

**THE IMPACT OF MICROFINANCE INDUSTRY ON POVERTY REDUCTION:  
A CASE OF FINCA**

**THE IMPACT OF MICROFINANCE INDUSTRY ON POVERTY REDUCTION:  
A CASE OF FINCA**

**By**

**John Mboma**

**A Dissertation Submitted in Partial Fulfillment of the Requirements for Award of  
the Degree of Master of Science in Accounting and Finance (MSc-A&F) of  
Mzumbe University**

**2014**

**CERTIFICATION**

We, the undersigned, certify that we have read and hereby recommend for the acceptance by the Mzumbe University, a dissertation entitled *The Impact of Microfinance Industry on Poverty Reduction: A Case of FINCA* in partial fulfillment of the requirements for award of the degree of master of Science in Accounting and Finance (MSc-A&F) of Mzumbe University.

.....  
Major Supervisor

.....  
Internal Examiner

Accepted for the Board of MUDCC.....

---

**DEAN/DIRECTOR, FACULTY/DIRECTORATE BOARD**

**DECLARATION**

**AND**

**COPYRIGHT**

I **John Mboma**, declare that this dissertation is my own original work and that it has not been presented and will not be presented to any other university for a similar or any other degree award.

Signature .....

Date.....

©

This dissertation is a copyright material protected under the Berne convention, the copyright Act 1999 and other international and national enactments, in that behalf, on intellectual property. It may not be reproduced by any means in full or in part, except for short extracts in fair dealing, for research or private study, critical scholarly review or discourse with an acknowledgement, without the written permission of Mzumbe University, on behalf of the author.

## **ACKNOWLEDGEMENT**

I am glad to take this great opportunity to acknowledge everyone who, in one way or another, has put a hand in any kind of help, support, advice, cooperation and guidance. I am greatly indebted to my supervisor Mzee Saburi who supervised this work from its initial stage up to its completion. I wish also to express my sincere thanks to my course lecturers and all members of staff at the Mzumbe University, for consistent advice, support and encouragement they accorded me during the whole program.

I greatly acknowledge the financial assistance from my employer and for his patience during the whole study duration. I wish to express my dearest gratitude to all respondents in the study area, for their kindness, great cooperation during the whole period of the data collections. They have been a very critical link in facilitating accomplishment of the study.

Special acknowledgement goes to my family for their kindness and moral support during the study period, much thanks to my dearest Family for their constant understanding and patience when I was busier with studies. Lastly I wish to acknowledge all class members for their friendly co-operation I enjoyed from them during the whole study period.

## **DEDICATION**

This report is dedicated to my lovely family who inspired me very much in my academic pursuit and tolerated my absence till accomplishment of my studies

## **LIST OF ABBREVIATIONS**

BDS	-	Business Development Services
FIs	-	Financial Institutions
FINCA	-	Foundation for International Community Assistance
GDP	-	Gross Domestic Product
MFIs	-	Microfinance Institutions
SMEs	-	Small and Medium Scale Enterprises
URT	-	United Republic of Tanzania

## **ABSTRACT**

The study on the impact of microfinance industry on poverty reduction was conducted at FINCA, Dar es Salaam. The objectives of the study were; to establish indicators of living standards in Tanzania; to determine the measures of microfinance growth in Tanzania; to establish other factors influencing the living standard in Tanzania and to determine the impact of microfinance industrial average growth on the living standard in Tanzania

A case study design was used whereas a sample of 63 respondents was involved. In collecting primary data the study used questionnaire and interview. Secondary data were collected through documentary analysis. Data was analyzed by using SPSS, tables and figures were used to present data.

The study found majority of the respondents (64.2%) identified level of income as a major indicator of living standard. Also, the study found the large number of the respondents (39.7%) identified that technology improvement facilitates microfinance growth. Moreover, the study found majority of the respondents (55.2%) identified that there is a need to improve service environment.

The study concluded that microfinance institution play significance role in poverty reduction and improving living standard through; job creation and saving. Poor people can and do save if they are given appropriate opportunities and incentives. Savings can help them accumulate assets which could be used for business and household purposes while also earning interest on savings. Also, the study concluded that there are a number of challenges facing MFIs. These include; inadequate sources of funding for MFIs, competition, poor management skills and lack of governance corporation. The study recommended that in order to create a good management staff MFIs need to strategically deal with challenges of business e.g. defining job roles, hiring and training, monitoring employee performance, inculcating an appropriate culture to motivate staff.

## TABLE OF CONTENTS

	Page
<b>CERTIFICATION .....</b>	<b>i</b>
<b>DECLARATION AND .....</b>	<b>ii</b>
<b>COPYRIGHT .....</b>	<b>ii</b>
<b>ACKNOWLEDGEMENT .....</b>	<b>iii</b>
<b>DEDICATION.....</b>	<b>iv</b>
<b>LIST OF ABBREVIATIONS .....</b>	<b>i</b>
<b>ABSTRACT .....</b>	<b>ii</b>
<b>TABLE OF CONTENTS.....</b>	<b>iii</b>
<b>LIST OF TABLES .....</b>	<b>vi</b>
<b>LIST OF FIGURES .....</b>	<b>vii</b>
<b>CHAPTER ONE .....</b>	<b>1</b>
<b>INTRODUCTION.....</b>	<b>1</b>
1.1 Background Information .....	1
1.2 Statement of the Problem .....	2
1.3 Objective of the Study .....	4
1.3.1 General Objective .....	4
1.3.2 Specific Objectives .....	4
1.4 Research Question .....	4
1.5 Significance of the Study .....	4
<b>CHAPTER TWO .....</b>	<b>7</b>
<b>LITERATURE REVIEW.....</b>	<b>7</b>
2.1 Introduction .....	7
2.2 Theoretical Literature Review .....	7
2.2.1 Definition of the Key Terms .....	7

2.2.2 Microfinance and Poverty Reduction .....	8
2.2.3 Measures of Microfinance Growth .....	11
2.2.4 The Impact of Microfinance Industrial Average Growth .....	15
2.2.5 Overview of Tanzania Micro Finance Sector .....	30
2.2.6 The Link between Micro Finance Institutions and Poverty Alleviation.....	32
2.3 Empirical Literature Review .....	35
2.4 Research Gap.....	37
2.5 Conceptual Frame Work.....	37
<b>CHAPTER THREE .....</b>	<b>39</b>
<b>RESEARCH METHODOLOGY .....</b>	<b>39</b>
3.1 Introduction .....	39
3.2 Research Design .....	39
3.3 Area of the Study.....	40
3.4 Population of the Study .....	40
3.5 The Sample Size .....	40
3.6 Sampling Techniques .....	41
3.7 Data collection Methods.....	41
3.7.1 Questionnaire .....	41
3.7.2 Interview .....	42
3.7.3 Documentary Analysis.....	42
3.8 Data Analysis procedure .....	42
3.9 Research Reliability and Validity.....	43
<b>CHAPTER FOUR.....</b>	<b>44</b>
<b>PRESENTATION AND DISCUSSION OF RESEARCH FINDINGS.....</b>	<b>44</b>
4.1 Introduction .....	44
4.2 Respondents Profile.....	44
4.2.1 Age of the Respondents' .....	44

4.2.2 Gender of the Respondents’ .....	45
4.2.3 Level of Education of the Respondents’ .....	46
4.2.4 Occupation of the Respondents .....	47
4.3 Results for Research Objectives .....	48
4.3.1 Indicators of Living Standards in Tanzania .....	48
4.3.2 Measures of Microfinance Growth in Tanzania .....	51
4.3.3 Other Factors Influencing the Living Standard in Tanzania .....	57
4.3.4 The Impact of Microfinance Industrial Average Growth .....	58
<b>CHAPTER FIVE.....</b>	<b>60</b>
<b>SUMMARY, CONCLUSION AND RECOMMENDAIONS .....</b>	<b>60</b>
5.1 Introduction .....	60
5.2 Summary of the Study .....	60
5.3 Conclusion.....	61
5.4 Recommendations .....	62
5.5 Areas for Further Studies .....	64
<b>REFERENCES.....</b>	<b>65</b>
<b>APPENDICES .....</b>	<b>68</b>
Appendix I: Questionnaire .....	68
Appendix II: Interview Guide .....	72

## LIST OF TABLES

	<b>Page</b>
Table 4. 1: Age of the Respondents' .....	45
Table 4. 2: Gender of the Respondents' .....	46
Table 4. 3: Level of Education Attained by Respondents.....	47
Table 4. 4: Occupation of the Respondents .....	48
Table 4. 5: Strategies Needed to Improve Loan Provision .....	50
Table 4. 6: Measures of Microfinance Growth in Tanzania .....	52
Table 4. 7: Challenges facing Microfinance Institutions (MFIs).....	53
Table 4. 8: Hindrances Pertaining MFIs Practice .....	56
Table 4. 9: Factors Influencing the Living Standard in Tanzania.....	57
Table 4. 10: The Role of Microfinance Institutions in Poverty Reduction.....	58

## LIST OF FIGURES

	<b>Page</b>
Figure 2. 1: Conceptual Framework.....	38

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background Information**

Microfinance has been a topic of much interest recently (Jansson, 2001; Lamberte, 2001). In fact Microfinance is not a new concept. It dates back in the 19<sup>th</sup> century when money lenders were informally performing the role of now formal financial institutions (Lehner, 2009). The informal financial institutions constitute; village banks, cooperative credit unions, state owned banks, and social venture capital funds to help the poor. These institutions are those that provide savings and credit services for small and medium size enterprises. They mobilize rural savings and have simple and straight forward procedures that originate from local cultures and are easily understood by the population (Morduch, 1999). In recent years, microfinance has received increasing attention in discussions about reducing poverty and promoting economic development.

Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smooth their consumption, manage their risks better, gradually build their asset base, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life (Kessy and Urio, 2006). It is generally accepted that without permanent access to institutional microfinance, most poor households would continue to rely on meagre self-finance or informal sources of microfinance, which limits their ability to actively participate and benefit from development opportunities (Morduch, 1999; Robinson, 2001)

Microfinance institutions (MFIs) are to finance the informal sector SMEs in developing countries and it is known that these SMEs are more likely to fail (Lamberte, 2001; Fukumoto, 2004). The creation of SMEs generates employment but these enterprises are

short live and consequently are bound to die after a short while causing those who gained job positions to lose them and even go poorer than how they were. It should be noted that microfinance is not a panacea but it is a main tool that foster development in developing countries. It is known worldwide that the poor cannot borrow from the banks. Banks do not lend to them because they do not have what is required to be granted a loan or to be provided with the bank services (Coleman, 1999).

The lack of financial power is a contributing factor to most of the societal problems. These problems emanate from poverty and it is known that with poverty one is bound to suffer so many consequences ranging from lack of good health care system, education, nutrition, Microfinance has proved this bank concept to be wrong. They target the poor who are considered risky but the repayment rate turns to be positive as compared with the regular commercial banks (Mosley and Hulme, 2008). Researchers have viewed microfinance in different dimensions. Microfinance gives people new opportunities by helping them to get and secure finances so as to equalise the chances and make them responsible for their own future. It broadens the horizons and thus plays both economic and social roles by improving the living conditions of the people. These improvements are in a nutshell to alleviate poverty, and according to this project, it will be seen from the point of the development of small and medium size enterprises SMEs and focusing mostly in the rural areas (Randhawa and Gallardo, 2003).

## **1.2 Statement of the Problem**

In Tanzania, the contribution of microfinance industry to poverty deduction is not gorgeous despite great efforts by government and non government organizations to foster microfinance growth (Olomi, *et al*, 2008). The introduction of MFIs is seen as the best alternative source of financial services for low income earners in rural areas as a means to raise their income, hence reducing their poverty level. However evidence has shown that these MFIs have limited coverage, poor organizational structures and some are donor driven (Kessy and Urio, 2006). Also beneficiaries are facing strong barriers in accessing microfinance services, among the obstacles related to beneficiaries, identified

as the lack of knowledge regarding the possibilities of obtaining financial resources from the microfinance institutions, the lack of awareness regarding the consulting institutions, the development of business plans that do not meet the requirements of the microfinance institutions as a lenders or investors, the reduced negotiating skills in relation with capital suppliers and the insufficient guarantees available. In some microfinance institutions there is high cost to obtain loans and the high cost of financial consultancy services, corruption and bureaucracy (Ngehnevu and Nembo, 2010).

Microfinance industry fails to reduce poverty in Tanzania (Richard and Mori, 2011). The lack of credit information has deterred microfinance institutions from lending to beneficiaries. Other factors that constrained microfinance Institutions from lending include; a lack of familiarity with the beneficiaries' business environment, an inability to deal with sub-standard financial record keeping and the absence of business plans, as well as limited management capabilities.

Therefore the study intends; to examine the role of microfinance institutions in poverty reduction; to determine challenges facing Microfinance Institutions (MFIs) in services provision and to identify strategies to enhance services provision in microfinance institutions.

### **1.3 Objective of the Study**

#### **1.3.1 General Objective**

The main objective of this study was to find out the impact of microfinance industry to poverty reduction.

#### **1.3.2 Specific Objectives**

The specific objectives of the study were as follows-

- i. To establish indicators of living standards in Tanzania
- ii. To determine the measures of microfinance growth in Tanzania
- iii. To establish other factors influencing the living standard in Tanzania
- iv. To determine the impact of microfinance industrial average growth on the living standard in Tanzania

### **1.4 Research Question**

The followings are the research questions that were involved under study:

- i. What are the indicators of living standards in Tanzania?
- ii. To what extent microfinance grow in Tanzania?
- iii. What is other factors influencing the living standard in Tanzania?
- iv. What are the impacts of microfinance industrial average growth on the living standard in Tanzania?

### **1.5 Significance of the Study**

The study added knowledge in this area that assisted in the growth and development of small businesses and tap into the underutilized resource of small entrepreneur's. In

trying to justify why the proposed study is important, it is vital to mention that, this area of study is very important to the development of the socio-economic activities in developing countries and their contributions to the development of small and medium size businesses in Tanzania.

The research will contribute to the current debate on the contribution of micro credit to poverty reduction. Specifically the study will bring evidence on whether poor and small entrepreneurs in Tanzania are effectively benefited from microfinance institutions. As MKUKUTA emphasizes trade development towards a diversified and competitive economy, the study will support the programme by provide clear picture and recommendations for create efficient and sufficient Micro-Financial Institutions and SACCOs in rural areas and facilitating access to credit by the rural people and entrepreneurs.

The study will bring more insight to policy makers to come up with proper mechanisms on targeting and making financial services accessible to poor and small entrepreneurs. It would also inform the ongoing policy debates on the effectiveness of pro-poor policies in Tanzania by different stakeholders.

Microfinance as a whole provides the rural population a means to have access to financial services in their localities to boost their living standards in a sustainable manner in line with the millennium development goals of alleviating poverty in developing countries. They can contribute in the fight against poverty by improving the agricultural sector which is the main source of living to the inhabitants of such developing nations. Thus it will pave a way forward for potential NGOs wishing to help in the sustainable development of SMEs to understand the difficulties they may come across and how they can succeed in their endeavours.

The study analyzed the argument of fighting poverty through supporting entrepreneurs and poor people in Tanzania as maintained by many microfinance institutions with

sustainability motives, given the overlapping nature of interests between the poor and non poor, how does microfinance cater for the needs of both categories.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter contains theoretical literature review and empirical literature review as well as conceptual framework. Theoretical literature review include theories and concept that guide the studies, while empirical literature review analyze different similar works in terms of objective of the study, methodology, findings as well as conclusion

#### **2.2 Theoretical Literature Review**

##### **2.2.1 Definition of the Key Terms**

###### **Microfinance**

Microfinance is the provision of financial services such as loans, savings, insurance, and training to people living in poverty (Armendariz *et al*, 2005; Jansson, 2001). Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance products to the poor and low-income households, for their microenterprises and small businesses, to enable them to raise their income levels and improve their living standards (Lamberte, 2001). The core principles for microfinance involves the poor needs access to appropriate financial services, the poor has the capability to repay loans, pay the real cost of loans and generate savings, microfinance is an effective tool for poverty alleviation, Microfinance institutions must aim to provide financial services to an increasing number of disadvantaged people, microfinance can and should be undertaken on a sustainable basis and Microfinance NGOs and programs must develop performance standards that will help define and govern the microfinance industry toward greater reach and sustainability (Buckley, 1997).

## **Poverty**

Poverty at its broadest level can be conceived as a state of deprivation prohibitive of decent human life (Kessy and Urio, 2006). This is caused by lack of resources and capabilities to acquire basic human needs as seen in many, but often mutually reinforcing parameters which include malnutrition, ignorance, prevalence of diseases, squalid surroundings, high infant, child and maternal mortality, low life expectancy, low per capita income, poor quality housing, inadequate clothing, low technological utilization, environmental degradation, unemployment, rural-urban migration and poor communication (Amin, 2002). Poverty is caused by both internal and external factors. Whereas the internal causes can be clustered into economic, environmental and social factors, the external causes relate to international trade, the debt burden and the refugee problem (Heidhues, 1995).

### **2.2.2 Microfinance and Poverty Reduction**

International comparisons of living standards and development are inescapable. Public opinion, inasmuch as it is represented by the media, has an insatiable appetite for world or regional rankings. Changes in these rankings are regularly used by politicians and policy analysts as a basis for assessing the efficacy of national policies. Governments and international organizations use measures of development to allocate funding to countries or regions. The underlying indexes of national progress are used extensively in econometric testing of theories of growth and development. Here we propose a contribution to the method by which such international comparisons are made, based on the economic theory of revealed preference (Ngehnevu and Nembo, 2010).

Most commonly, international comparisons of living standards or development are made in terms of gross domestic product (GDP) per capita. Such comparisons have been criticized on a number of grounds. The most common criticism is based on the fact that standard GDP indexes are more properly regarded as partial measures of aggregate

output than as indicators of well-being. No allowance is made for environmental differences, non-market household production, or production and consumption externalities. For example, if polluting industries cause illnesses that require expensive medical treatment, both the output of the polluting industry and the expenditure on medical services will be counted as part of GDP. Thus, aggregate output may increase although well-being, as measured by various social indicators, declines.

Measuring the standards of living of an economy is a fundamental concern, not only in development economics. First, knowing how well off the members of a country are on average is extremely important for development policies. Second, it is necessary to be able to make comparisons both over time and across countries, thus assessing improvements and performances (Morduch, 1999).

Traditionally, the Gross Domestic Product (GDP) is the most widely accepted indicator of a country's size and economic performance, although in the last decades many contributions have suggested the need to adopt a larger set of indicators in order to capture people's wellbeing. The monetary income element is also captured by the Gross National Income (GNI), which is often regarded as an either complementary or alternative measure with respect to the GDP. In recent years, the GNI has been largely used, but we will show that – contrary to the held view that GNI is the best indicator for a population's monetary income, it fails to account for some key elements. A third indicator, the Gross National Disposable Income (GNDI) proves to be more informative and useful in many fields. Let us briefly summarize the argument (Morduch, 1999).

Microfinance as an industry evolved in all the third world countries almost at the same time span (Jansson, 2001; Ledgerwood, 1999). World over, it was getting widely recognized that improving income levels of low-income community is essential to improve their well-being. During the 1970s and 1980s, the microenterprise movement led to the emergence of Non- Governmental Organizations (NGOs) that provided small

loans for the poor. One of the significant events that helped it gained prominence in the 1970s (Lamberte, 2001).

Microcredit and microfinance are relatively new terms in the field of development, 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 subsidized rural credit programmes. These often resulted in high loan a default, high loses and an inability to reach poor rural households (Robinson, 2001).

Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “microcredit” came to prominence in development (Ledgerwood, 1999). The difference between microcredit and the subsidized rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit. It was now clear for the first time that microcredit could provide large-scale outreach profitably (Fukumoto, 2004).

The 1990s saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale (Robinson, 2001). Jansson, (2001) refers to the 1990s as “the microfinance decade”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (Heidhues, 1995).

### **2.2.3 Measures of Microfinance Growth**

According to Ledgerwood (1999) MFIs can offer their clients who are mostly the men and women who could be below or slightly above the poverty line a variety of products and services. The most prominent their services is financial, that they often render to their clients without tangible assets and these clients mostly live in the rural areas, a majority of whom may be illiterate (Navajas *et al*, 2003). Formal financial institutions do not often provide these services to small informal businesses run by the poor as profitable investments. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral (farms) due to distance. It is by this that the cost to lend a dollar will be very high and also there is no tangible security for the loan. The high lending cost is explained by the transaction cost theory (Lehner, 2009).

The transaction cost can be conceptualized as a non financial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan. The cost incurred by the lender include; cost of searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinising loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts. On the other hand, the borrowers may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings (Ngehnevu and Nembo, 2010). The parties involved in a project will determine the transaction cost rate. They have the sole responsibility to reduce the risk they may come across (Morduch, 1999).

Microfinance triangle comprise of financial sustainability, outreach to the poor, and institutional impact. There are costs to be incurred when reaching out to the poor and most especially with small loans. The financial institutions always try to keep this cost

as minimum as possible and when the poor are in a dispersed and vast geographical area, the cost of outreach increases. The provision of financial services to the poor is expensive and to make the financial institutions sustainable requires patience and attention to avoid excessive cost and risks (Mosley and Hulme 2008).

The deliveries of MF products and services have transaction cost consequences in order to have greater outreach. Some microfinance institutions visit their clients instead of them to come to the institution thereby reducing the cost that clients may suffer from (Robinson, 2001). For MFIs to be sustainable, it is important for them to have break-even interest rates. This interest rates need to be much higher so that the financial institution's revenue can cover the total expenditure (Hulme and Mosley, 1996). The break-even rate which is higher than the market rate is defined as the difference between the cost of supply and the cost of demand of the products and services. The loan interest rates are often subsidized (Robinson, 2001).

The loans demanded by smaller enterprises are smaller than those requested by larger once but the interest rates remain the same. This indicates that, per unit cost is high for MFIs targeting customers with very small loans and possessing small savings accounts (Robinson, 2001). Even though the interest rate is high for applicants requesting very small loans, they are able to repay and even seek repeatedly for new loans. The social benefits that are gained by clients of MFIs supersede the high interest charged (Heidhues, 1995). The high interest rate is also as a means to tackle the problem of adverse selection where a choice is made between risky and non risky projects. The good clients suffer at the expense of the bad ones (Lamberte, 2001). Microfinance clients admit that convenience is more important to them than return (Jansson, 2001).

Low-income men and women have a serious hindrance in gaining access to finance from formal financial institutions. Ordinary financial intermediation is not more often than not enough to help them participate, and therefore MFIs have to adopt tools to bridge the gaps created by poverty, gender, illiteracy and remoteness. The clients also need to be trained so as to have the skills for specific production and business management as well

as better access to markets so as to make profitable use of the financial resource they receive (Lehner, 2009). In providing effective financial services to the poor requires social intermediation. This is “the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals” (Morduch, 1999). Some microfinance institutions provide services such as skills training, marketing, bookkeeping, and production to develop enterprises. Social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly (Legerwood, 1999).

The services provided to microfinance clients can be categorized into three broad different categories. According to Nangia and Vaillancourt, (2006), these include:-

- i. Financial intermediation or the provision of financial products and services such as savings, credit, insurance, credit cards, and payment systems should not require ongoing subsidies.
- ii. Social intermediation is the process of building human and social capital needed by sustainable financial intermediation for the poor. Subsidies should be eliminated but social intermediation may require subsidies for a longer period than financial intermediation.
- iii. Enterprise development services or non financial services that assist micro entrepreneurs include skills development, business training, marketing and technology services, and subsector analysis. This may or may not require subsidies and this depends on the ability and willingness of the clients to pay for these services.

MFIs have as main objective to provide financial intermediation which involves the transfer of capital or liquidity from those who have excess to those who are in need both at the same time (Buckley, 1997; Navajas *et al*, 2003). Finance in the form of savings and credit arises to permit coordination. Savings and credit are made more efficient when intermediaries begin to transfer funds from firms and individuals that have

accumulated funds and are willing to shed liquidity. It is visually known that almost all MFIs provide credit services. Other MFIs also provide some financial products such as; savings, insurance, and payment services. Each MFI has its objectives and the choice of the financial service to provide depends on the demands of its target market and its institutional structure. Two important considerations when providing financial services are; to respond effectively to the demand and preference of clients and to design products that are simple and easy to understand by the clients and easily managed by the MFI (Ngehnevu and Nembo, 2010).

According to Ngehnevu and Nembo, (2010), The common products that MFIs provide include; credit, savings, insurance, credit cards, and payment services. These points are briefly described and also show how financial services are provided to SMEs

**Credit:** These are borrowed funds with specified terms for repayment. People borrow when there are insufficient accumulated savings to finance a business. They also take into consideration if the return on borrowed funds exceeds the interest rate charged on the loan and if it is advantageous to borrow rather than to postpone the business operations until when it is possible to accumulate sufficient savings, assuming the capacity to service the debt is certain (Diagne and Zeller, 2001). Loans are usually acquired for productivity reasons; that is to generate revenue within a business.

**Savings:** Savings mobilization in microfinance is a very controversial issue. They have been increase awareness among policy makers and practitioners on the vast number of informal savings schemes. MFIs such as credit union organizations around the world have been very successful in rallying clients to save (Morduch, 1999).

**Insurance:** This is one of the services and products that are experimented by MFIs. Many group lending programs offer insurance or guarantee scheme as collateral and the Grameen bank is a typical example of MFI in this scheme. One percent of the loan is required to be presented by the group member as their contribution for the insurance for the loan (Ledgerwood, 1999).

**Credit cards:** These are cards that allow borrowers to have access to a line of credit if and when they need it. This card is also use to make purchase assuming the supplier of the goodwill accepts the credit card or when there is a need for cash. The card is also called a debit card when the client is accessing his or her own savings (Ledgerwood, 1999).

**Payment Services:** payment services include cheque cashing and cheque writing opportunities for clients who retain deposits (Heidhues, 1995). In addition to cheque cashing and cheque writing privileges, payment services comprise the transfer and remittance of funds from one area to another (Lamberte, 2001).

#### **2.2.4 The Impact of Microfinance Industrial Average Growth**

Microfinance enables the poor and excluded section of people in the society who do not have an access to formal banking to build assets, diversity livelihood options and increase income, and reduce their vulnerability to economic stress (Robinson, 2001). In the past, it has been experienced that the provision for financial products and services to poor people by MFIs can be practicable and sustainable as MFIs can cover their full costs through adequate interest spreads and by operating efficiently and effectively. Microfinance is not a magic solution that will propel all of its clients out of poverty. But various impact studies have demonstrated that microfinance is really benefiting the poor households (Ngehnevu and Nembo, 2010).

Throughout the world, poor people are excluded from formal financial system. Exclusion ranges from partial exclusion in developed countries to full or nearly full exclusion in Less Developed Countries (LDCs). Absent access to formal financial services, the poor have developed a wide variety of informal community based financial arrangement to meet their financial needs. Microfinance is created to fill this gap (Amin, 2002).

Microfinance pertains to the lending of small amount of capital to poor entrepreneurs in order to create a mechanism to alleviate poverty by providing the poor and destitute with resources that are available to the wealthy, albeit at a small scale. According to Buckley, (1997), microfinance bank is not just providing capital to the poor, but to also combat poverty at an individual level, it also has a role at institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector.

In Africa and other developing regions, microfinance institutions (MFIs) are regarded as the main source of funding micro enterprises. Formal credit and savings institutions for the poor are also available around the globe providing customers who were traditionally neglected by commercial banks a way to obtain financial services through cooperative and development finance institution. Suffice it to say that the unwillingness or inability of the formal financial institutions to provide financial services to the urban and rural poor, coupled with the unsustainability of government sponsored development financial schemes contributed to the growth of private sector-led microfinance in Nigeria (Amin, 2002).

The gap filled by microfinance institution has made become part of the formal financial system of a country and so can access capital market to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Fukumoto, 2004).

The importance of microfinance is to eradicate poverty, made the Federal Government of Nigeria adopted it as the main source of poverty reduction in Nigeria and mandated the CBN to develop appropriate policy and framework for the operations of MFIs (Fukumoto, 2004).

In Africa there are many community-oriented policies and programmes which incorporate different objectives related to economic development, national development, nation building or simply development. For example, the operation feed yourself in Ghana, the special rural development programme in Kenya, the agricultural development projects (integrated rural development projects), and the green revolution are well known inside and outside Africa. Most of these policies and programmes were or are designed to improve the socio-economic conditions of the rural population. Microfinance programme has been viewed as a unique programme for the reduction of vulnerability, and hence the achievement of the Millennium Developmental Goals (Jansson, 2001). Microfinance allows poor people to diversify and increase income sources, the essential path out of hunger. Diversification makes people more resilient to external shocks.

The study of poverty and its alleviation are not new. Rather what are revisited are the spatial differences in levels of poverty among real units. Poverty is a global phenomenon, which affects continents, nations and peoples differently. It afflicts people in various depths and levels, at different times and phases of existence (Coleman, 1999). The most commonly way to measure poverty is based on income or consumption line. A person is considered poor if his or her consumption level falls below 1USD per day, a level necessary to meet basic needs. This minimum level is called the poverty line (Fukumoto, 2004). Limited access to social and economic infrastructure such as education, health, portable water, and sanitation; and consequently, has limited chance of advancing his or her welfare to the limit of his or her capabilities". Jansson, (2001), systematically defined poverty when he said that "don't ask me what poverty is because you have met it outside my house. Look at the house and count the number of holes. Look at my utensils and the clothes that I am wearing. Look at everything and write what you see. What you see is poverty".

Micro-finance is a term used to refer to different methods for giving poor people access to financial services. Lehner, (2009). defined microfinance as the provision of financial services such credits (loans), savings, micro-leasing, micro-insurance, and payment transfers to economically active poor and low income household to enable them engage in income generating activities or expand/grow the small businesses. Microfinance is sectionally defined as a financial intervention that focuses on the low-income group of a given society. The intervention primarily involves credit services and may also include savings, insurance on credits and savings.

Furthermore, Morduch (1999) defined microfinance as the supply of loans, savings and other basic financial services to the poor. Microfinance evolved as an economic development approach intended to benefit the low-income part of a given society, both men and women (Irobi, 2008). According to Morduch, (1999) the term refers to provision of financial services (including saving and credit) to the poor. Micro-finance banks therefore are institutions that are established to provide financial services to the poor. Microfinance institutions can be non-governmental organizations, savings and loan cooperatives, loan unions, government banks, commercial banks, or non-bank financial institutions (Ledgerwood, 1999). The policy seeks to make financial services available on a sustainable basis to the economically active poor, low-income earners and micro, small and medium enterprises through privately owned enterprises.

The objective of microfinance according to Jansson, (2001), is not providing capital to the poor to combat poverty; it seeks to create an institution that delivers financial services to the poor who are ignored by the formal banking sector.

Earlier studies about micro-financing have evaluated whether micro-credit programs such as popular in Nigeria reach the relatively poor and vulnerable in their operations. Recent studies have shown evidence of positive impact as it relates to first six out of seven Millennium Goals (Lamberte, 2001), all subscribed to the believe that

microfinance is an effective and powerful tool for poverty reduction. For example, Lehner, (2009) focus on the ability of microfinance to reach the poor and affirmed that microfinance has served people below and above the poverty line.

The results of empirical evidence indicates that the poorest can benefit from microfinance from both an economic and socio well-being point-of-view, and that this can be done without jeopardizing the financial sustainability of the Micro-financial institutions (Lamberte, 2001). For instance, Lehner, (2009) in several related studies using statistical method on assessment of impact of microfinance among three Bangladesi programs found that every additional taka lend to a woman add additional of 0.18 taka to annual household expenditure. Similarly, in an updated study using panel data in Bangladesh, Khandker (2005), found out that each additional 100 taka of credit to women increase total annual household expenditures by more than 20 taka. These studies showed overwhelming benefit of increase in income and reduction of vulnerability.

On the other hand, some authors have challenged the positive effects of microfinance on poverty alleviation. For instance, Richard and Mori, (2011) while acknowledging the role of microfinance can have in helping to reduce poverty, concluded from their research on microfinance that “most contemporary schemes are less effective than they might be”. They stated that microfinance is not a panacea for poverty – alleviation and that in some cases the poorest people have been made worse-off by microfinance.

The microfinance services are supplied mainly by informal sources. Their collective outreach, both breadth and depth, is vast in most countries. They supply mainly short-term credit and charge higher interest rates than semi formal and formal sources. Because of the relatively greater bargaining power enjoyed by the informal suppliers in general, the terms and conditions under which services are provided do not enable the clients to fully harness economic opportunities. The informal sources operate in highly

localized areas. Therefore, their contribution to financial intermediation and improvement of resource allocation is also limited. For example, informal sources do not allow savings to be collected from more than a small group of individuals well known to one another, and they do not move funds over large distances. Most informal insurance mechanisms are typically weak, particularly against repeated shocks, and often provide only inadequate protection to poor households (Richard and Mori, 2011).

The involvement of formal sources in microfinance has increased during the last two decades. This greater involvement has stemmed from the expansion of the scope of formal institutions into microfinance through downscaling and establishment of linkage programs with semiformal sources of different types; the emergence of new formal institutions focused on microfinance, such as the Grameen Bank of Bangladesh; reforms of state-owned financial institutions such as BRI; and the introduction of new microfinance programs by the governments through nonfinancial institutions. However, the formal operations concentrate mostly on providing credit facilities, and savings mobilization has yet to receive adequate attention, with few exceptions.

The MFIs and other financial institutions (OFIs) providing microfinance services have expanded their outreach from a few thousand clients in the 1970s to over 10 million in the late 1990s. The developments in microfinance in the Region have set in motion a process of change from an activity that was entirely subsidy dependent to one that can be a viable business.

household may not be able to finance the investment in one lump sum but may be able to do so in installments. Poor household that is not able to self-finance discrete increases in investments will be compelled to use traditional technology and continue with low-productivity activities. Thus, McKinnon noted that

poverty and the inability to borrow can be formidable barriers to the adoption of even the simplest and most productive innovations. The important point, however, is the virtual impossibility of a poor farmer's financing from his current savings the whole of the balanced investment needed to adopt the new technology. Access to external financial resources is likely to be necessary over the one or two years when the change takes place. Without this access, the constraint of self-finance sharply biases investment strategy toward marginal variations within the traditional technology

There are facts that poverty is indeed increasing in Nigeria, based on the poverty assessment study commissioned and sponsored by the World Bank in 1995 (Akanji, 2006). Attacking 'poverty' is based on a deeper understanding of the meaning and causes of poverty. In the opinion of Akanji (2006), the World Bank report shows that economic development continues to be central to success in reducing poverty, but that poverty is also an outcome of economic, social and political processes that interact with and reinforce each other in ways that can ease or exacerbate the state of deprivation in which poor people live. Effectively functioning financial markets have fundamental roles to play in fostering development. At the level of individual livelihoods, financial markets can perform very crucial functions. They can be a principal means for the poor to get access to financial assets; through facilitating savings, they can be of importance in reducing the vulnerability associated with uneven and unpredictable year-to-year changes in circumstances, and they can help convert illiquid assets into liquid ones in the event of emergencies (Olomola, 2008).

Nonetheless, any poverty reduction programme must seek to address the inefficiency and inadequacies of financial markets since they rarely effectively discharge the expected functions. The credit policy for the poor involves many practical difficulties arising from the operations of financial institutions and the economic characteristics and financing needs of low-income households. For Example, commercial banking institutions require that borrowers have a stable source of income out of which principal

and interest can be paid back according to the agreed terms. However, the income of many self-employed households is not stable. A huge number of micro loans are needed to serve the poor, but banking institutions prefer dealing with big loans in small numbers to minimize administration expenses. They also look for collateral with clear title-which many low-income households do not have. In addition, bankers tend to consider low income households a bad risk, imposing exceedingly high information monitoring costs on operation (Shastri, 2009). This paper therefore, will critically assess how the poor has been empowered through the operation of microfinance as a strategy for poverty reduction in Nigeria.

Although all the programs were directed at improving the productive base for sustainable growth, most of the efforts at purveying micro credit to alleviate poverty were largely irrelevant, urban-structured from the standpoint of the realities of (who is the poor?)- understanding the poor (Akanji, 2006). There are basically formal and 5informal models of purveying microcredit to the target group. The most successful had been the informal model because in Nigeria and several developing economies where poverty is high, some individuals, households and regions remain isolated from markets and from mechanisms for borrowing and lending or insuring against risk (Aryeety, 2005). Consequently, informal lenders tend to target the poor (including women), although not always successful; attempts by better financed innovative schemes to target the same poor people

have not been more successful (Akanji, 2006). The issue there is no longer a simple one of targeting or not targeting, but of how to equip institutions that can reach the poor at least cost (that is, informal lenders) to extend their reach.

Most of the formal institutions that purvey credit to the poor had not been successful. The reasons adduced for their failure had been limited knowledge of the poor and no closer relationship between the formal institutions and the informal institutions. The framework for linking informal savings collectors to the formal institutions is a welcomed development. The banks' readiness to acquire more information about the

informal sector and making serious efforts at strengthening group schemes encouraged the successful turnaround of micro-credit programmes in Nigeria. An example is the merger of the Nigerian Agricultural and Cooperative Bank (NACB), Peoples Bank of Nigeria and Family Economic Advancement Program (FEAP), to form Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB) in 2001 (Coleman, 1999).

Income in Nigeria is closely linked to social and economic status: whilst the upper and middle classes inhabit the 'formal income from their formal ventures and employment, on the other hand, the poorest and low income status are largely 'informally' employed. Low income households are not usually involved in regular income occupations and therefore wait for job creation strategies to absorb them; they 'permanently inhabit' a dependent segment of the so called developing Nigerian economy, in which opportunities for jobs, or for independent and self-sustaining entrepreneurial capital accumulation, are minimal (Coleman, 1999).

Though poverty reduction has long been a high priority for the Government of Nigeria, microfinance is still an experimental tool in its overall strategies. The Federal Government of Nigeria has over the years demonstrated strong commitment to the provision of financial services and economic empowerment of the poor and low income groups. The critical role of finance in the realization of the goals motivated the government, in collaboration with the Central Bank of Nigeria, to formulate the Financial System Strategy (FSS) 2020 in 2007, as part of an overall National vision, which aims to make Nigeria one of the 20 largest economies in the world by 2020 (Appiah *et al.*, 2008).

The formal microfinance model is built around formal financial institutions such as the commercial banks, rural banks etc. Most of the formal institutions that purvey credit to the poor had not been successful. The reasons adduced to their failure had been limited

knowledge of the poor and no closer relationship between the formal institutions and the informal institution. The Grammen experience is an example of that model that has been able to transform from informal to formal model of purveying micro-credit to the poor (Buckley, 1997).

The World Bank Group and the International Monetary Fund's efforts at assisting countries to understand the poverty situation in their economy, assess the level and determine to reduce the level, knowing that most developing economies are held back with debt obligation, have proved quite successful in most developing countries. It has helped Nigeria to open up discussions with our creditors at the Paris Club Group of creditors. The cancellation of the Nigerian debt by the Paris Club of creditors on January 21, 2008, promises a great relief to the country. The World Bank and IMF determined in 1999 that nationally owned participatory poverty reduction strategies should provide the basis for all their concessional lending and debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) initiative. This approach builds on the principles of the comprehensive development papers on Poverty Reduction Strategy by country authorities for submission to the Bank and fund boards (Appiah *et al.*, 2008).

An assessment of the microfinance environment post-2005 reveals some marked improvements. For instance, there is a heightened awareness among stakeholders such as government, regulatory authorities, investors, development partners, financial institutions and technical assistance providers on the need for microfinance, a total of 866 microfinance banks and 3 credit bureaux have been established. Similarly, the microfinance certification programme for operators of microfinance banks has been put in place, while the regulatory and promotional machinery have been beefed up (Buckley, 1997).

From the perspective of donor partners, the United Nations Development Programmes (UNDP), provided support for the microfinance policy and funded the "Sustainable

Development of the Microfinance sub-sector Programme for Nigeria” in the period 2004-2007. It is currently supporting the drafting of a comprehensive National Microfinance Development Strategy (NMDS) that will define the roles and responsibilities of stakeholders with a view to enhancing the success of the policy and the achievement of the set targets (Appiah *et al.*, 2008).

Nonetheless, it seems that microfinance has significantly dented the informal credit markets by undermining debt-bondage and usury in the rural areas of Nigeria. Thus microfinance is having a modernizing impact, even if inadvertent, unacknowledged and unsung. However, the validity of some of the usual arguments against informal finance has been questioned and the co-existence of both the traditional institutions and modern financial intermediaries has been advocated (Fukumoto, 2004). The private sector seems to be bracing up for the challenge through the formation of informal financial groups (IFGs) and the participation of NGOs, including donor agencies. Available literature indicates that lenders resort to the disbursement of credit to groups rather than individuals as a way of overcoming the problems of high transaction costs and loan default and as a way of extending their coverage of beneficiaries of small loans. However, results have been mixed, with failures outnumbering successes (Heidhues, 1995). Unfortunately, the persistent skepticism of most development theorists about the contribution of informal finance to development derives partly from the fact that much of the available information about traditional savings and credit associations has been sketchy and inaccurate, with little detailed analysis.

In addition, linking the informal finance to formal financial institutions should be emphasized. Judging from the proved advantages of informal finance, policy attention has to shift in the direction of integrating the formal and informal systems rather than eliminating the latter. Further inquiry into the operations of informal finance is warranted to correct existing misapprehensions and misperceptions and to tap fully the savings and credit potential of the informal sector. Indeed, rather than disappearing, informal finance continues to expand in Nigeria (Robinson, 2001). In the opinion of

Morduch, (1999) informal finance is much more extensive and diverse than formal finance and accounts for most of the financial services, other than term finance, provided to the rural sector. In most sub-Saharan African (SSA) countries, formal rural credit accounts for less than 10% of total credit disbursed. Moreover, the survival of informal finance over the years and its persistence both in rural and urban economies in spite of policy emphasis on modern financial intermediaries indicate the advisability to seek a better understanding of its operations with a view to drawing useful lessons for the improvement of the rural financial system.

The inefficiencies of many state-run specialized financial institutions have provided a strong rationale for market-based financial sector reforms. It is now realized that these reforms had their own limitations, while SMEs and the agricultural sector, especially food production, need state support. Therefore, instead of focusing solely on microfinance, designing efficient state-run financial institutions as part of developing an inclusive financial sector should also be integral to the poverty reduction efforts. Management and operational lessons learnt from successful MFIs can provide valuable inputs into the design of specialized financial institutions for SMEs and the agricultural sector (Morduch, 1999).

Access to financial services is but, one aspect of the support needed by entrepreneurs running SMEs and micro- enterprises. They also need training in business skills and access to marketing information so that they can expand to take advantage of both domestic and international markets and thereby create decent jobs. Here too, the government has important role to play, as the majority of SMEs and micro-entrepreneurs will not be able to afford the market-determined fees for such training or marketing information (Morduch, 1999).

In sum, while NGOs are making valuable contributions to safety-net by providing micro-credit to the poor and vulnerable, the government cannot abrogate its role in the area of

social provision. The government also has to be a major player in the design and operation of an inclusive financial sector to cater for the needs of the “missing” middle in the informal and agricultural sectors. This is crucial to ensure that growth is employment - intensive to maximize its impact on poverty reduction (Lehner, 2009).

The poorest and poverty reduction have become the object of unprecedented attention at international summits in the 1990's. Canada, through the Canadian International Development Agency (CIDA), has committed to the targets set by both the OECD International Development Goals and, most recently, the Millennium Goals which focus on poverty reduction for those living on less than a dollar a day (Lehner, 2009).

Microfinance has proven to be an effective and powerful tool for poverty reduction. Like many other development tools, however, it has insufficiently penetrated the poorer strata of society. The poorest form the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to microfinance (Amin, 2002).

While there is no question that the poorest can benefit from primary health care and from basic education, it is not as intuitive that they can also benefit from microfinance, or that microfinance is an appropriate tool by which to reach the Millennium goals (Amin, 2002).

Microfinance has been extensively examined over the past 10 to 15 years, and the resulting literature is now very large. A focused review of the literature was conducted to evaluate recent publications regarding the impact of microfinance on poverty reduction (Amin, 2002).

Microfinance is not for everyone. Most importantly, entrepreneurial skills and ability are necessary to run a successful microenterprise and not all potential customers are

equally able to take on debt. While these points will be true across all strata of poverty, it is assumed that they will have a greater effect on the very poorest (Buckley, 1997)

The sick, mentally ill, destitute etc. who form a minority of those living below the poverty line are typically not good candidates for microfinance. Most researchers agree that this group of people would be better candidates for direct basic assistance (Buckley, 1997)

More optimistically, microfinance can be effective for a broad group of clients, including those who are living in the bottom half of those below a country's poverty line (to use a categorization proposed by CGAP). We will call this strata the "poorest" and note that they constitute the group that generally intersects the various definitions of extreme poverty: landlessness, limited access to basic social services, average per capita income of less than \$1 a day, and bottom third of a relative poverty ranking (Coleman, 1999).

There is general consensus that facilitating savings is important, because there is a high demand for it among the poorest and because savings play a role in protecting against the seasonality of cash-flows and fulfilling an insurance function. In addition, building up deposits reinforces financial discipline for customers and can eventually yield collateral and serve as a source of funding for MFIs (Coleman, 1999).

Savings alone, however, have only a minor developmental impact: the protection against shocks might allow children to remain in school or income-earners to get medical treatment and minimize time away from work, but it is slow to create any significant wealth in itself unless credit is also available.

MFIs that focus on savings more than credit tend to reach a smaller proportion of the poorest, have a lower and slower impact on poverty reduction, and are therefore less conducive to reaching the Millennium Goals by the target dates. While the savings-first institutions are easier to finance by donor agencies (far less start-up capital required), the

few comparative studies available show that borrowers fare better than non-borrowers (Ngehnevu and Nembo, 2010).

There is ample evidence to support the positive impact of microfinance on poverty reduction as it relates to fully six out of seven of the Millennium Goals. In particular, there is overwhelming evidence substantiating a beneficial effect on income smoothing and increases to income (Robinson, 2001).

There is less evidence to support a positive impact on health, nutritional status and increases to primary schooling attendance. Nevertheless, the evidence that does exist is largely positive (Robinson, 2001).

Microfinance is an instrument that, under the right conditions, fits the needs of a broad range of the population including the poorest those in the bottom half of people living below the poverty line. While there will be people in this group who will not be suited for microfinance because of mental illness, etc., the exclusion of this small percentage of the population will likely not be a limiting operational issue for MFIs (Ngehnevu and Nembo, 2010).

Empirical indications are that the poorest can benefit from microfinance from both an economic and social well-being point-of-view, and that this can be done without jeopardizing the financial sustainability of the MFI. While there are many biases presented in the literature against extending microfinance to the poorest, there is little empirical evidence to support this position. However, if microfinance is to be used, specific targeting of the poorest will be necessary. Without this, MFIs are unlikely to create programs suitable for and focused on that group (Ngehnevu and Nembo, 2010).

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses (Navajas *et al*, 2003)

In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self confidence and the training of members in that group on financial literacy and management (Morduch, 1999). There are different providers of microfinance (MF) services and some of them are; Non Governmental Organizations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non banking financial institutions. The target group of MFIs are self employed low income entrepreneurs who are; traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers and artisans blacksmith (Mosley and Hulme 2008).

### **2.2.5 Overview of Tanzania Micro Finance Sector**

The financial sector reforms in Tanzania set in motion a decade ago included liberalizing interest rates, eliminating administrative credit allocation, strengthening Bank of Tanzania's role in regulating and supervising financial institutions, restructuring state-owned financial institutions, and allowing entry of private banks into the market. Although there is a progress in the financial reforms, access by large segments of the rural and urban population to financial services has remained stunted especially for women entrepreneurs (Randhawa and Gallardo, 2003). Microfinance play important role on generating entrepreneurial activities for women. This cause the International Labour Organization (ILO) entered into a general agreement with the Ministry of Industry and Trade (MIT) to implement a Women's Entrepreneurship Development and Gender Equality (WEDGE) Programme in Tanzania (Olomi *et al*, 2008)

Government, in collaboration with the donor community such as IMF, acted to facilitate microfinance development initiating a microfinance policy formulation process in 1996 with a nation-wide demand study, and the drafting of a National Microfinance Policy

document. The National Policy provides the vision and strategy for the development of a sustainable microfinance industry as an integral part of the financial sector, specifying the respective roles of the key stakeholders, the Government and its principal agencies in policy formulation and implementation, the different institutional providers of microfinance services, and the donor community. The Government a tiered but relatively new and shallow financial sector, consisting of 20 licensed banks and 11 non-bank financial institutions, and a 17.5% degree of monetization (Randhawa and Gallardo, 2003). Most bank branches are concentrated in Dar es Salaam, and only a few have a countrywide network that could be linked to the provision of microfinance services. Three commercial banks have entered into microfinance

Microfinance in Tanzania is critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable women entrepreneurs to smooth their consumption, manage their risks better, gradually build their asset base, develop their micro enterprises, enhance their income earning capacity (Olomi *et al*, 2008). Thus, the principal providers of microfinance services in Tanzania are Savings and Credit Cooperatives (SACCOs) and several foreign donor-assisted NGOs. They have preceded the establishment of a microfinance-specific regulatory framework, operating in spite of significant difficulties in several key areas of limited access to external funds and the lack of skilled manpower with banking and financial competence. The regulatory frameworks for microfinance institutions (MFIs) and cooperative financial institutions (CFIs) are still in process of being enacted into pertinent laws and corresponding implementing regulations. There is need for a clearly defined strategy on how to integrate SACCOs and NGOs into the emerging microfinance regulatory framework, and what policy environment, resource and capacity requirements will be required not only by the institutions but also by the regulatory bodies (Randhawa and Gallardo, 2003).

MFI schemes in Tanzania were initiated to meet different objectives. The most commonly mentioned objectives include: poverty alleviation and improved living

standards, offering financing to the poor, women's empowerment, and the development of the business sector as a means of achieving high standards and reducing market failure (URT, 2002).

The distribution with respect to the concentration of microfinance activities in Tanzania is skewed in favor of the urban areas leaving rural areas grossly under served. Most MFIs with an exception of tiny rural based SACCOs are reluctant to extend their services to the rural areas due to poor infrastructure, high risk and high cost of operation, the latter is brought about by the fact that rural areas in Tanzania by nature are sparsely populated (Olomi *et al*, 2008). In Tanzania indicate there are about 646 registered societies of SACCOs, of which some 60% or 395 can be classified as rural SACCOs and 40% or 251 as urban SACCOs (mostly wage-based membership). The total membership base is some 130,000 with urban SACCOs accounting for 47,000 and rural SACCOs having some 83,000 members. Total members' funds amounted to the equivalent of US\$ 17 million, consisting of US\$6.5 million in members' shares and US\$ 10.5 million in members' deposits. The bulk of members' shares came from the urban SACCOs (US\$4.7 million), as did members' deposits (US\$9.4 million). To place these savings and share capital amounts in perspective, rural SACCOs had an average of Tsh 27,500 (US\$34) in shares and deposits per member; average deposits per member came to US\$14. The profile for urban SACCOs presents a stark contrast – average shares and deposits per member were almost 10 times larger at Tsh 240,000 or US\$300, of which average deposits per member amounted to Tsh 160,000 or US\$200 (Randhawa and Gallardo, 2003).

### **2.2.6 The Link between Micro Finance Institutions and Poverty Alleviation**

MFI schemes were initiated to meet different objectives. The most commonly mentioned objectives include: poverty alleviation and improved living standards, offering financing to the poor, women's empowerment, and the development of the business sector as a means of achieving high standards and reducing market failure. Empirical evidences and surveys give mixed results on the performance of MFIs. In some cases debacle stories

have been reported, yet there have been success stories. In other cases the reasons for failures or successes have not been well documented (Kessy and Urio, 2006).

Recent studies show that, linking MFIs with other interventions such as poverty alleviation often complicates the functioning of MFIs by pushing them to areas not considered sustainable. This implies that there is a conflict in measuring financial performance and poverty alleviation. Most of sustainability indicators focus on the MFI as a profitable institution (loan repayment, profitability and degree of subsidization). Thus for an MFI to meet the microfinance best practices, as given by Consultative Group to Assist the Poorest (CGAP), and be financially sustainable, it has to regard itself as a business venture. As a consequence of this and especially in the rural areas, very few people qualify for a business loan (Kessy and Urio, 2006).

Jansson, (2001), illustrates the various ways in which microfinance, at its core combats poverty. The study states that microfinance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organization building, enables people to move out of poverty. By providing material capital to a poor person, their sense of dignity is strengthened and this can help to empower the person to participate in the economy and society (Jansson, 2001).

The aim of microfinance according to Ledgerwood, (1999), is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. Armendariz *et al*, (2005) state that the poor are generally excluded from the financial services sector of the economy so MFIs have emerged to address this market failure. By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial system of a country and so can access capital markets to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Coleman, 1999).

Referring to various case studies, they show how microfinance has played a role in eradicating poverty, promoting education, improving health and empowering women (Coleman, 1999). However, not all commentators are as enthusiastic about the role of microfinance in development and it is important to realize that microfinance is not a silver bullet when it comes to fighting poverty. Heidhues, (1995) while acknowledging the role microfinance can have in helping to reduce poverty, concluded from their research on microfinance that “most contemporary schemes are less effective than they might be. They state that microfinance is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off by microfinance. Diagne and Zeller, (2001) finds five major faults with MFIs. He argues that:-

- i. They encourage a single-sector approach to the allocation of resources to fight poverty,
- ii. Microcredit is irrelevant to the poorest people,
- iii. An over-simplistic notion of poverty is used,
- iv. There is an over-emphasis on scale,
- v. There is inadequate learning and change taking place.

Buckley, (1997) states that much of the scepticism of MFIs stems from the argument that microfinance projects “fail to reach the poorest, generally have a limited effect on income drive women into greater dependence on their husbands and fail to provide additional services desperately needed by the poor”. In addition, Wright says that many development practitioners not only find microfinance inadequate, but that it actually diverts funding from “more pressing or important interventions” such as health and education. As argued by Fukumoto, (2004) there is a danger that microfinance may siphon funds from other projects that might help the poor more. They state that governments and donors should know whether the poor gain more from microfinance, than from more health care or food aid for example. Therefore, there is a need for all involved in microfinance and development to ascertain what exactly has been the impact of microfinance in combating poverty.

Considerable debate remains about the effectiveness of microfinance as a tool for directly reducing poverty, and about the characteristics of the people it benefits (Lamberte, (2001). Heidhues, (1995) argues that it is notoriously difficult to measure the impact of microfinance programmes on poverty. This is so she argues, because money is fungible and therefore it is difficult to isolate credit impact, but also because the definition of ‘poverty’, how it is measured and who constitute the ‘poor’ “are fiercely contested issues.

### **2.3 Empirical Literature Review**

Recent studies have shown that, there are over 50 registered MFIs in Tanzania but their overall performance has been poor. 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 (Kessy and Urio, 2006).

The findings revealed that, the overall performance of MFIs in Tanzania is poor and only few of them have clear objectives, or a strong organisational structure. It was further observed that MFIs in Tanzania lack participatory ownership and many are donor driven. Although client outreach is increasing, with branches opening in almost all regions of the Tanzanian mainland, still MFIs activities remain in and around urban areas. Their operational performance demonstrates low loan repayment rates and their capital structures is dependant on donor or government funding.

In conclusion, the author pointed to low population density, poor infrastructures and low house hold income levels as constraints to the MFIs’ performance. Many of these MFIs have no clear mission and objectives. Also their employees lack capacity in credit management and business skills. Among the questions which arise out of these research findings is whether these MFIs whose performance is questionable will have any impact on poverty alleviation (Kessy and Urio, 2006).

Other studies on microfinance services, in Tanzania were carried out by Kuzilwa (2002) and Rweyemamu et al, (2003). Kuzilwa examines the role of credit in generating entrepreneurial activities. He used qualitative case studies with a sample survey of businesses that gained access to credit from a Tanzanian government financial source. The findings reveal that the output of enterprises increased following the access to the credit. It was further observed that the enterprises 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 quasi-informal financial institutions can continue to be easily accessed by micro and small businesses.

Rweyemamu et al evaluated the performance of, and constraints facing, semi-formal microfinance institutions currently providing credit in the Mbeya and Mwanza regions. The primary data, which were supplemented, by secondary data, were collected through a formal survey of 222 farmers participating in the Agricultural Development Programme in Mbozi and the Mwanza Women Development Association in Ukerewe. The analysis of this study revealed that the interest rates were a significant barrier to the borrowing decision. Borrowers also cited problems with lengthy credit procurement procedures and the amount disbursed being inadequate. On the side of institutions, the study observed that both credit programmes experienced poor repayment rates, especially in the early years of operation, with farmers citing poor crop yields, low producer prices and untimely acquisition of loans as reasons for non-payment.

It was further revealed that poor infrastructure of the MFIs led to high transportation costs, which increased the transaction costs in credit procurement, and disbursement and this ultimately hindered the effectiveness of the credit programmes. This happened because most of borrowers lived in rural areas, far from credit offices. The coverage by Kuzilwa was on the National Entrepreneurship Development Fund only, while Rweyemamu et als' study was on assessing the micro-finance services for the agricultural sector only.

From the above evidence the researchers found that there was a strong need to study the schemes existing in Tanzania and see to what extent their operations contribute to poverty reduction in the country. From of this study, recommendations were made to policy makers so as to find alternatives through which financial services could be offered to the low income earning population or rather restructure the existing schemes for poverty reduction.

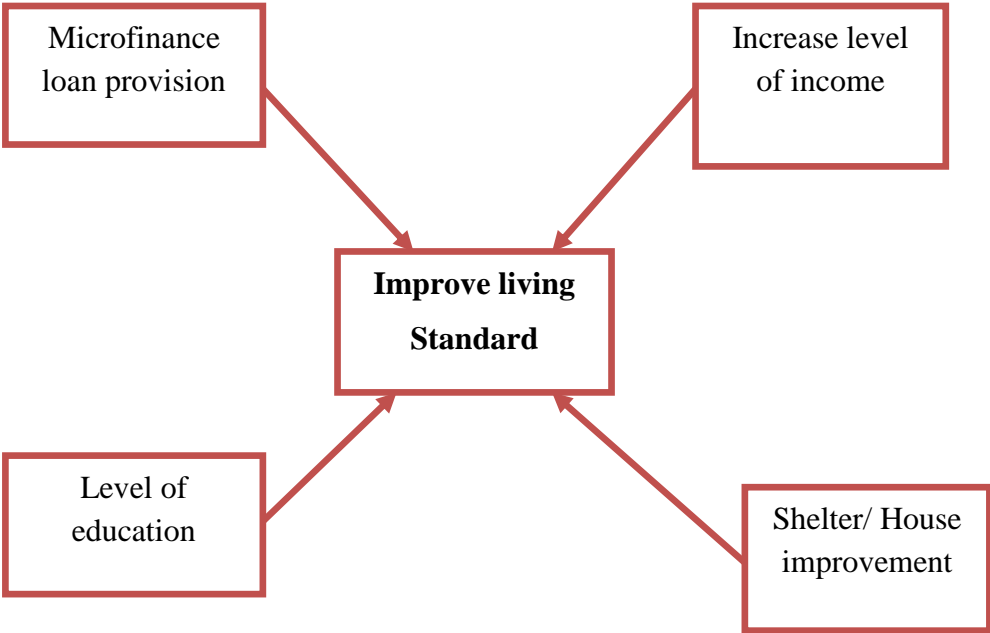
#### **2.4 Research Gap**

By considering the above empirical literature review its evident that a good number of similar research have been done, but there is no published documents that indicate that the same research have been done at Finca. Therefore the data t collected for this study the conclusion and recommendation covered the gape and provides strong suggestion for managements of the companies on the impact of microfinance industry on poverty reduction

#### **2.5 Conceptual Frame Work**

The study assumes that, there are dependant, and independent variables. The study assumes that, the dependet variable of the study is improvement in living stands. The study assumes living standards depend on; microofinace loans and level of income. Moreover, the study assumes that living standard depend on shelter/house improvement and level of education. These assumptions are summarized in Figure 2.1

**Figure 2. 1: Conceptual Framework**



**Source:** Researcher Construct, 2014

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The general objective of this chapter is to provide the description of the methods that applied in carrying out the research study, how data were collected and analyzed as well as the presentation of the data. It organized under the following sections: research design, study area, sample size, study population, sampling techniques, data collection methods, Data analysis procedure and presentation as well as validity and reliability issues.

#### **3.2 Research Design**

Research design is well understood as a logic plan of how to conduct a research (Kothari, 2004). This study used both a qualitative and quantitative research approaches. Both approaches used so as to complement each other and overcome the weaknesses of a single design, therefore enhance validity.

Qualitative research approach refers to all non-numeric data or data that have not been quantified and can be a product of all research strategies (Saunders and Thornhill, 2009). While Quantitative approach involves collection of quantifiable data which are normally in-terms of numbers, tables, charts and figures to mention a few. It is the approach which produces findings arrived at by means of statistical procedures or other means of quantification. One disadvantage of quantitative research is that the more structured data collecting approach may cause stress to the participants, thus not showing an accurate reflection of the true results, this disadvantage therefore overcome by using qualitative data collection which allows much flexibility to participants.

Therefore, a case study research design used in this study because the researcher intends to gain a deep and thorough understanding of the phenomena and because of its flexibility of the data collection methods. A case study design used because participants

wcome from a single case, also an experimental study design is not appropriate because there will be no random assignment of participants into control and treatment groups. Also case study is mostly associated to qualitative research method.

### **3.3 Area of the Study**

The Study conducted at FINCA Dar es salaam, FINCA is FINCA Tanzania works in Dar es Salaam and the coastal region, Morogoro, Dodoma, Ifakara, Iringa, Mbeya, Njombe, Mwanza, Mara, Shinyanga, Tabora, and Bukoba; it now covers about 40% of the country overall, including 65% in population centers.

The area is chosen because its familiar the researcher, relevant according to the nature of the study and most of the FINCA branches in Dar es salaam are located not far away from town, this minimize transportation cost.

### **3.4 Population of the Study**

According to Adam *et al.*, (2008) a population in research is the totality of the objects under investigation while a sample is a part of the population. Saunders *et al.*, (2007) suggests that population is the complete set of cases or group members while a sample are a subgroup or part of a larger population.

Since the current number of employees at FINCA is more that 1000 employees the study deliberately select respondents from the FINCA branches located in Dar es salaam, basing on education, age, gender and position from all levels of the branch due to the limitation of the study such inadequate time and financial constraints. The major classification was management and employees.

### **3.5 The Sample Size**

A sample is a small group or subject of the population which a study selects from the purpose of the study and from which generalization is made about the characteristics of the population (Saunders *et al.*, 2005).

The researcher included about three FINCA branches, where about 21 respondents were taken in each FINCA branch that gave a total of 63 respondents. The researcher acquires the total of about 63 respondents. Equal number of respondents was selected so that to avoid bias and the sample size was quota sampling to include all age and sex in the study

### **3.6 Sampling Techniques**

Purposive and stratified samplings were used as sampling techniques. Purposive sampling technique was used since the researcher deliberately selected the relevant respondents in order to save time and cost, and make sure that only relevant data was collected. Stratified sampling technique used since the researcher classified respondents basing on their positions mainly employees and management. In addition, stratified sampling technique was chosen because it makes the field interview more efficient, since the researcher can plan for interviews at each level in the workplace.

### **3.7 Data collection Methods**

The researcher used two methods of data collection, both the primary and the secondary data collection methods. For the primary data collection, the instruments used include questionnaires and interviews. Secondary data were obtained through text books, journals, research and other documents.

#### **3.7.1 Questionnaire**

A questionnaire refers to questions printed or typed in a definite order on a form or sets of forms, the respondents have to answer the questions on their own (Kothari, 2004).

The researcher prepared questionnaire, structured and unstructured questionnaires.

Questionnaires used in data collection, since they are very effective in collecting quantitative data. Also the questionnaires enabled the researcher to collect data from a relatively large sample. This method is chosen because wide data can be obtained and it limits bias on the side of the researcher. However, it also has disadvantages like low

response rate, misunderstanding of some questions, no opportunity to ask further questions by the researcher, which are challenges to validity.

### **3.7.2 Interview**

The interview method of collecting data involves presentation of oral-verbal stimuli and reply in terms of oral-verbal responses (Kothari, 2004). This involves verbal interaction between the researcher and respondent. The researcher prepared the interview guide questions in connection to research questions. The technique was used because, sample were control more effectively, more information and that too in greater depth can be obtained, also the technique associated with greater flexibility, therefore the researcher had the opportunity to restructure questions so as to reach the research objectives.

### **3.7.3 Documentary Analysis**

Secondary data collection involved Documentary review. A number of documents including official documents from FINCA, reports and seminar papers in relation with the problem were reviewed to supplement the primary data collected by the researcher. The method helped the researcher to understand the magnitude of the problem. Documents are important in research because bridges the information obtained from data collected through the use of other research methods such as questionnaires and interviews. Documentary review guide were used as an instrument during data collection from different documents.

### **3.8 Data Analysis procedure**

Data analyzed in accordance with the objectives of the study by using SPSS. Qualitative data will be collected and processed, Qualitative data refers to data representing qualitative phenomenon, example phenomena relating to or involving quality or kind. For instance, when investigating the reasons for human behaviour (Kothari, 2004). Data processing involved editing, coding, tabulation which were used as a key factor in whole

process of research. This was done in the area in order to make the research be accurate and effective as follows;

Editing was done immediately after receiving questionnaire from respondents. It involved correction of errors that might have appeared in the whole process of research writing. Also to help the researcher to translate and look for clarification on what respondents wrote about.

Coding was done in order to ensure whether the response categories were appropriately classified and exhausted to the problem under the study and arrange data collected according to group or classes they base on the basis of their common characteristics.

Tabulation was done to assemble data into concise and logical order. The researcher analyzed data collected qualitatively where words were used to explain findings and quantitative analysis where the data used numbers, computation of total and percentages, data analysis based on research objectives

### **3.9 Research Reliability and Validity**

The study focused on the validity of contents. This type of validity addresses how well the measures developed provides an adequate and representative sample of the potential respondents that might have a great influence on the quality of findings. In the case of reliability, the study focused on the stability of data collection methods particularly questionnaires that were administered at different times to the same respondents in order to determine consistency of the scores.

## **CHAPTER FOUR**

### **PRESENTATION AND DISCUSSION OF RESEARCH FINDINGS**

#### **4.1 Introduction**

This chapter contains presentation and discussion of the research finding. Presentation and discussion of the findings inline with the objectives of the study, the first section of the chapter gives indicators of living standards in Tanzania. Section two presents measures of microfinance growth in Tanzania. The last section of the chapter gives the impact of microfinance industrial average growth on the living standard in Tanzania

#### **4.2 Respondents Profile**

This section presents respondents profile; in terms of age, gender, level of education and occupation.

##### **4.2.1 Age of the Respondents'**

The study was interested to examine age of the respondents in order to identify the influence of age on microfinance practices. The study found age of the respondents contains different composition of all age groups as presented in Table 4.1. The study found majority of the respondents (52.4%) were aged between 18 to 24 years. The study found significant number of the respondents (31.7%) was aged between 25 to 34 years.

Also, the study found small number of the respondents (6.3%) was between 35 to 44 years old. Meanwhile, the study found small number of the respondents (6.3%) was aged between 45 to 55 years. Moreover, the study found unimportant number of the respondents (3.2%) were above 55 years. The study examines age of the respondents in order to identify the capability of the respondents. Furthermore, age of the respondents was used to examine the influence of age on microfinance practices

**Table 4. 1: Age of the Respondents'**

Option	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 18-24	33	52.4	52.4	52.4
25-34	20	31.7	31.7	84.1
35-44	4	6.3	6.3	90.5
45-55	4	6.3	6.3	96.8
55+	2	3.2	3.2	100.0
Total	63	100.0	100.0	

**Source:** Field Data, (2014)

#### **4.2.2 Gender of the Respondents'**

The study was interested to examine gender of the respondents in order to identify their influence on microfinance practices. The study found majority of the respondents were males. The study found out of 63 respondents, (63.5%) were males while minority of the respondents (40.8%) was female, as presented in Table 4.2.

**Table 4. 2: Gender of the Respondents'**

Option	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Male	40	63.5	63.5	63.5
Female	23	36.5	36.5	100.0
Total	63	100.0	100.0	

**Source:** Field Data, (2014)

#### **4.2.3 Level of Education of the Respondents'**

The study was interested to examine the level of education in order to examine its influence on microfinance practices. The study found the large number of the respondents (66.6%) had tertiary level of education this include diploma, first degree/advanced diploma, postgraduate diploma and masters. Also, the study found out of 63 respondents, 9 (14.3%) had primary education whereas (19.0%) of the respondents had secondary education. Table 4.3 presents respondents distribution by level of education. It's observed that, the large portion of the respondents (31.7%) identified had first degree/advanced diploma. The level of education is important in order to establish the influence of education on microfinance practices.

**Table 4. 3: Level of Education Attained by Respondents**

Option		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Primary School	9	14.3	14.3	14.3
	Secondary education	12	19.0	19.0	33.3
	Certificate	8	12.6	12.6	45.9
	Diploma	5	7.9	7.9	53.8
	First Degree	20	31.7	31.7	85.6
	Masters/Phd	9	14.3	14.3	100.0
	Total	63	100.0	100.0	

**Source:** Field Date, (2014)

#### **4.2.4 Occupation of the Respondents**

The study was interested to examine occupation of the respondents in order to identify respondent position. Respondents were asked to identify their positions, in their reply the study found majority of the respondents (66.7%) were FINCA clients. Also, the study found, minority of the respondents (33.3%) were FINCA officials, as presented in Table 4.4. This indicates required respondents participate in the study.

**Table 4. 4: Occupation of the Respondents**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid FINCAL Clients	42	66.7	66.7	66.7
FINCA officials	21	33.3	33.3	100.0
Total	63	100.0	100.0	

**Source:** Field Data, (2014)

### **4.3 Results for Research Objectives**

This section presents the findings of the study in line with the objectives of the study. The first part of this section provides establish indicators of living standards in Tanzania. Part two gives the measures of microfinance growth in Tanzania. The last section of the chapter gives the impact of microfinance industrial average growth on the living standard in Tanzania.

#### **4.3.1 Indicators of Living Standards in Tanzania**

The study was interested to examine indicators of living standard. The study conduct interview with microfinance oficals in order to examine indicators of living standard. During interview, the study found that, there are various indicators of living standard. The study found majority of the respondents (64.2%) identified level of income as a major indicator of living standard

The study found small number of the respondents (11.1%) identified expenditure is one of the indicators of living standard. Also, the study found important number of the respondents (24.7%) identified shelter as indicator of living standard

Meanwhile, the study was interested to identify the strategies needed to improve service provision in MFIs. The study found there are various strategies that can be used to improve MFIs service. The study found majority of the respondents (55.5%) identified that there is a need to improve service environment. This is similar to the study made by Diagne and Zeller, (2001), the study found despite general improvement in the policy environment for financial sector programs, the policy environment for microfinance in many countries remains unfavorable for sustainable growth in microfinance operations. For example, in Tanzania, the ceilings on interest rates limit the ability of MFIs to provide permanent access to an increasing segment of the excluded households.

**Table 4. 5: Strategies Needed to Improve Loan Provision**

Option		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Policy environment	35	55.5	55.5	55.5
	Build MFIs capacity	13	20.6	20.6	76.1
	Improve financial infrastructure	6	9.5	9.5	85.6
	Lower interest rate	5	7.9	7.9	93.5
	Use lease certificates	4	6.5	6.5	100.0
	Total	63	100.0	100.0	

**Source:** Field Data, (2014)

Results in Table 4.5 revealed that there are different strategies that can be used to improve service provision in MFIs. The study found significant number of respondents (7.9%) identified lowering interest rate could improve loans accessibility, this implies that the rate of interest rate in MFIs is high, also small number of respondents (6.5%) stated accepting lease certificates will improve loans accessibility, one of the interviewed respondent revealed that

*“All financial institutions including MFIs should accept lease certificates issued by municipal council as a collateral, were other financial institutions accepting lease certificates as a security for small business to take loans most of the small business owners we don’t have title deed*

*issued by the Ministry of Land but we have leasing certificates issued by municipal that implies we are the owners of the said land. Therefore I advice the FIs to accept lease certificates as it only accept title deed”*

Also the study found important number of the respondents (20.6%) identified that there is a need to building MFIs capacity. This relate to the study conducted by Ledgerwood, (1999), the study suggested that MFIs should strengthen its human resources and knowledge base through adjustments in the staff skill-mix of operational departments and offices, increasing awareness of and training staff to improve and expand their assistance to microfinance. MFIs should build capacity through improve awareness of staff involved in microfinance-related work at a general level, including managers of operational departments and offices in microfinance development issues; and thoroughly train staff involved in microfinance project processing and administration in various aspects of microfinance.

Moreover, the study found small number of the respondents (9.5%) suggested that there is a need to improve financial infrastructure. Randhawa and Gallardo, (2003) found inadequate financial infrastructure is a major problem facing MFIs. Financial infrastructure includes legal, information, and regulatory and supervisory systems for financial institutions and markets. Most of the governments have focused on creating institutions or special programs to disburse funds to the poor with little attention to building financial infrastructure that supports, strengthens, and ensures the sustainability of such institutions or programs and promotes participation of private sector institutions in microfinance.

#### **4.3.2 Measures of Microfinance Growth in Tanzania**

The study was interested to examine measures of microfinance growth in Tanzania. The study found there are various measures of microfinance growth in Tanzania. The study found the large number of the respondents (39.7%) identified that technology improvement will facilitate microfinance growth.

**Table 4. 6: Measures of Microfinance Growth in Tanzania**

Option		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Train employees	20	31.7	31.7	31.7
	Improve technology	25	39.7	39.7	71.4
	Lower interest rate	18	28.6	28.6	100.0
	Total	63	100.0	100.0	

**Source:** Field Data, (2014)

The study found that, small number of the respondents (28.6%) identified that, by lowering interest rate microfinance institution will increase covered, consequently this will facilitates the growth of microfinance in Tanzania. Also, the study found that, the large number of the respondents suggested that technology improvement can facilitates the growth of microfinance in Tanzania

Meanwhile, the study examines challenges facing Microfinance Institutions (MFIs). The study found majority of the respondents (60.3%) identified poor management as a major challenge facing MFIs. Table 4.4 presents challenges facing microfinance institutions

**Table 4. 7: Challenges facing Microfinance Institutions (MFIs)**

Option	Frequency	Percent	Valid Percent	Cumulative Percent
Valid				
Sources of Funding for MFIs	13	20.6	20.6	20.6
Business Competition	7	11.1	11.1	31.7
Poor Management Skills	38	60.3	60.3	92.0
Lack of Governance Corporation	2	3.2	3.2	95.2
Lack of Management Information Systems	3	4.8	4.8	100.0
Total	63	100.0	100.0	

Source: Field Data, 2014

Table 4.7 presents facing Microfinance Institutions (MFIs). The study found significant number of the respondents (20.6%) suggested that source of fund is a major challenge for most of the MFIs. This is similar to the study made by Diagne and Zeller, (2001), the study found that MFIs are facing challenges in acquiring foreign or external financing and most of them rely on domestic funding which is not easy to obtain. According to Fukumoto, (2004) structuring partnerships with commercial banks are a form of financing. It is essential to ensure that solid business principles prevails and that no one of a company's business will depend on an ongoing subsidy for its success, though start-up subsidies often help reduce the risk of experimentation, but dependence on subsidy and donors will lead to operational hiccups and failure. The dependency on subsidies as a source of funding for MFIs significantly reduces the chances of success.

Also, the study found small number of the respondents (11.1%) identified competition among MFIs is a major challenge facing most of the MFIs. Coleman, (1999) articulates that the more threatening competition to existing MFIs is not coming from informal moneylenders as in the past; but from private commercial banks and other regulated financial intermediaries. However, Jansson, (2001), went on to argue that increased competition is always welcome, because competition spurs technical efficiency; competition spurs improvements in the quality of outreach and in the variety of services offered. Competition spurs actions to reduce costs that, in turn, allow lower interest rates. This has clearly happened in Tanzania. Lamberte, (2001), backs up the need for increased competition because they believe that it encourages efficiency but it also increases risk. However, the drawback of competition is that it may force some MFIs out of the market.

Moreover, the study found that the large number of the respondents (60.3%) identified poor management skills as a major challenge facing most of the MFIs. This is similar to results obtained by Lehner, (2009), the study found that the major challenge facing most of the MFIs is poor management skills. According to Mosley and Hulme (2008) results indicate that management performance and skills are clearly associated with financial performance. Each of the four dimensions which includes leadership skills, technical skills, organizational and communication abilities provide better results for MFIs performance.

The study found small number of the respondents (3.2%) suggested lack of Government Corporation as a major as a major challenge facing MFIs. Nangia and Vaillancourt, (2006), ascertain that the emergence of structural problems has emphasized the importance of MFIs management and governance. Indeed the MFIs community has experienced major failures, for which inadequacy of government and management is to blame. Good corporate governance can improve firm performance and help assure long-

term survival (Robinson, 2001). The issue of corporate governance has therefore been of increasing interest for microfinance as it is today considered to be one of the weakest area in the industry (Robinson, 2001).

Furthermore, the study found lack of management information system as a major challenge facing most of the MFIs. MFIs usually operate in remote and rural areas and therefore, employees are predominantly not well educated. Further, MFIs have low budgets, making it difficult to build and operate Management Information Systems (MIS) that can have a positive impact. The major challenges such firms face are that MFIs are significantly different from commercial banks, existence of infrastructure issues in implementing MIS in MFIs, lack of Information and Technology (IT) support in MIS , lack of organized training in IT for the MFI employees and lack of standardization in procedures in the MIS (Nangia and Vaillancourt, 2006).

Meanwhile, the study was interested to identify hindrances pertaining to MFIs practice. Respondents were asked to identify hindrances pertaining to MFIs practice, in the reply the study found that majority of the respondents (57.1%) revealed that laws and regulations as a major hindrances, as presented in Table 4.8

**Table 4. 8: Hindrances Pertaining MFIs Practice**

Option	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Laws and regulations	36	57.1	57.1	57.1
Budgetary limitation	5	7.9	7.9	65.0
Lack of expert	4	6.3	6.3	71.3
Technology	16	25.4	25.4	96.7
Lack government support	2	3.2	3.2	100.0
Total	63	100.0	100.0	

**Source:** Field Data, 2014

Table 4.8 show hindrances pertaining MFIs, the study found majority of the respondents (57.1%) identified laws and regulations. This is similar to the study made by Robinson, (2001), the study found some laws and regulations cause unavailability of collateral to poor people. Lack of collateral especially immovable collateral affect the rate of loan provision in financial institutions, this is similar to responses obtained during interview, one of the loan officer revealed that

*“Most of the poor people have no immovable collaterals, thus fails to obtaining sufficient loans, we are processing loans to small business owners by considering movable collaterals such as Television,*

*Refrigerators and other items. This is the challenge for financial institutions because these properties are movable, therefore need careful monitoring”.*

Also, the study found small number of respondents (3.1%) identified lack of government support as a major factor hinder MFIs practices in provision of financial services to women entrepreneurs. Moreover, the study found significant number of the respondents (25.4%) identified lack of technology as a hindrance affects MFIs operations. The study found small number of the respondents (6.3%) and (7.9%) identified lack of experts and budget limitation respectively.

#### **4.3.3 Other Factors Influencing the Living Standard in Tanzania**

The study was interested to examine other factors influencing the living standard in Tanzania. The study found that, majority of the respondents identified level of education as a factor influencing the living standard.

**Table 4. 9: Factors Influencing the Living Standard in Tanzania**

Option	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Consumption rate	17	30.0	30.0	30.0
Level of education	46	73.0	73.0	100.0
Total	63	100.0	100.0	

**Source:** Field Data, 2014

Table 4.9 presents other factors influencing the living standard in Tanzania. The study found that, small number of the respondents identified (30.0%) identified consumption rate. This indicates that, there are various factors influencing the living standard in Tanzania.

#### 4.3.4 The Impact of Microfinance Industrial Average Growth

The study examines the impact of microfinance industrial average growth on the living standard in Tanzania. The study found microfinance institutions play different role in poverty reduction. The study found significant number of the respondents (15.9%) identified that microfinance institution facilitate capital accessibility to poor people, as presented in Figure 4.7

**Table 4. 10: The Role of Microfinance Institutions in Poverty Reduction**

Option	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Create employment	27	42.8	42.8	42.8
Economic growth	23	36.5	36.5	79.3
Capital availability	10	15.9	15.9	95.2
Saving	3	4.8	4.8	100.0
Total	63	100.0	100.0	

**Source:** Field Data, 2014.

Table 4.10 presents the impact of microfinance industrial average growth on the living standard in Tanzania. The study found the large number of the respondents (42.8%) identified MFIs create employment. This is similar to the study made by Appiah *et al.*, (2008) the study found microfinance play an important role in poverty alleviation through job creation by supporting micro and small business.

Also, the study found small number of the respondents (4.8%) identified microfinance institutions encourage saving. This is similar to the study made by Fukumoto, (2004) the study found that microcredit has been viewed as a help in alleviating poverty, there is a growing trend in microfinance that views savings as a way to help poor people decrease risks and expenses associated with borrowing. Jansson, (2001) shown that poor people can and do save if they are given appropriate opportunities and incentives. Savings can help them accumulate assets which could be used for business and household purposes while also earning interest on savings. Savings deposits also provide capital formation for microfinance institutions thereby enabling them to grow and expand so as to better serve their communities.

Moreover, the study found significant number of the respondents (36.5%) identified microfinance facilitates economic growth. Armendariz *et al.*, (2005) found microfinance are generally able to finance productive ventures immediately, thereby improve their economic circumstances without incurring unnecessary debts. Microfinance make access to required capital for those with limited resource available option.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter gives summary, conclusion and recommendations of the study. The first section of the chapter gives summary of the study while conclusion is discussed in second section. The last section of the chapter gives areas for further studies.

#### **5.2 Summary of the Study**

The study on the impact of microfinance industry on poverty reduction was conducted at FINCA, Dar es Salaam. The objectives of the study were; to establish indicators of living standards in Tanzania; to determine the measures of microfinance growth in Tanzania; to establish other factors influencing the living standard in Tanzania and to determine the impact of microfinance industrial average growth on the living standard in Tanzania

A case study design was used whereas a sample of 63 respondents was involved. In collecting primary data the study used questionnaire and interview. Secondary data were collected through documentary analysis. Data was analyzed by using SPSS, tables and figures were used to present data.

The study found majority of the respondents (64.2%) identified level of income as a major indicator of living standard. Also, the study found the large number of the respondents (39.2%) identified that technology improvement facilitates microfinance growth. Moreover, the study found majority of the respondents (55.2%) identified that there is a need to improve service environment.

The study concluded that microfinance institution play significance role in poverty reduction through; job creation and saving. Poor people can and do save if they are given appropriate opportunities and incentives. Savings can help them accumulate

assets which could be used for business and household purposes while also earning interest on savings. Also, the study concluded that there are a number of challenges facing MFIs. These include; inadequate sources of funding for MFIs, competition, poor management skills and lack of governance corporation. The study recommended that in order to create a good management staff MFIs need to strategically deal with challenges of business e.g. defining job roles, hiring and training, monitoring employee performance, inculcating an appropriate culture to motivate staff

### **5.3 Conclusion**

The study concluded that microfinance institution play significance role in poverty reduction and improving living standard through; job creation and saving. Poor people can and do save if they are given appropriate opportunities and incentives. Savings can help them accumulate assets which could be used for business and household purposes while also earning interest on savings. Also, the study concluded that there are a number of challenges facing MFIs. These include; inadequate sources of funding for MFIs, competition, poor management skills and lack of governance corporation. To a large extent MFIs operation in Tanzania has brought about positive changes in the standard of living of people who access their services. Although some of the clients have not benefited, most MFIs clients have benefited positively. Despite the achievements of MFIs clients, most of them complained that, the interest rates charged by MFIs were very high. Microfinance has proven to be an effective and powerful tool for poverty reduction. Like many other development tools, however, it has insufficiently penetrated the poorer strata of society. The poorest form the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to microfinance. While there is no question that the poorest can benefit from primary health care and from basic education, it is not as intuitive that they can also benefit from microfinance, or that microfinance is an appropriate tool by which to reach the Millennium goals.

#### **5.4 Recommendations**

MFIs have the capacity to access funds from commercial banks and they need to perfect their service delivery methods and product design to respond to the demands of their market in a rapid and efficient way, ensuring an increased volume of operations and repeat borrowing. Any donor support should encourage this additional financing and early diversification of funding sources. As banks might soon be able to provide short-term finance, donors could complement such funding during this period where there is no liquidity in the banking system with medium and long-term lines of credit. MFIs should also try to access international/ foreign funds which could be cheaper than domestic funding and also to coordinate personal funds into proper use to avoid shortage of funds. Capital markets may also work in increasing self sufficiency of MFIs.

Micro finance institutions should support their initiatives with small loans. This is true because well established and sustainable micro and small enterprises in many societies contribute to the growth of national income, more employment opportunities, better standard of living and hence to the reduction of poverty.

In order to create a good management staff MFIs need to strategically deal with challenges of business e.g. defining job roles, hiring and training, monitoring employee performance, inculcating an appropriate culture to motivate staff. Thus, to a significant extent, the keys to effective MFI management are universal to business. MFIs should also use a recruitment policy or pure academic qualifications in recruiting management personnel.

The interest rate should be lowered to a level that would cover MFIs' operating expenses and at the same time facilitate the growth of their clients' business.

MFIs should consider the possibility of increasing the grace period and reducing the frequency of repayment so as to provide for clients with long term loans turn to businesses such as farming.

MFIs should restructure their training contents to include improving their clients' business skills. They should organize regular business training for their clients and qualified training institutions should conduct this.

Financial sector should also be integral to the poverty reduction efforts. Management and operational lessons learnt from successful MFIs can provide valuable inputs into the design of specialized financial institutions for SMEs and the agricultural sector.

Banks should convert and build up professional system into social banking system for the poor. The Government should also provide support for capacity building initiatives and ensure transparency and enhanced credibility through disclosures.

The government should arrange enabling environment for the microfinance programme by ensuring political stability, a stable macro-economic environment and low inflation rates. In order to have a sustainable microfinance intervention, the government should also keep infrastructures in place that link more remote areas to market.

Microfinance program funding should be allocated directly to programs that target the poorest. This percentage should increase over the next five years until the poorest are receiving a percentage that is proportional to their representation in the population. Targeting should be done through the use of recognized poverty assessment/wealth ranking tools. Financial institutions should service the needs of the disabled, (aged) or infirm (it would be unreasonable to expect the to meet all social welfare needs), rather, it is to point out that explicit and implicit claims that such programmes reach the 'poorest of the poor' need to be tempered.

MFIs should promote saving before they issue loans it promotes discipline and provides some of the capital necessary to finance the loan portfolio. Open-access savings facilities also provide an important service to risk-averse poor and will result in the MFI attracting a larger number of better satisfied clients.

### **5.5 Areas for Further Studies**

Impending studies should assess whether MFIs direct their services to the poor population and micro and small businesses (particularly in rural areas) and whether conditions and procedures for credit favour these target groups. Also, there is a need for future studies to investigate whether the customers reached by these schemes improved their general performance in terms of growth, creation of employment and generation of income. Moreover, future studies should identify percentage of clients who received technical services from specified MFIs

## REFERENCES

- Amin, A. (2002). *An Examination of the Sources of Economic Growth in Cameroon*, AERC Research paper No. 116, Nairobi
- Appiah, K. Turkson, J. and Hagan, P. (2008), *The Role of Micro Financial Institutions in Ghana: The Small and Medium Enterprise Perspective*, Kwame Nkrumah University, Ghana
- Armendariz, D. Beatriz, A and Morduch, J. (2005), *The Economics of Microfinance*. The MIT Press, Cambridge Massachusetts
- Buckley, G. (1997) *Microfinance in Africa: Is it either a Problem or the Solution?* World Development, Vol. 25 No 7, pp 1081-1093.
- Coleman, B. (1999) *The Impact of Group Lending in North East Thailand*, Journal of Development Economics, Vol 60, pp105-141.
- Diagne, A and Zeller, M. (2001) *Access to Credit and its Impacts in Malawi*, Research Report No.116 Washington DC, USA: International Food Policy. (IFPRI).
- Fukumoto, M. (2004) *Development Policies for Small and Medium Enterprises in APEC-In the case of the Philippines*, APEC Study Center Institute of Developing Economies
- Heidhues, F. (1995) *Rural Finance Markets-An Important Tool to Fight Poverty*, Quarterly Journal of International Agriculture Vol.34 No.2, pp 105-108.
- Jansson, T (2001), *Microfinance: From Village to Wall Street*, Inter-American Development Bank.
- Kessy, S.S. and Urio, F. (2006) *The Contribution of Microfinance Institutions to Poverty Reduction in Tanzania*. REPOA, Mkukina Nyota Publishers, Dar es Salaam

- Kuzilwa, J. A. (2002) *The Role of Credit for Small Business Success: A Study of the National Entrepreneurship Development Fund in Tanzania* A Paper Presented at the 6th Annual International Conference on Entrepreneurship and Small Business Development (ICAESB), White Sand Hotel, Dar es Salaam.
- Kothari, C. (2004). *Research Methodology: Methods and Techniques*, New Age, New Delhi, International (P) Ltd
- Lamberte, M. (2001), *Expanding Banking Services to Micro, Small, and Medium Enterprises and Poor Households in the Philippines*. PIDS Discussion Paper Series, Makati City, Philippines
- Ledgerwood, J. (1999), *Microfinance handbook: An institutional and financial perspective*, Washington, D.C World Bank
- Lehner, M. (2009). *Governance and the Efficiency of Economic Systems (GESY): Group Lending Versus Individual Lending in Microfinance*
- Morduch, J. (1999) *The Microfinance Promise*, Journal of Economic Literature , vol. 37(4): 1569–614.
- Mosley, P. and D. Hulme (2008) *Microenterprise Finance: Is there a trade off between growth and poverty alleviation*, PRUS working paper No 3.
- Nangia, R. and Vaillancourt, L. (2006), *Small and Medium Enterprise*, International Finance Corporation
- Navajas S., Conning J., Gonzalez-Vega C., (2003), *Lending Technologies, competition and Consolidation in the Markets for Microfinance in Bolivia*, Journal of Institutional Development 15,747-770

- Ngehnevu, C. and Nembo, F. (2010), *The Impact of Microfinance Institutions (MFIs) in the Development of Small and Medium Size Businesses (SMEs) in Cameroon*, Swedish University of Agricultural Sciences
- Olomi, D. Mori, N. Mduma, E. and Urassa, G. (2008), *Constraints to Access to Capital by Tanzanian SMEs*, Dar es Salaam: REPOA
- Randhawa, B. and Gallardo, J. (2003), *Microfinance Regulation in Tanzania: Implications for Development and Performance of the Industry*, Africa Region Working Paper Series No. 51
- Richard A. and Mori, C. (2011) *SMEs Access to Micro Financial Services for Economic Developments: Tanzanian bankers' eye*
- Robinson, M. (2001), *The Microfinance Revolution. Sustainable Finance for the Poor*, The World Bank
- Rweyemamu D.C. Kimaro M.P. and Urassa O. M. (2003) *Assessing Micro-Finance Services in Agricultural Sector Development: A Case Study of Semi-Formal Financial Institutions in Tanzania* Economic and Social Research Foundation.
- Saunders, M. and Thornhill, A (2009) *Research Method for Business Students*. Pearson education limited Harlow England
- URT, (2002), *Small and Medium Enterprise Development Policy*, Government printer, Dar es salaam

## APPENDICES

### Appendix I: Questionnaire

My name is **John Mboma**. I do research on “**The Impact of Microfinance Industry on Poverty Reduction: a Case of FINCA**”. Your participation on answering this question could make my research be effective and complete. Your name is not needed in this research. Therefore by so doing I request your attention to read and answer these question effectively.

Please I request your attention and respond to the questions bellow so as to facilitate my research.

Please put (√) mark in the correct answer and fill the blanks

#### 1. Age

a) 15 – 24 [      ]

b) 25 – 34 [      ]

c) 35 – 44 [      ]

d) 55+      [      ]

#### 2. Gender

a) Male      [      ]

b) Female [      ]

#### 3. Occupation

a) FINCA client      [      ]

b) FINCA official      [      ]

4. Level of education

- a) Primary school [     ]
- b) Secondary school [     ]
- c) Certificate [     ]
- d) Diploma [     ]
- e) First Degree [     ]
- f) Masters/Phd [     ]

5. What are indicators of living standards in Tanzania?

- a) Level of income [     ]
- b) Expenditure [     ]
- c) Shelter/house [     ]

6. What are other indicators of living standards in Tanzania?

.....

.....

.....

7. What are the impact of microfinance industrial average growth on the living standard in Tanzania?

- a) Create employment [     ]
- b) Encourage Saving [     ]
- c) Facilitate economic development [     ]
- d) Facilitate capital availability [     ]

8. What are other roles of microfinance institutions in poverty reduction? Please mention

.....  
.....  
.....

9. What are the challenges facing Microfinance Institutions (MFIs) in services provision?

- a) Sources of Funding for MFIs [     ]
- b) Business Competition [     ]
- c) Poor Management Skills [     ]
- d) Lack of Governance Corporation [     ]
- e) Lack of Management Information Systems [     ]

8. Identified other challenges facing Microfinance Institutions (MFIs) Please mention

.....  
.....  
.....

9. What are hindrances partnering MFIs practices

- a) Budgetary limitation [     ]
- b) Law and regulations [     ]
- c) Lack of government support [     ]

10. What are other hindrances partnering MFIs practices

.....  
.....  
.....

11. What are the strategies that can enhance service provision in MFIs?

- a) Lower interest rate [     ]
- b) Build microfinance capacity [     ]
- c) Improve financial infrastructure[     ]
- d) Improve policy environment [     ]

12. What are other strategies that can enhance service provision in MFIs? Please mention

.....  
.....  
.....

## **Appendix II: Interview Guide**

1. What are the indicators of living standards in Tanzania?
2. To what extent microfinance grow in Tanzania?
3. What is other factors influencing the living standard in Tanzania?
4. What are the impacts of microfinance industrial average growth on the living standard in Tanzania?