors affecting a dependent variable that are not captured in the model.

STATA econometrics data analysis software was used to run the pooled OLS regressions. The Pooled Ordinary Least Square is selected because the MFIs used have different years of their reports i.e. some have eight years while others have three years. The results show the evidence on how the microfinance outreach affects operational self-sufficiency.

3.5 Data sources and Collection Methods

The approach to data collection is several empirical research based on secondary data (published data). The use of such data is advantageous because the data already exist I can evaluate them prior to use. Saunders *et al* (1997,p.171) argue that, “the time you spend evaluating any potential secondary data source is time well spent, as rejecting unsuitable data earlier can save much wasted time later”. Collecting primary data by using questionnaires and interviews may be expensive and time consuming. The problems of getting adequate of respondents are all solved when published data is used. The use of secondary data also allows for a large volume of data to be analysed which would have been a problem in collecting primary data. The quality of attributed data is also a merit to the use of published data.

For example the use of published financial information will have a prior approval by auditors before its publication. This type of quality will be completely absent if the data was put together personally. One major set-back of secondary data is the specific purpose for which it was collected for which may be different from the research questions or the objectives of the study unlike primary data which is

designed to the requirement of the study Saunders *et al* (2003). They more comment that secondary data can be aggregated for the purpose meeting the requirement of the original research as a result may not be quite so suitable for this research.

Despite these limitations, secondary data were the main source used for this research work since the benefits far outweigh the disadvantages. Using empirical research based on published data will help confirm theoretical propositions in a way which is not time consuming but maintains validity and still allow room to include whether relationships exists between the dependent and independent variables.

In context of this research work, our dataset was extracted from the MIX market. The sample contains data from 2000 until 2008. In total, 9 institutions are being used. The MIX classifies institutions under different legal status; cooperatives, non-bank financial institutions, banks, rural banks and non-profit organizations. We have used all categories and include as much observations as possible in order to reduce any sample bias.

The dataset includes 9 MFIs from Tanzania. These are: FINCA-Tanzania, PRIDE-Tanzania, SEDA, Akiba, BRAC-Tanzania, Faulu-Tanzania, Mbinga Community Bank, IDYDC, Tujijenge. The legal distribution is as follows: 2 NGOs, 2 cooperatives, 1 non-banks financial institutions, 2 rural banks, and 2 banks.

According to these descriptive statistics, we are sure that the data gives a representative image of the microfinance institutions in Tanzania. Nevertheless, some drawbacks of the data must be kept in mind. MIX market data has some disadvantages as follows; first, the MIX data is self-reported information platform, can reduce the quality of the data. However, the goodness is that MIX has since a couple of years installed a quality control system in order to help ensure the validity of the data and this has increased its fineness. The second challenge is that, sometimes the MIX sample is not representative for the whole sector; this is because microfinance institutions that are interested in providing information for potential donors and social or commercial investors are reporting. However, it is reasonable to

believe that its representativeness has increased over the years as microfinance institutions are pushed to be more transparent. Therefore, the observations and conclusions should be viewed in light of these drawbacks

CHAPTER FOUR

RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the findings on the assessment of microfinance institution and financial sustainability in Tanzania. The findings and results as follow, a review of the Tanzania economy, the poverty status and the strategy for poverty reduction, microfinance in Tanzania. It also presents the descriptive statistics of the sample, testing of the data for multiple regression analysis and summarizing the findings.

4.2 The Tanzania Economy

Tanzania occupies an area of 945,000 km² on the coast of East Africa, with a total of over 34 million people as per 2002 population census. Approximately 80 percent of the poor live in rural areas where about 70 percent of the population lives (URT, 2004) and depend on Agriculture which contributes about 80 percent of the Gross Domestic Product (GDP) and 54 percent of the nation's foreign exchange earnings.

The Tanzania government is determining to stay the course of economic and social reforms and maintain improved macroeconomic stability. Real GDP is expected to reach the average growth rate of 6-8 percent per annum between 2005/06 and 2009/10. Domestic revenue mobilization effort will be accelerated and external support utilized to increase the capacity for steady growth. Projections for 2005/06-2009/10 assume improvements in the productivity of agriculture and other productive and economic service sectors, tourism and mining and a strategic trade regime fostering international competitiveness, promoting private sector development and implementation of policies in respect of the Small and Medium Enterprises (SMEs), micro -finance and cooperatives.(URT,2005).

4.3 Tanzania poverty Status

According to World Bank, World Development Report 2000/2001. Attacking Poverty, evidence generated over the last 20 years in various parts of the world conclusively indicates that the availability of well – designed financial services can significantly improve the incomes and drastically reduce the poverty levels of the poor in both rural and urban areas.

Tanzania enjoys peace, political stability and is also gifted with huge natural resources but the majority of its people especially the rural population live in absolute poverty. According to the Household Budget Survey of 2003/04 the proportion of the population below the national food poverty is 18.7 per cent and that below the national basic needs poverty line is 35.7 percent. Poverty remains overwhelmingly high in rural areas where 87 percent of the poor population lives and is highest among households who depend on agriculture (source: Tanzania Participatory Poverty Assessment (TPPA) 2003/04). In a similar note PRSP report points out thus “poverty is largely a rural occurrence, in the rural areas, incomes are lower and poverty is more widespread and deeper than in the urban centers”(PRSP,2000,P.6)

In comparison between men and women the PRSP reports that women represent 51 percent of the population and head 14 percent of the households and the results from household surveys show that women-headed households are not necessarily poorer than male-headed households. For more clarification the report make example of 1991/1992 HBS reports which shows a poverty incidence level of 45 percent for female -headed households, and 49 percent for male-headed households (PRSP 2000).

The PRSP report more explains on a recent case study which also established that male-headed household (without wives) are likely to be as poor as female-headed households (without husbands). This notwithstanding, a good number of studies suggests that women are in fact poorer than men. In particular, according to the results of the survey done by PPA 1995 (PRSP 2000,P.7) is commenting that

“women perceive themselves to be poorer than men owing to their weakness, the lack of asset ownership (including land and livestock) and limited schooling”.

According to PRSP (2000) the incidence of poverty appears to have declined during 1983-1991 and 1991-1993, and risen during 1993-1998 , the report comments that this “ situation is probably attributable to worsening income inequality, and relatively low rate of economic growth, particularly in the rural areas” (PRSP 2000,P.7).

On the issue of education PRSP (2000, p.8) reports that “the poor are more likely to be less educated”. The report further clarified the concept by providing the statistics “in 1991, 54.3 percent of the rural poor were literate, compared to 61 percent for the rural population as a whole and between 1983 and 1991 illiteracy among the poor increased while the proportion of the illiterate women remained the same but still higher than any other socio-economic group” (PRSP 2000, P.8).

According to PRSP report the life span of Tanzanian is at the average of 48 years of age, compared to 52 years in 1990 and 45.3 years in 1970. The report more explains that “more recent decline in life expectancy is largely attributable to the impact of HIV/AIDS and other communicable diseases” (PRSP, 2000, p.8).

4.4 The strategy for Poverty Reduction

Poverty is the main challenge and fundamental issue in economic development in Tanzania. The government is committed to address this challenge in consultation with key stakeholders in the economy, especially the private sector, civil society, Non Government Organizations and other development partners. There is increasing number of households, which are not only absolutely poor but also live far below subsistence level.

The government of Tanzania both past and present has focused on ignorance, disease and poverty reduction as the main aim of their development strategy. This began in 1961 with medium and long term development plans.

Macroeconomic and sector policies associated with various reform measures were formulated by the government. These policies, strategies and reforms are aimed primarily at attaining the Tanzanian's development vision 2025 of achieving a "sustainable socioeconomic development by the year 2025" (URT, P.14).

The government prepared the National Poverty Eradication Strategy (NPES) in 1998 to provide a framework to guide poverty eradication initiatives in the country. According to URT (2002) the implementation of NPES is envisaged to reduce poverty by 50 per cent by the year 2010, and eradicate absolutely poverty by 2025. The NPES was translated into a medium term strategy for poverty reduction known as the Poverty Reduction Strategy Paper (PRSP) in 2000. The PRSP was prepared in the context of the Highly Indebted Poor Country initiatives (HIPC) process. The focus of PRSP is to reduce income poverty, improving human capabilities, survival and social well-being, and containing extreme vulnerability among the poor (URT, 2002).

The review of the PRSP in 2004 culminated into the establishment of the National Strategy Growth and Reduction of Poverty (NSGRP). The NSGRP is the second national organizing framework for poverty reduction and promotion of social inclusion. It emphasizes growth and poverty reduction at the centre of the country's development agenda. It represents a more comprehensive approach to poverty reduction than the PRSP.

Thus, NSGRP builds on the PRSP and integrates components of the country's existing overall and sector strategies and policies by giving poverty more of a focus. Unlike its predecessor, NSGRP place emphasis on priority outcomes and results rather than focusing on priority sectors as were the case with the PRSP. Furthermore, it recognizes the contribution of every sector, includes cross cutting issues such as governance and communications (URT, 2005).

The Tanzania development vision 2025 outlines the goals of sustainable live hoods and sustained economic growth. Consequently, the development of the country's

Microfinance Institutions (MFIs) is defined in various policies and strategies that include; the National Microfinance Policy 2000, Small and Medium Enterprises Development Strategy 2003, and Cooperative Development Policy 2002. It is out of these policies that the legal and regulatory framework for the financial sector was developed.

4.5 Microfinance in Tanzania

Financial sector reform in Tanzania began with the Economic Recovery Program of 1986. The Banking and Financial Institutions Act (1991), Cooperative Societies Act 1991 and Bank of Tanzania were amended and permitted entry of private banks into the financial market and subsequently led to restructuring of all Government of Tanzania's major banks and financial institutions. This included the downsizing and privatizing of the National Bank of Commerce and Cooperative and Rural Development Bank (CRDB). Banks were required to operate on a commercial basis. In addition, prudential norms for operations and the provisioning requirements for non-performing assets out of the profits were introduced, and regulatory functions of Bank of Tanzania (BoT) intensified.

According to CIDA *et al* (2003) while a combination of macro-economic stabilization and a financial sector reform process started in early nineties have laid the basic foundations for the development of sound financial sector, this has not resulted in significantly improved access to financial services by the low income people. Despite some of the gains from these reforms – liberalized interest and exchange rates, a relatively fluctuating Tanzanian Shilling, liberalized access to credit among others – the Government is acutely aware of the limitation of the traditional banking sector's ability to mobilize and capture savings from and extend credit to poor people in rural areas. As a case in point, the 1991 financial sector reforms compelled the National Bank of Commerce to close down its 77 branches located in various rural districts Countrywide. This further aggravated the situation of inadequate availability of financial services to the rural poor.

The rural population which has a weak financial resource base is in dire need of financial services that cater for its unique circumstances. The traditional banking sector is unable to answer the needs of the poor rural populace because it perceives provision of Credit in the rural sector; a very risky business, collateral requirements are not easily attainable by the rural poor and are operationally and administratively costly.

From the previous one can safely conclude that the traditional banking sector is therefore not sufficiently prepared besides being reluctant to provide financial services to the rural poor.

There is therefore a need for either financial institutions specializing in micro-finance services to step up to the challenge and provide specialized financial services to the low income groups or the poor organize themselves into savings and credit associations or financial cooperatives to address this need.

In July, 1998, IFAD, in close collaboration with the government of Tanzania and potential beneficiaries, prepared a Tanzania Country Strategic Opportunities Paper (COSOP) to clarify preferential areas for future interventions by the fund. The COSOP supports the ongoing government of Tanzania process of policy reform and restructuring of the public sector which aims to reverse the national economic and social declining trends of the past.

Key features of the reform process are: the introduction of an open and liberal economic policy regime, redefinition of the role of government to that of a facilitator, regulator and policy setter of the development process, decentralization of administration power to the districts and communities and the development of microfinance services as a major instrument in an overall effort to alleviate poverty.

The role of Bank of Tanzania toward microfinance institutions is “to develop a policy, legal and regulatory framework, guide the development of the sector, coordinate Government intervention and interface with other stakeholders in the

field, monitor performance of the sector and disseminate relevant information to the public” www.bot-tz.org/MFI

The government policy from the strategic vision 2025, through the National Poverty Eradication Strategy (NPES) and Tanzania assistance Strategy (TAS) to the Poverty Reduction Strategy Paper (PRSP), the Local Government Reform Programme (LGRP), Rural development Strategy (RDS) and the Agricultural Sector Development Strategy (ASDS) as mentioned early sees pro-poor, private sector led, economic growth as key to long- term sustained poverty reduction. All these documents emphasize the critical role to be played by the financial services.

In an endeavor to rationalize the development of a strong microfinance sector, the government of Tanzania has developed and adopted a Rural and Micro Finance Policy covering all aspects of Micro Finance Institutions (MFIs) development through registration, governance, supervision and inspection. The National Microfinance policy (NMP) responding to these higher level policy demands, articulates the government’s vision for the development of pro- poor finance in Tanzania as follows:

“... Achieving widespread access to microfinance throughout the country, made possible by institutions operating on commercial principles. A wide range of institutions will be involved in the provision of services, including specialized and non- specialized banks, non- bank financial institutions, rural community banks, cooperative banks, SACCOS, and NGOs. Some providers will focus on credit, some on savings and others on both. Microfinance will be integrated with the mainstream financial system with the flexibility that ensures that their special features are not compromised. The institutions will use a variety of methodologies, each adopted for its particular Market niche. Competition will ensure that service providers operate efficiently and provide high quality services.

The system as a whole will provide financial intermediation without necessarily relying on injections of external donor or Government funds. Subsidies will no

longer be needed, except perhaps for organizations pushing the frontiers of the system out to the most remote or poorest clients” (URT, 2000, p.8)

The rationale behind the need for Microfinance is that for the majority of Tanzanians, whose income are very low, access to financial services offers the possibility of managing scarce household and enterprise resources more efficiently, protection against risks, provision for the future, and taking advantage of the investment opportunities for economic returns.

Below is the status of Microfinance Institutions in Tanzania according to Tanzania microfinance institutions directory (2005).

Summary: Regional Distribution of MFIs in Tanzania

	Banks	Non-governmental Organizations (NGOs)	Financial Service Associations	Government Programs/Schemes	Savings and Credit Cooperative Societies (SACCOS)	Savings and Credit Associations (SACAs)	Community Based Organizations (CBOs)	Total
TANZANIA MAINLAND								
Arusha Region	-	8	-	-	68	1	-	77
Coast Region	-	-	-	11	33	-	1	50
Dar es Salaam Region	4	5	-	5	175	-	-	189
Dodoma Region	-	4	-	6	83	1	1	100
Iringa Region	1	2	-	-	100	-	-	103
Kagera Region	1	7	-	10	97	-	1	116
Kigoma Region	-	2	-	8	25	-	1	34
Kilimanjaro Region	1	-	-	-	92	1	-	94
Lindi Region	-	-	-	-	22	-	-	22
Morogoro Region	-	-	-	-	50	-	-	50
Mtara Region	-	1	-	10	99	-	1	111
Mtewa Region	-	1	-	-	160	33	2	196
Mwanza Region	-	1	-	11	87	-	-	94
Mtwara Region	-	1	-	-	41	1	-	43
Mwanza Region	-	4	1	14	207	-	1	227
Mtwa Region	-	3	-	-	22	10	-	35
Mwanza Region	1	-	-	-	47	1	-	44
Sarungu Region	-	4	-	10	45	-	29	80
Singida Region	-	2	-	7	46	-	6	61
Tabora Region	-	6	-	13	17	-	2	30
Tanga Region	-	2	-	-	39	-	-	41
Sub-total	8	53	1	105	1,503	48	45	1813
ZANZIBAR								
North Pemba Region	-	-	-	-	5	-	-	5
South Pemba Region	-	-	-	-	17	-	-	17
North Unguja Region	-	-	-	-	6	-	-	6
South Unguja Region	-	-	-	-	24	-	-	24
Urban West Region	-	4	-	-	30	-	-	34
Sub-total	0	4	0	0	82	0	0	86
Grand Total	8	57	1	105	1,635	48	45	1,899

Source: Tanzania Microfinance Institutions Directory (2005, p. iii)

www.bot-tz.org/MFI/Documents/Directory

4.6 Summary of the findings

There are some amount of material being produced on the issue of poverty reduction especially in development finance and economics by way of researches and projects. Developing countries especially those in Africa are now the focus of international organizations, poverty alleviation programmers and researchers both individual and governmental. Their aim is to focus on tackling the root cause of economic and development problems and seeing their work result in actions, which go a long way to decrease poverty and financial exclusion of the poor in society.

For poverty alleviation programs to work at the macroeconomic level the root cause of economic and developmental problems need to be tackled at the grass root level. In this vein the country's poverty reduction strategy has been taken as the context within which microfinance or small scale finance provision is being used as a tool to get to the not-so well-off in the country.

Any impact of microfinance must be assessed to determine if the objective of reaching the poor is being achieved. For the goal of helping the poor to be achieved MFIs must be financially stable as without the necessary finance the target group will not be reached and the country's aim of reducing poverty levels in the medium to long term will to some extent not be achieved.

Since microfinance is seen as a link between finance and development every possible means must be taken to ensure the poor in society get the necessary finance needed to enable them rise above the poverty line and contribute their quota to nation building and economic development.

4.7 Descriptive Analysis of Data

Table.1 below displays information on general characteristics of all variables used in the regression model. The explanatory variables are operational self sufficiency (oss), total assets and cost per borrower all represent financial performance that we aim at testing the influence to the number of active borrowers (outreach).

The number of observation on operational self sufficiency (oss) during the period of study is 45 observations. The average operational self sufficiency for each microfinance institutions is about 101 per cent; the small and big institutions have 17 percent and 249 percent respectively. This shows that microfinance institutions with 17 percent operational self sufficiency do not achieve financial breakeven.

On total assets, there are 50 observations on total assets. The average of each institution has the value of total assets US\$ 8,875,311 while the small and big institutions having the value of total assets amounting US\$ 215,740 and US\$ 4.49e+07 respectively.

Other independent variable observed is cost per borrower. Out of 40 observations, each institution has an average of about US\$ 103; the small institution has a minimum of US\$ 7 while the big institution has a maximum of US\$ 367 cost per borrower. Indicating that there is great difference between small and larger MFIs in efficiency. The small ones cannot manage to maintain their active borrowers (clientele).

The last variable is number of active borrowers which is dependent variable for this study. Out of 49 observations of number of active borrowers, the average of each microfinance institution has a number of 25880 active borrowers, while the small and big institutions have a number of 233 and 106082 active borrowers respectively.

Table 4.1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Oss	45	1.007167	0.339362	0.1685	2.4941
Cost/borrower	40	102.6138	92.33031	7	367
Aborrower	49	25880.33	26114.9	233	106082

4.8 Regression Analysis

Lastly the data analysis was conducted using the Pooled Ordinary Least Square regression to establish the cause and effect relationships between microfinance outreach and operational self-sufficiency. The hypothesis was: to test this hypothesis, we used step-wise regression analysis. The first step, we explain the effect of the number of active borrowers on cost per borrower. The second step explains how in turn, the cost per borrower affect the operational self-sufficiency. The final step shows how generally, the number of active borrowers (breadth of outreach) affects the operational self-sufficiency. The econometrics results from the three regression output are summarised in table 2 to table 4.

Step 1: Effects of outreach on cost per borrower

. reg costborrower aborrower

Source	SS	df	MS			
Model	12874.7435	1	12874.7435	Number of obs =	40	
Residual	319595.787	38	8410.41544	F(1, 38) =	1.53	
Total	332470.53	39	8524.88539	Prob > F =	0.2236	
				R-squared =	0.0387	
				Adj R-squared =	0.0134	
				Root MSE =	91.708	

	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
costborrower						
aborrower	-.000682	.0005512	-1.24	0.224	-.0017978	.0004339
_cons	123.5334	22.27424	5.55	0.000	78.44151	168.6252

Step 2: Effects of cost per borrower on profitability

. reg oss costborrower

Source	SS	df	MS			
Model	.04257984	1	.04257984	Number of obs =	40	
Residual	3.97713767	38	.104661518	F(1, 38) =	0.41	
Total	4.01971751	39	.10306968	Prob > F =	0.5274	
				R-squared =	0.0106	
				Adj R-squared =	-0.0154	
				Root MSE =	.32351	

	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
oss						
costborrower	-.0003579	.0005611	-0.64	0.527	-.0014937	.000778
_cons	1.051775	.0770146	13.66	0.000	.8958671	1.207683

Step 3: Overall effects of outreach on profitability

. reg oss aborrower

Source	SS	df	MS			
Model	.00439515	1	.00439515	Number of obs =	45	
Residual	5.06293918	43	.117742772	F(1, 43) =	0.04	
Total	5.06733433	44	.115166689	Prob > F =	0.8477	
				R-squared =	0.0009	
				Adj R-squared =	-0.0224	
				Root MSE =	.34314	

	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
oss						
aborrower	3.79e-07	1.96e-06	0.19	0.848	-3.58e-06	4.34e-06
_cons	.9966056	.074863	13.31	0.000	.84563	1.147581

The findings summarised in table 2 to table 4 indicates that, the number of active borrowers is negatively related with the cost per borrower. The cost per borrower is positively related with the operational self-sufficiency. And on the overall, the number of active borrowers is positively related with the operational self-sufficiency.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

In the above chapter the relationships between microfinance outreach and operational self-sufficiency using the step-wise regression models was analysed. The econometrics results indicated that: the number of active borrowers is negatively related with the cost per borrower; the cost per borrower is positively related with the operational self-sufficiency; and the number of active borrowers is positively related with the operational self-sufficiency. These findings imply the following:

5.2 Number of borrowers and Cost per borrower

The number of active borrowers is negatively related with the cost per borrower. This shows that, when the number of borrowers increases, the cost per borrower decreases. Some implications of this finding are: first, because the cost per borrower decreases with the number of borrowers, then a large portion of the microfinance institutions' costs tend to be fixed in nature. The fixed costs represents the costs of microfinance institutions that remains constant in total when regardless of the number of borrowers being served by the microfinance institutions. Second, it could also imply efficiency in cost reduction. On the overall, the finding suggests that to attain operational self-sufficiency the microfinance institutions have to reduce their cost of operations. One way of doing that is through increasing the number of borrower. This works well when the largest portion of the microfinance costs is fixed in nature.

5.3 Cost per borrower and operational self-sufficiency

The operational self-sufficiency is a ratio of operating revenue over the operating expenses. The operational self-sufficiency could be increased by either, increasing the operating revenue or reducing the operating costs. When there is an increase in number of borrowers, as a result the decrease in cost per borrower, the operational self-sufficiency will increase. The increase in number of borrowers will also increase

in the microfinance revenue. This finding follows the basic accounting principle that cost reduction leads to higher profitability.

Comparison of the findings with existing theory and previous empirical research

Firstly, we found that MFIs with many total assets reach more active borrowers than those with few assets. Therefore, these findings suggest that, all things being constant large MFIs have more active borrowers than the smaller ones. The findings for this variable are similar to Vanroose and D'espallier (2009) that larger MFIs in terms of assets perform better in outreach.

Secondly, we also observed that there is negative link between cost per borrower and outreach. In simply way, we can state that when microfinance institutions tends to be more efficiency in maintaining cost of an active borrower does not mean that number of active borrowers will increase. The result is in line with Lensink *et al* (2008) who researched on outreach and efficiency of MFIs by using stochastic frontier analysis with 1300 observation. They found negative relationship between efficiency and outreach to the poor people.

Thirdly, operational self-sufficient affects negatively the breath of outreach (number of active borrowers). In other words, microfinance institutions tend to increase profit by providing larger loan (mission drift) the number of poor clients decrease.

This shows that in Tanzania in one way or other microfinance institutions tend to deviate from poverty reduction mission by serving wealthier clients who request relatively large average loan size. This result supports argument of cull *et al* (2008) that microfinance institutions with highest profit levels perform the weakest in term of outreach. Vanroose *et al* (2009) also agree by suggesting that microfinance institutions that reach more borrowers are slightly more profitable.

5.4 Conclusion and Recommendations

This research was examining the effects outreach, as measured by the number of active borrowers, on the operational self-sufficiency. To achieve this study objective,

we tested the hypothesis that: as outreach increases, cost per borrower decreases, and profitability (operational self-sufficiency) increases. This hypothesis is rejected if the p-values of the test statistics are statistically significant. The null hypothesis is not rejected when the p-values of the test statistics are not statistically significant. From the summary of results presented in chapter five, the coefficients of the number of active borrowers on cost per borrower, and the one for the cost per borrower on operational self-sufficiency are not statistically significant. These p-values indicate that we cannot reject the null that as outreach increases cost per borrower decreases, and profitability (operational self-sufficiency) increases.

5.5 Conclusion

Based on the study findings, we conclude that the number of active borrowers results into decrease in the cost per borrower which in turn leads into increased profitability. Thus generally, the study concludes that the number of active borrowers has a positive influence on the profitability of microfinance institutions.

Based on the study findings, the study recommends that in order for the microfinance institutions in the country to be profitable, they should ensure that they increase the number of active borrowers. The objective of this research is to explain the extent to which microfinance institutions financial performance impacts their ability to reach a larger number of the poor society. In general the findings are consistent with some previous studies used as the principal references. On concluding we base on our hypotheses;

Based on the findings of this study we used multiple regression analysis to determine the explanatory variables chosen that affect the outreach of MFIs. I first found that total assets which also used as a measure of the size of MFIs, having positively associated with outreach. In other words, MFIs which are large in size perform better than the small ones, the effects being statistically significant. This shows that our first hypothesis is invalid; total assets do not affect the number of active borrowers of microfinance institutions, hence we reject the null hypothesis and confirm that total assets affect the number of active borrowers other things remain constant.

Then I found cost per borrower, a determinant of the average cost of maintaining an active borrower having negatively associated with outreach (number of active borrowers). The effect of cost per borrower to number of active borrowers is significant, this does not support with our second hypothesis;

Cost per borrower does not affect the number of active borrowers of microfinance institutions; also I reject the null hypothesis and agree with alternative hypothesis: Cost per borrower affects the number of active borrowers assuming other variables are not changing.

Lastly, I observed operational self sufficiency which measure the ability of the institution to cover its operational costs also having negative relationship with outreach, while the effect being significant. This show that my third hypothesis is invalid; operational self sufficiency does not affect number of active borrowers, therefore I reject it and confirm the alternative hypothesis that in one way or another operational self sufficiency has an effect on number of active borrowers. This demonstrates that microfinance institutions perform better when there are faithful to their outreach maximization i.e. they are not providing larger loans to the wealthier clients.

5.6 Areas for Further Studies

As aforesaid there is limited knowledge on the operational and financial performance of the Microfinance Institutions in Tanzania. From the literature knowledge available and as the study has revealed, many of the MFIs are receiving a lot of external technical and financial support. There is need for further research to determine the extent to which the external support will affect the operational and financial self-sustainability of the Microfinance Institutions in Tanzania.

The study has explored the clear relationship between the financial performance of microfinance institutions and outreach in Tanzania, however there still need to improve and develop the study in the future. The model of this study could be

applied in different countries specifically in Africa, we then compare the results among those countries in order to get the broader views of MFIs.

Also the study used pooled ordinary least square for the analysis of multiple regression model because of reports of MFIs differ in year wise. Therefore, any study in this area should try and use different model. Hence, researching with different model likely come out with variety of conclusion that appropriate for comparison purpose.

Lastly, as I discussed before, that my main data are from MIX market. Most of MFIs in Tanzania have no information on it, hence, it would be better if further research could be done to see whether the results hold when using different database.

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