

**Interdepartmental Project on the Urban Informal Sector**

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**DAR ES SALAAM SEMINAR, 23 - 24 MAY, 1995**

**DISCUSSION PAPER NO. 1**

**FINANCIAL SERVICES**

**Michiel Bastiaenen**  
**Enterprise and Cooperative Development Department**



**International Labour Office Geneva**

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*Note: The Discussion Papers are preliminary documents circulated informally in a limited number of copies mainly to stimulate discussion and to obtain critical comments.*

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## **1. SUMMARY OF FINDINGS**

### **1.1 FINANCIAL NEEDS IN THE SELECTED CLUSTER AREAS**

The report of the inception mission of the INTERDEP project on the Informal Sector identified improved access to credit as one of the three major areas of concern of Informal Sector operators. This would thus imply that financial needs among informal sector units are prominent and that the access to credit by IS operators in Dar Es Salaam is inadequate. This assessment is confirmed by the UNDP Umbrella Programme for Microenterprise Credit Organizations, which refers to the outcome of the 1991 Informal Sector Survey, when stating that the unavailability of capital and credit can be considered as one of the major problems of IS operators to establish and run their enterprises.

To verify the degree and characteristics of financial needs among Dar Es Salaam informal sector workers, the mission conducted a number of visits to different Informal Sector Workers Cooperative Societies in each of the three districts of Dar Es Salaam. Societies visited were the Vusha Fisheries Cooperative Society and the DASICO Cooperative Society in the Ilala District, the Upendo Cooperative Society of Mwenge and Mwananyamala Food and vegetable Supplies Cooperative Society in the Kinondoni District and the Cassana Industrial Cooperative Society, Masoko Madono Savings and Credit Cooperative Society and manufacturing groups in the Mwisho area of the Temeke District.

Most of the visited units consist of just one self employed worker, though within some of the Societies small groups of operators work together to share boats, sheds, machines and orders. The clusters visited consist of manufacturing and trade units and are specialized by sector. Manufacturing is the predominant activity, concentrating on metal works, welding, carpentry, carving and paper bag making. Sub-sectors among trade units operating in the cluster areas are vegetables, fruit, fish, textiles and other non-food items. An important characteristic of the units found in the clusters is the high proportion of units operated by men. Only the Mwananyamala Cooperative Society has significant female membership, but even here they represent only 10% of total membership (40 out of 404). This low representation of women is clearly a disadvantage, when it comes to the promotion of savings and credit schemes.

In practically all areas visited the lack of credit for the purchase of merchandise, raw materials, tools and machines was mentioned as one of the major problems in the development of the businesses. In a few cases finance was required for more substantial investments, generally for assets to be used by groups or the entire Society (fishing boats, construction of Cooperative building, multipurpose machines for groups of carpenters).

It was observed that operators often have difficulties in assessing their capital needs in relation to what their business could absorb and what they reasonably could pay back. Nonetheless, typical loan requirements of manufacturing units can be assessed as being in the range of Sh. 40,000 to 100,000 for working capital and tools and Sh. 150,000 for machines. The need of credit for the purchase of raw materials in bulk was also mentioned, which would require larger investments, but this could be resolved by the pooling of smaller individual loans. Lack of organization seems to be often the bottleneck in joint activities. Traders referred to the existence of short term loans among operators of the same trade, but said that these arrangements are complicated and therefore less attractive than formal credit.

Few of the interviewed operators said to have savings, for their income does not allow to save. However, some further questioning revealed that savings could be generated, if savings would be the condition for access to credit. Savings capacity thus exists, but is small among other reasons due to the contribution of 7-10% of daily sales to the cooperative society for services provided. None of the operators interviewed ever received a bank loan.

In general terms, the potential for savings and credit schemes is good. Savings capacity exists and in some of the cluster areas operators are already working in small groups of similar trade. The concentration of operators is very high, which facilitates the diffusion and exchange of information and thus the scope for promotion, organization and training activities. The membership of Cooperative Societies is for informal sector operators practically the only way to obtain title deed and secure the premises. These objectives enhance social integration and control and facilitate systems based on peer pressure. The low proportion of women operators in the cluster areas is to be considered as a handicap for the promotion of savings and credit schemes and would require more stringent forms of monitoring and contract enforcement.

## **1.2 FINANCIAL SECTOR REFORM**

The pre-reform financial system in Tanzania was characterized by clear repressive features. All major financial institutions were either partially or entirely owned by the government and state bank management was under direct government control. Likewise, credit allocation and interest rate fixation were dictated by the government and the regulatory framework was practically non-existing. Each financial institution was guided by its own establishment act, in line with their specifically assigned sectoral or geographical role.

In this environment, the performance of formal financial institutions in terms of resource mobilization, credit operations, quality of service and profitability remained extremely poor. The mis-direction of credit to the public sector, insolvent parastatals and cooperatives resulted in portfolios affected by a high proportion of non-performing loans. As an indication, by the end of 1991 about 94% of the portfolio of the state owned National Bank of Commerce, which in 1992 still accounted for 85% of the national market for loans and deposits, consisted of loans considered to be sub-standard, doubtful or rated as loss.

To enhance financial sector reform a number of financial liberalization measures have been taken since 1986. These include the removal of interest rate ceilings, the introduction of indirect instruments of monetary control, increasing competition by granting more bank licenses, permitting the entry of private domestic and foreign banks, the minimization of credit allocation directives and the restructuring, rationalization and recapitalization of formal financial institutions. However, the reform process has been slow and has so far only reversed some elements of the wrong policies.

The Bank of Tanzania is in the process of strengthening its banking Supervision directorate and reviewing the Central Banking Act. It has limited its role to that of regulator and supervisor.

## **1.3 FORMAL FINANCIAL SECTOR INSTITUTIONS**

### **1.3.1 STRUCTURE OF THE FORMAL FINANCIAL SECTOR**

Until 1993 the formal financial sector in Tanzania consisted of only 15 institutions, of which 3 commercial banks (NBC, CRDB, and People's Bank of Zanzibar), 3 thrift institutions (THB, TPB, DJIT), 2 contractual savings institutions (NPF, PPF), 2 development finance institutions (TIB, TDFL), 2 insurance companies (NIC, ZIC), 1 hire purchase company and the Bank of Tanzania. In 1993 two new private commercial banks started business operations, the Standard Chartered and the Meridien BIAO Bank, as well as a Venture Capital Fund for small and medium enterprises promoted by USAID and managed by Equity Investment Management (EIM). A number of foreign banks are presently in the process of obtaining license to start operations in Tanzania.

### 1.3.2 SCOPE FOR FORMAL FINANCIAL SECTOR SERVICES TO THE INFORMAL SECTOR

Though there is evidence that the government is gradually reducing its pressure on commercial banks to lend to the public sector, the private borrowers still account for only 20% of the total loan portfolio. Smallholder farmers and small and micro enterprises are still practically excluded from access to formal financial sector lending.

Banks with a history of lending to the informal sector are the National Bank of Commerce (NBC), the Co-operative and Rural Development Bank (CRDB) and the Tanzanian Investment Bank (women groups). The NBC has been extending limited credit to small scale registered enterprises since 1984 under its microenterprise support programme, but the impact of this scheme has been very limited. The bank, which has a small enterprises department and a special women section, started in 1991 uncollateralized lending to informal sector units, but due to low repayment rates this programme was shelved.

Recently, the NBC has also been involved in a number of targeted schemes funded by international donors. These experiences, such as the ILO-RYTE project, show that the bank prefers to assume the role of mere administrator and that it has been lax in loan monitoring and collection. Though the NBC has decentralized its procedures for loan approval in small scale lending schemes, there are no signs that the bank is interested to adapt its other procedures to the specific requirements of small scale operators. Like other state owned banks, the high proportion of outstanding debts and liquidity problems have forced the NBC to restructure its portfolio. Applying stricter rules of risk management, the bank is presently not committed in lending to informal sector units using the bank's own resources.

Like the NBC, the CRDB has been involved in special projects for mainly rural informal sector credit. Presently the CRDB is going through the restructuring of its portfolio to solve the severe liquidity problems it is facing. There are hopes that the bank will be able to meet DANIDA's deadline of October 1994 for recapitalization through the sale of shares to cooperatives, in which case DANIDA will take a 30% stake in the bank. Of all the banks, the CRDB seems to be the one most open to working with small borrowers. The bank has a window for special projects and is willing to administer donor funds under that window. It has furthermore a flexible attitude towards alternative lending mechanisms (solidarity groups etc). However, given its precarious position, it strictly applies collateral requirements under its regular lending programme and is presently not ready to share any risks nor commit itself to any leverage of donor funds. In spite of these constraints, the SNV-FAIDA programme has opted for collaboration with the CRDB in the context of its Small Enterprise Promotion Programme in the Arusha Region.

### 1.3.3 FRAGMENTATION OF FINANCIAL MARKETS

On the basis of the earlier observations it may be concluded that the on-going financial sector reforms will keep the formal financial sector for at least the coming years away from lending to the informal sector. The newly established private banks in Tanzania still have to build up a branch network and show for the time being no interest in small scale lending. The only remaining option is to involve banks in the administration of donor Funds targeted at informal sector units. However, as long as the institutions restrict their involvement to pure administration of donor funds and do not accept any risk sharing, there is little hope that such involvement may lead to downgrading of financial services to small borrowers. The promotion of guarantee mechanisms as one means of persuading formal financial institutions to lend to borrowers without bankable collateral would have little meaning under these circumstances.

In a recent study, Bagatchwa argues that the fragmentation between the formal and informal financial institutions in Tanzania can not only be explained in terms of government induced financial repression. The coexistence of formal and informal financial institutions reflects the fact that the two systems face different prices, offer differentiated services and serve different market segments. According to the author, this implies that the various financial market segments may in fact be representing efficient specialization for different niches suggesting a need for selective systems rather than the extension of

the formal financial sector's frontier. This seems to point to the need for promoting and supporting informal financial institutions and specialized financial intermediaries, which are better tuned to the needs and requirements of informal sector units and which can deliver small scale services in a more cost-effective way.

#### **1.4 INFORMAL AND SEMI-FORMAL FINANCIAL INSTITUTIONS**

##### **1.4.1 URBAN INFORMAL FINANCIAL INSTITUTIONS**

Results of a study carried out by Bagachwa on the informal financial sector in Tanzania, reveals that in urban areas Rotating Savings and Credit Associations and Savings and Credit Societies are the principle informal financial institutions. While own savings and relatives and friends are the principal sources of start up capital of informal sector enterprises, the role of informal financial sector institutions in the supply of financial services seems to be increasing, in spite of financial sector liberalization. This is reflected by an increasing number of loan applications and approvals handled by IFI's surveyed during the period 1990-92 as well as fast growth in deposits received by these institutions. An important finding of the study is that these institutions can operate with much lower transaction costs due to low cost screening methods and monitoring mechanisms and the absence of a need to enforce contracts due to low default rates.

Most of the existing urban based savings and credit societies are made up by permanent employees of formal sector organisations. Urban based Savings and Credit Societies are generally limited to government workers. An exceptional case is a 20 year old SACCO of small market traders in the Temeke district. This Cooperative of 113 members has been functioning both as a normal cooperative and as a savings and credit Cooperative. The savings and credit activities have suffered due to the mismanagement of funds in two opportunities. SIDO-GTZ is providing support to the SACCO in its financial management.

The Savings and Credit Co-operative Union League of Tanzania Limited (SCCULT) exists since 1992 as an independent Apex organisation of Savings and Credit Cooperative Societies. After having existed as the Savings and Credit Cooperative Union its predecessor, the national association called the Savings and credit Union League of Tanganyika represented SACCOS during the period 1964-1975. Between 1976 and 1992, all SACCOS came under the umbrella of the Savings and Credit Department of the Cooperative Union of Tanzania. In 1991, the Cooperative societies act again allowed for separate entities apart from the government. In 1993 SCCULT had 994 affiliated savings and credit societies, of which 470 are urban societies and 524 are rural societies with a total membership of close to 180,000. SACCOS are invited to join SCCULT, since membership is not compulsory as it was before 1992. The organization will provide services in the areas of promotion, education/training, auditing, management advice and representation, but lacks right now the means to provide adequate services to its members. The organization has one Head Office with three Departments (Finance, Training and Women's Development) and ten zonal offices with one officer each. The League is also setting up a Central Finance Facility for its members which would collect savings and provide loans to member organizations. Only 207 of the 994 societies were said to have contributed to the Facility, thus raising only Tsh. 2.07 million (US\$ 4,140) or 20% of the expected contributions. The SCCULT has the potential to play an important role as the provider of financial services to SACCOS, including those created by microentrepreneurs and small traders. However, finding itself in the transition phase from a Government controlled organization towards an independent Apex organization it will need support to set up a system of adequate services.

## 1.4.2 INFORMAL FINANCIAL INSTITUTIONS IN THE CLUSTER AREAS

### 1.4.2.1 Rotating Savings and Credit Associations (ROSCAS)

Self-help initiatives to solve the problem of finance have existed or are emerging in the selected cluster areas. Rotating Savings and Credit Associations (Upatu system) have been operating in only a few of the areas, but seem to emerge and go down in time. They were said to be organized mainly by women and serve basically for consumption purposes. Since most of the units in the clusters are run by men, ROSCAS are not very prominent in the project area.

### 1.4.2.2 Accumulating Savings and Credit Associations

Accumulating savings and credit associations also exist in some areas. The SIDO-GTZ project is assisting members of several of the Cooperative societies in the cluster areas in the creation of such associations. In Vusha and Cassana such schemes are already operating, though they are still in their initial stage of savings mobilization. In Mwenge the idea has already been discussed, while also in Mwanananyamala there may be scope for such associations. As these initiatives are recent, little can be said of their possible impact.

## 1.4.3 MICROENTERPRISE CREDIT SCHEMES

A relatively small number of credit programmes and schemes in support of microenterprises are being implemented by either NGOs or financial institutions in Dar Es Salaam. The outreach of these schemes is still very limited. A study of the major schemes operating in Tanzania, carried out by the UNDP for the purpose of its Umbrella Credit Programme for Microenterprise credit organizations, indicates that their total portfolio in 1993 amounted to around US\$ 1.2 million. Though the figures were not complete, they clearly indicate that microenterprise lending is still in its infant stage and there is an urgent need for expansion of these type of programmes. Apart from their limited scope, most of the programmes are still struggling with high operational costs and low rates of repayment.

In Dar Es Salaam major actors have been ILO-TYDEF, PTFSR and SIDO. Newcomers are Poverty Africa and PRIDE Africa, which intends to open branches in Dar es Salaam in the near future. The Umbrella Credit Programme for Microenterprise Credit Organizations, to be executed under the National Income Generating Programme, intends to support a selection of existing NGOs to become sustainable financial intermediaries for microenterprise credit. The US\$ 5 million umbrella programme will have a duration of five years and a targeted output of 12,000 loans to microenterprises, 20 organizations operating with increased efficiency, expanded services and a total of 200 staff persons trained. The programme may be expected to have an important long term impact on the microenterprise credit supply, even though the immediate effect will be limited. One constraint it will probably face, is that it intends to support organizations, which in their majority are following an integrated approach and would have to go through thorough reorganization in order to reach the sustainability targets which the Programme sets as a condition for support.

Most of the existing and recently established credit institutions concentrate on short term loans for working capital. Only SIDO concentrates on term loans (2-8 years) by means of three different Hire Purchase schemes (Rural, Urban and Micro project H-P). Up to 1992, in the Dar Es Salaam region 192 units were supported under the RHP scheme and 68 units under the MPHP scheme. No information could be gathered on the outreach of these schemes among urban informal sector units.

## 1.5 SCOPE FOR SPECIAL INFORMAL SECTOR FINANCE INSTITUTIONS

The Banking and Financial Institutions Act and associated policy and procedural guidelines on licensing of 1991 did not leave much scope for the creation of Specialized Informal Sector Finance Institutions, as it was mainly drafted with nationwide formal banks in mind (see Keddie 1992). One of the major



thresholds for the establishment of small full service banks was the minimum core capital requirement, which were fixed at Tsh. 1 billion (US\$ 2 million) for banks and Tsh. 500 million (US\$ 1 million) for other financial institutions.

Recent amendments on the Act, which are presently passing through parliament, are addressing this constraint by introducing distinct requirements for the establishment of Rural Community Banks, which can only operate at the District level. Major features and requirements for establishment of these District Banks are the following (based on a brochure and manual issued by the BOT Rural Finance Directorate):

- A Rural Community Bank (RCB) is defined as a private unit bank organized by members of a community for the prime purpose of mobilizing savings and transforming these savings for on-lending within the community.
- Any individual or society or organization may buy equity shares in a RCB not exceeding 5 % of the total share capital.
- A RCB limits its operations to its district; neither branches nor agencies are established outside the district.
- A RCB, like any other bank, may engage in all kind of banking business within the limits and under the provisions of the Banking and Financial Institutions Act, but in the initial stages should limit itself to the basic functions of mobilization of savings and granting of credit facilities to customers.
- A RCB can extend its credit facilities to all economic operators in its catchment area who qualify in terms of its criteria (cooperative or individual ventures).
- The capital requirement of a rural community bank is Tsh. 50 million (around US\$ 100,000).

The Bank of Tanzania will act as a facilitator in the promotion of these kind of local banks and provides technical advice in the following areas:

- Preparation of pre-establishment feasibility studies.
- Preparation of application for banking license.
- Organization of the Rural Community Banks.
- Promotion of the development of banking skills of officials and staff.
- Accounting and auditing procedures
- Any other technical advice that may be deemed desirable for the successful operations of the bank.

According to the Bank of Tanzania the concept of the rural community banks is also applicable to urban districts and thus opens interesting opportunities for the establishment of district banks for the urban informal sector. It is further mentioned that the local knowledge of the customers enables a RCB to minimize or eliminate altogether the need for collateral and that it combines the features of informal rural system with some features of a formal financial institution. This implies that the BOT acknowledges the need for different lending requirements for RCB clients and that in its role as supervisory body it will take this into account.

## **2. PROBLEM AREAS TO BE ADDRESSED**

### ***(a) Expansion of financial services for small and micro entrepreneurs***

In the selected cluster areas most entrepreneurs have never received credit. Savings and repayment capacity are low, so the loan size should be gradually built up, starting with very small loans of between Tsh 50,000–100,000 and gradually increasing loan amounts in consecutive loan cycles.

The formal financial sector is presently not interested nor capable of providing small scale financial services. Most state owned banks are going through a process of restructuring and will opt for credit rationing and conservative lending for at least the next few years. The bottleneck is not just the problem of small borrowers incapacity to provide real collateral. Guarantee mechanisms could solve the collateral problem, but lose their potential, as long as banks are not prepared to share risks by providing leverage with their own funds. In addition, recent experiences with informal sector schemes linked to formal sector institutions indicate that banks are not capable of responding to the specific needs of small clients regarding simple but effective application procedures, appraisal, timely approval and delivery of financial services, supervision and monitoring and follow up on loan collection.

The weakness of the formal financial sector institutions also severely limits the options for the Government and outside donors to channel resources towards the informal sector. Rediscounted credit lines would have little impact if the banks are not prepared to adjust their procedures for small scale lending.

The direct alternative has to be sought among financial intermediaries (NGOs, first and second tier Self-help Organisations), which are better geared to provide services to the sector of micro-entrepreneurs and small producers. However, most of the actors in this sector have recently started and are still in the pilot phase of their programmes. As a result, these programmes are characterised by low cost-effectiveness and limited outreach. Some NGO programmes based on foreign experiences such as those of PRIDE Tanzania have the potential of becoming important actors in micro enterprise lending, but in the short and medium term can only cover a small segment of the market.

One priority area is therefore to promote viable financial intermediaries capable of providing financial services at a large scale. This can partly be done by strengthening the existing institutions providing micro-enterprise credit as will be done by the NIGP Umbrella Program for Microenterprise Credit Organizations, but it is also necessary that new actors enter into the market to speed up the process and introduce alternative modalities.

Apart from enhancing the supply of short term micro loans for working capital, attention should also be given to the supply of term loans for fixed capital investments. Further research on the demand and existing supply of these services is required as to determine the need and scope for the development of special schemes providing term loans or leasing services.

### ***(b) Savings mobilization***

The mobilization of savings among informal sector workers has the dual objective of strengthening the capital base of the informal sector units and at the same time allocating resources towards other productive opportunities existing in the same sector. In addition, savings can contribute to the establishment of insurance facilities for emergencies, health problems and death.

Another positive aspect of savings mobilization is that in the context of micro-enterprises credit programmes it can serve the purpose of substituting for collateral requirements and enabling the programmes to expand their lending activities.

Finally, savings mobilization can play an important role in preparing a fertile soil for the promotion of District Community Banks owned and managed by the local community.

Savings mobilization should therefore be an integral part of any credit scheme for informal sector operators.

**(c) *Alternative collateral arrangements***

The lack of bankable collateral is one of the constraints generally faced by individual informal sector operators when attempting to obtain bank credit. However, in the selected cluster areas of the INTERDEP project there are a number of conditions which may be providing alternative solutions to the collateral problem in at least two ways. Since membership of a Cooperative Society has proven to facilitate the procurement of title deeds, there seems to be scope for the use of land titles as full fledged collaterals. Secondly, most of the Cooperative Societies collectively own infrastructure and equipment, which may be used as collateral for bank loans. As little is known about the extent to which these mentioned forms of collateral can be exploited by the members of Cooperative Societies and are acceptable by banks, it may be worthwhile to do some research on these options.

**(d) *The promotion of District Informal Sector Banks***

The opportunities offered by the recent amendmends in the Banking and Financial Institutions Act allowing for the creation of Rural Community Banks with relatively low core capital requirements opens a completely new perspective for the development of specialized informal sector credit institutions. Although the amendmends were particularly made with a view to the promotion of Rural Community Banks, the concept is equally relevant for urban districts. To determine the scope for the promotion of urban community banks as informal sector banks at the district level in Dar Es Salaam may be subject to further research.

**(e) *Continued efforts to involve policy making institutions and private sector institutions in informal sector finance***

Though financial sector reform and liberalization seem to draw the attention of formal financial sector institutions away from the informal sector, efforts should continue to involve this sector in the discussion on informal sector finance. The recent amendmends on the 1991 Banking and Financial Institutions Act concerning Core Capital requirements for Rural Community Banks are proof that important results can be obtained from such efforts. It is therefore recommendable that key persons from these institutions are invited to take part in seminars and workshops and to become active members in the boards of Microenterprise Credit Institutions.

**3. PROPOSED FOLLOW UP ACTIVITIES IN THE CONTEXT OF THE INTERDEP PROJECT**

Given the limited duration of the INTERDEP project, immediate solutions to the credit constraints faced by the informal sector operators in the cluster areas have to be sought in the promotion of savings and credit schemes, based on the savings capacity of the informal sector workers themselves and designed according to the priorities of the beneficiaries. The promotion of second tier credit and saving institutions or microenterprise credit institutions capable of channeling outside resources to the cluster areas would require a longer time-span and would for reasons of sustainability also have to include informal sector workers outside the selected cluster areas. Two of these longer term proposals are presented in the following chapter, the second of which (a proposal of the ILO Cooperative branch) has already been presented for funding under the NIGP.

As far as the promotion of savings and credit schemes is concerned, activities have already started in several of the selected cluster areas under the guidance of the SIDO-GTZ project. The project has developed methodologies, which leave the initiatives concerning framework, conditions and procedures of the schemes to the beneficiaries and mainly assist them in the screening of the proposals made to meet feasibility standards and in the introduction of simple accounting concepts. The project does not provide any external funding, in any case not in the initial phase, which seems to be an appropriate approach. In DASICO conditions for the application of a similar approach are good. The ILO-SIDO project has received signs of serious interest of cooperative members to engage in savings and credit schemes and would be advised to build on the experiences and methodologies applied by its sister SIDO-GTZ project.

In the context of the INTERDEP project, follow-up activities in the area of financial services are considered necessary in three areas, which are each addressing particular key constraints and opportunities for financial services to informal sector units.

- (1) **Analysis on the potential of title deeds and collective assets of Cooperative Societies as bankable collaterals.**  
**Output:** Report on collateral constraints and alternatives for informal sector operators organized in Cooperative Societies.
- (2) **Research on the potential of community banks as specialized informal sector banks in urban areas (in collaboration with the bank of Tanzania).**  
**Output:** Background paper on the promotion of community banks (unit banks) in support of the urban informal sector.
- (3) **Evaluation of existing demand for and supply of term loans for fixed capital investments by informal sector operators.**  
**Output:** Report presenting alternative proposals to address the demand for capital investment loans by informal sector units.

#### **4. PROPOSALS TO IMPROVE FINANCIAL SERVICES FOR INFORMAL SECTOR OPERATORS IN DAR ES SALAAM IN THE MID TO LONG TERM**

##### **A. PROJECT FOR THE CREATION OF AN URBAN MICROENTERPRISE CREDIT PROGRAMME BASED ON THE PRINCIPLES OF K-REP JUHUDI SCHEME (SOLIDARITY GROUP APPROACH)**

#### **OBJECTIVE**

Contribute to the development of a financial services system for urban microenterprises

#### **CHARACTERISTICS (see also Annex 1)**

- (A) **Creation of a micro enterprise credit Trust, to be governed by a Board of Trustees of businessmen, bankers, representatives of NGOs, Government officials and the donor.**
- (B) **Establishment of two credit offices and a head office:**
  - . 2 branches reaching 1800 clients each after 3-4 years
  - . branch operational sustainability within 4 years
- (C) **The target areas are the cluster areas assisted by the INTERDEP project and their immediate**

surroundings (DASICO and an area to be identified in the Temeke District).

- (D) The programme follows a minimalist approach, limiting non-financial services to the strictly necessary (promotion of solidarity groups, pre-loan training)
- (E) During the preparatory and implementation phases the Trust monitors its target groups and identifies requirements for additional (advisory or training) services not being provided by the Trust.
- (F) The Trust collaborates narrowly with institutions which provide non-financial services to micro-entrepreneurs and exchanges information on the needs of their clients for such services.
- (G) Once assured the sustainability of the branches (operational and capital costs), the Trust evaluates the possibilities of conversion of the branches into District Community Banks and actively participates in the promotion of such a conversion.
- (H) Based on the experience and capacity developed during the first three years of operations, the Trust will create a services centre in Dar Es Salaam for other micro-entreprise credit schemes. The centre will provide consultancy services as well as class room and field training to Tanzanian NGO's and other institutions providing financial services to micro-entrepreneurs. In addition, the centre will carry out research and organize workshops and seminars in on microenterprise credit systems. This last component is an optional one, as it has to be carefully analysed whether this component can be supplementary to the role assumed by the Umbrella Programme for Microenterprise Credit Organizations.

**TOTAL ESTIMATED COSTS: US\$ 1,350,000 (loan fund \$US 700,000)**

(subject to a feasibility study)

**POSSIBLE SOURCES FOR FUNDING: NIGP, Bilateral donors**

## **B. TECHNICAL SUPPORT PROGRAMME TO THE SAVINGS AND CREDIT COOPERATIVE UNION LEAGUE OF TANZANIA LTD (SCCULT)**

The ILO Cooperative Branch formulated a Draft Programme Support Document which envisages the strengthening of the Savings and Credit Cooperative Movement in Tanzania. The programme would assist SCCULT basically in the following areas:

- conduct of a countrywide survey on the economic viability, the management capacity and the management weaknesses of credit unions - design and introduction of improved accounting, audit and financial management systems.
- establishment of a monitoring and technical advisory services system.
- establishment of a training and education unit.
- creation of central finance facility.
- training of SCCULT staff in the provision of adequate services in to its member organizations in the referred areas.

The proposal has been presented to the UNDP for consideration under its Umbrella Programme for Microenterprise Credit Organizations. The relevance of the project for the INTERDEP Informal sector is twofold. First, the SCCULT could play a substantial role in the promotion of SACCOS of informal

sector workers. Though most of the urban based SACCOS are unions of formal sector workers there is a potential for the development of SACCOS of informal sector workers, as is indicated by the experiences of the SIDO-GTZ project in the promotion of savings and credit association within primary Cooperative Societies in Dar Es Salaam. Secondly, the development of the capacity of the SCCULT to provide adequate services and particularly provide financial services through its Central Finance Facility is of particular interest to urban SACCOS, as the experience is that rural SACCOS generally have excess liquidities during major part of the year, which could be channeled towards urban SACCOS. Affiliation to the SCCULT could thus open up access to considerable credit resources under appropriate conditions.

**POSSIBLE SOURCES FOR FUNDING: NIGP, Bilateral donors**

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**BANK OF TANZANIA – Rural Finance Directorate – A Manual on Establishment of rural Community Banks in Tanzania**

**KEDDIE J. – Financial Services to Informal Sector Enterprises ( ILO Project URT/88/007), November 1992**

**UMBRELLA CREDIT PROGRAMME FOR MICROENTERPRISE CREDIT ORGANIZATIONS – Project Document**

**DRAFT SUMMARY PROJECT OUTLINE  
FOR THE PROMOTION OF A MICRO ENTREPRISE CREDIT PROGRAMME**

**1. BACKGROUND AND JUSTIFICATION**

**CORE PROBLEM**

Informal sector workers in Dar Es Salaam are faced with a number of constraints to establish and expand their businesses. Along the problems of legal access to land and premises, low skills levels and marketing problems, the lack of access to financial services is recognized as one of the principal constraints. The formal financial sector is not capable of providing the small scale financial services needed by informal sector units. Where in the past state owned banks initiated special programmes for the informal sector, right now financial sector reform has forced banks to restructure their portfolio and step up their risk management. As a result, formal financial institutions refrain from lending to a sector they consider too costly due to the small size of loans required and non-eligible for their lack of bankable collateral. There are no signs that this situation might improve in the short term.

Though a small number of financial intermediaries (NGOs, Self help Organizations) are providing financial services to the informal sector in Dar es Salaam, their outreach is very limited and they provide their services at relatively high costs. One of the reasons for their low cost-effectiveness is their insufficient management capacity vis-a-vis financial services delivery, which can be explained by either a lack of specialization or the lack of support in designing effective delivery mechanisms.

It is in this context, that priority should be given to the development of institutions which can provide adequate financial services in a sustainable way to microenterprises. In the short run these institutions would be crucial to fill a small part of the demand-supply gap, which exists due to the lack of access to formal financial sector services. In the mid to long term these institutions have the potential to evolve into local specialized informal sector banks or expand their lending programme by opening up new credit offices. In both scenarios, expansion of services to every time larger segments of the informal sector belongs to the possibilities, as long as sustainability targets can be reached and services are geared towards the specific needs of the client group.

**STRATEGY**

The programme will evolve as a demonstration project for micro enterprise finance to be managed by a non-profit private sector institution to be set up for this purpose. The credit and savings component is based on principles developed by the Grameen Bank and adjusted by K-REP to the Kenyan context. The aim is to provide credit and savings services to poor entrepreneurs using the solidarity group principle and to do this on a commercially viable basis. The first element of the strategy is therefore to develop a self-sustaining micro-enterprise credit institution operating in the target areas of the ILO INTERDEP project.

The second element concerns the integration of financial and non-financial services. Though the institution will only provide pre-loan training and financial services, it will contribute in the monitoring of their clients regarding their needs for non-financial services and in coordinating the assistance by other specialized institutions in these non-financial areas.



The third element concerns the investigation of the possibilities of graduating individual branch offices into local district banks, owned by local shareholders. These banks could draw on the savings mobilized by clients of the microenterprise programme as well as the staff capacity and lending methodologies developed during the first years of operation. While this graduation is one option, the programme may also study the possibilities of the expansion of its programme by opening up new branches.

The fourth (optional) element consists of the establishment of a research, training and consultancy services unit. These services would build on the installed capacity and methodologies developed by the Trust and would be made available to other microenterprise credit organizations on a commercial basis.

## **TARGET GROUP**

The programme targets micro entrepreneurs in the manufacturing, trade and services sub-sectors. As the programme will operate in coordination/under the umbrella of the ILO INTERDEP project, as target areas are proposed the Cooperative Society of DASICO and surroundings (Ilala District) and a concentration area in the Temeke District. A detailed area assessment will have to take place, including a census of the classification by type, ownership, and size of all microenterprises and the assessment of demand.

## **INSTITUTIONAL FRAMEWORK**

The institution which will implement the programme is to be a non-profit private sector organization, which will be promoted by a Board of Trustees. The Board of trustees will be composed by a representative of the donors as well as 6-8 other members reflecting a cross section of society, including private businessmen, bankers, government officials and other influential persons with a clear interest in Informal Sector assistance. Such a cross section becomes especially important in a later stage of development of the institution, when the financial expertise and contacts of board members are needed to access capital and improve the institutions planning and management. At the same time, their inclusion brings the issue of informal sector promotion to other circles than the usual development circles.

## **IMPLEMENTATION**

The implementation of the project includes five major lines of action, namely:

- a. The Constitution of a Legal Structure which will aim at the approval, authority and license of a private Trust or Foundation to provide loans at commercial rates to a great number of poor borrowers.
- b. Establishment of a Project Management Structure which will guarantee the efficient and effective overall implementation, monitoring and evaluation of the project;
- c. Implementation of Lending Operations Programme which will extend credit to a great number of micro-entrepreneurs at commercial terms, using peer pressure and mutual guarantee in lieu of physical guarantee. Under this programme, the credit policies, methodologies, terms and conditions will be tested and refined;
- d. Implementation of a Training Programme which will involve an intensive and rigorous training of the management, staff and borrowers. Foreign and, if possible, local training will be conducted and will be refined to a training programme that will meet the needs of the Trust and its borrowers. In a later stage of the project, the Trust will also develop a training programme for local institutions and individuals involved in micro-enterprise lending in Tanzania.

- e. Establishment of a Monitoring and Evaluation System, which will monitor the progress of the project at each level of implementation and will submit regular internal reports as well as reports to the Trustees.
- f. Research and Promotion Programme. Linked to the monitoring and evaluation activities, further research in relevant areas will be carried out and results will be published. Workshops and seminars will be organized to disseminate findings of the internal evaluations.

## **2. DEVELOPMENT OBJECTIVE**

To set up an efficient credit delivery and savings mobilisation institution for improving the income and employment position of microenterprises operating in the urban informal sector of Dar Es Salaam.

## **3. IMMEDIATE OBJECTIVES**

### **IMMEDIATE OBJECTIVE 1**

To institutionalize a specialized non-profit financial institution (hereafter called Trust) to cater for the credit needs of informal sector units by following the solidarity group approach.

#### **Output 1**

Trust Head Office and two branch offices are established and equipped with trained staff in two districts of dar Es Salaam.

#### **Activities for Output 1.1**

Formation of committee of trustees who will assist in the adoption of Trust deed and the establishment of the Trust.

Assist Trust to establish head office and 2 Branch Offices with clear cut division of roles and functions.

Procurement of vehicles, office equipment etc.

Assist trust to develop and finalize staff regulations and staff development plans.

Assist Trust in establishing linkages with relevant Government and non-government Agencies for technical and extension support to the borrowers in the selected areas of operation.

#### **Output 2**

Trustees are indoctrinated and all project staff are trained in solidarity group lending approach.

#### **Activities for Output 1.2**

Assist trust in recruitment of trainee staff for the posts of Project Manager, Branch Managers and staff for the two branches.

Develop a staff training plan and develop training manuals.

Arrange study tour for the Trustees to K-REP in Kenya.

Train Project manager, branch Managers and branch staff according to the staff training plan.

## **IMMEDIATE OBJECTIVE 2**

To assist the Trust in the establishing and implementing a micro credit and savings programme targeted at informal sector operators.

### **Output 2.1**

Micro credit and savings programme is established and operational. Loans are disbursed and recovered, savings are collected as planned.

#### **Activities for output 2.1**

Preparation of credit, savings and accounting manuals

Establish administrative, accounting and financial control systems for efficient and effective functioning of the Trust.

Carry out an area assessment survey to classify potential beneficiaries and identify other support organizations operating in the target areas.

Launch awareness and promotion campaigns in the identified areas about the credit and savings services available.

Promote the formation of groups and centers within the framework of the Grameen Bank- K-REP principles.

Start lending and recovering loans and mobilizing savings at the group meetings in accordance with the manuals.

Monitor the project progress closely and take corrective measures, as needed.

Continuous financial monitoring of lending and savings and presentation of progress reports to the Management committee of the Trust.

## **IMMEDIATE OBJECTIVE 3**

Promote the creation of local informal sector banks owned by and directing specialized services towards informal sector operators.

### **Output 3.1**

If proved feasible, at least one of the branch offices is converted into a local district informal sector bank, maintaining the staff of the branch and adopting lending and saving methodologies developed under the project.

### Activities for output 3.1

Upon reaching sustainability at the branch level, carry out a feasibility study on the possibility to convert the branch into a local district bank.

Support in the promotion of local initiatives to set up a local district bank and to mobilize of potential shareholders among informal sector operators.

Assist in the conversion process as proposed in the feasibility study.

### IMMEDIATE OBJECTIVE 4 (OPTIONAL)

To set up a research, training and consultancy services unit on microenterprise credit programmes.

#### Output 4.1

A unit established within the Head Office with capacity to organize microenterprise credit training programmes and workshops, provide consultancy services and carry out research activities.

#### Activities for output 4.1

Identify staff which could be involved in training activities, consultancies and research activities.

Assist in the design of a curriculum for a comprehensive class room and on the job training programme on micro enterprise lending for outside programme managers, trainers and credit officers.

Prepare modules and materials for training courses.

Set up programme linked research activities.

Prepare a programme of seminars and workshops.

Publication of results of research and programme evaluations.

### INDICATIVE PROJECT COSTS (rough estimate)

Pre-operating Year:	US\$ 190,000
Year 1:	US\$ 540,000 (Loan Fund US\$ 400,000)
Year 2:	US\$ 330,000 (Loan Fund US\$ 200,000)
Year 3:	US\$ 310,000 (Loan Fund US\$ 120,000)

Total Costs US\$1,370,000 (Loan Fund US\$ 720,000)

\* A detailed cost-estimate would have to be based on a feasibility study.