

**EFFECT OF MICROFINANCE INSTITUTIONS ON INCOME OF
MICRO AND SMALL ENTERPRISES OWNERS IN MAFIA DISTRICT**

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**A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTER OF SCIENCE IN
AGRICULTURE AND APPLIED ECONOMICS OF SOKOINE
UNIVERSITY OF AGRICULTURE, MOROGORO, TANZANIA.**

ABSTRACT

This study identified the effect of MFIs on income of MSE owners who had better access to credit facilities. Micro credit was found to be a critical instrument in improving the income of poor people. The present study examined the extent to which microfinance services were successful in delivering their promise, particularly to the poor and its resultant effect on household income. Both primary and secondary data were used in the study. The study collects data from 110 respondents, including 60 beneficiaries and 50 non-beneficiaries of MFIs credit. A survey design in this study involved both participant of MFI and non-participant. The results of the study showed that contribution of microfinance had significant medium effect on the income of owners of MSEs which can be geared towards improving self employment opportunities. Although microfinance is vital for MSE survival its operations is often associated with several transactions cost imposed not only by time spent in the application process but also complying with monitoring and supervision rules. The results also showed these microfinances faced a significant transaction cost on credit; the average transaction cost on loan was about 28% which is higher compared to IIM (2014) where transaction cost was around 7%. The high Transaction Cost (TC) associated with these loans has always been the concern of both researchers as well as policy makers. A significant reduction in TC for clients has been advocated as the main mantra of microfinance.

DECLARATION

I, XHWATSAL GWANDU, do hereby declare to the Senate of Sokoine University of Agriculture, that this dissertation is my own original work done within the period of registration and that it has neither been submitted nor being concurrently submitted for degree award in any other institution.

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Date

The above declaration is confirmed

Prof. F.T.M. Kilima
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Date

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AKNOWLEDGEMENTS

Immeasurable thanks should go to the Almighty God who gives me strength and lead my ways and finally enabled me to completing my MSc programme

.

I would like to extend special thanks to my supervisor Prof. F.M.T Kilima, for his supportive and constructive guidance throughout the period I was writing this dissertation. His advice, commitment and encouragement finally made this dissertation a success.

Special thanks should go to Justus Titus for supporting me in the collection of data. Moreover, I would like to extend my sincere thanks to my family members who enabled me to have a smooth start of this Masters Programme.

Finally, I would like to acknowledge the support of all other people who in one way or another have contributed to the completion of my studies including my classmates who were registered to pursue MSc Agricultural and Applied Economic in 2013-2015 and all members of the Department of Agricultural Economics and Agribusiness.

DEDICATION

This dissertation is dedicated to my beloved daughter Restuta and my beloved son Joshua for their kind and hearted love and being obedience during whole time of my study.

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LIST OF ABBREVIATION AND ACRONYMS

ANOVA	Analysis Of Variance
GDP	Gross Domestic Product
IIM	Indian Institute of Management
MFI	Microfinance Institutions
MSE	Micro and Small Enterprise
NGO	Non Governmental Organization
SACCOS	Saving and Credit Cooperatives Society
SSA	Sub Sahara Africa
TC	Transaction Cost
URT	United Republic of Tanzania
VICOBA	Village Community Bank

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background Information

Microfinance can be a critical element of an effective poverty reduction strategy especially for developing countries. The services provided by microfinance institutions can enable the poor to smooth consumption, manage risks better, accumulate assets, establish enterprises, increase earning and enjoy an improved quality of life. Empirical evidence shows that a dynamic and growing Micro and Small Enterprises (MSEs) had contributed to the achievement of a wide range of development objectives including: the attainment of equitable income distribution and poverty reduction (Abdul, 2012), creation of employment (Daniels and Ngwira, 1993), savings' mobilization (Beck *et al.*, 2005), and production of goods and services that meet the basic needs of the poor (Cook and Nixon, 2000). Ayyagari *et al.* (2003) shows that almost 30 per cent of employment in developing countries is generated by the informal economy while an additional 18 per cent is provided by (formal) small and medium enterprises. Together these two groups of enterprise account for 63 per cent of the total employment other than farming/ agriculture.

In the case for Tanzania Micro and small enterprise (MSEs) contribute about 12%, 34% and 32% of the rural employment, urban employment and country's GDP (Wangwe and Semboja, 1997). Thus, the Government of the United Republic of Tanzania in recognition of the contribution of MSEs in economic growth and development ratified the National Microfinance Policy which enables low-income

earners to access financial services (URT, 2000). Microfinance institutions (MFI's) provide a wide range of services including deposits, loans, payment services, money transfer and insurance to the poor/low-income households (Chijoriga, 2000).

Whilst MSEs are an important part of the business landscape in any country, they face significant challenges that inhibit their ability to function and contribute optimally to economic development in many African countries (Livingstone, 2014). Realizing the potential of small businesses as the engine of growth in the Tanzanian economy, the government took some steps toward addressing the challenge to their growth and survival. However, all these programmes could not achieve the expected goals due to abuses, poor project evaluation and monitoring as well as moral hazard problems with regards to the use of public funds intended to promote private sector enterprise (Yumkella, 2003). Thus, when compared with other developing countries, many programmes for assisting small businesses implemented in many Sub-Saharan African (SSA) countries failed to realize sustained growth and development (Hossain 1988). This was an outcome of small-sized enterprises vulnerability to economic shocks resulting from poor business and managerial skills, access to finance and macroeconomic policy.

Lack of access to finance has been identified as one of the major constraints to small business growth in SSA (Owualah, 1999; Carpenter, 2001; Anyawu, 2003; Lawson, 2007). It is important to note that the provision of financial services is an important means for mobilizing resources for more productive use (Watson and Everett, 1999). Small enterprises' access to fund determines the extent to which enterprises can save

and accumulate their own capital for further investment (Hossain, 1988). However, small business enterprises in Tanzania find it difficult to access funds/capital from formal financial institutions such as commercial banks. The inability of the MSEs to meet the terms of credit from the formal financial institutions provided a fertile ground for the formation of micro-finance in Tanzania.

In spite of the renowned importance of MSEs in stimulating economic growth and development its contribution has generally been limited as many potential entrepreneurs are unable to seize business opportunities because they have limited access to financial services from formal institutions which is needed to invest in these enterprises (Green *et al.*, 2002; Kessy and Temu, 2009).

Venturing in MSEs requires initial and working (operating) capital that poor people cannot afford to accumulate as they have constant cash demands to meet their basic needs. Under such circumstances, loans could help the poor to accumulate capital and investment in income generating activities thereby creating new employment opportunities (Hossain, 1988). Loans enable the individual's member or enterprises to enjoy the benefit of economies of scale (Grade, 1984).

According to Yunus (1984) availability of credit to MSEs and low income households is critical to boost their economic base and allow them to get out of the vicious circle of low income – low saving – low investment. Financial problems of most MSEs arise due to poor financial management, existence of information asymmetry, and credit rationing practices, especially in the formal financial

institutions. Chijoriga and Cassimon (1999) and Ogawa and Suzuki (2000) pointed out that bank do not want to offer loans to MSEs because the nature of loans required is too small and it is more expensive to manage a large number of these small loans. According to Chijoriga and Cassimon (1999), most formal institutions regard low-income households as too poor to save and with limited credit history and skills to appraise and manage their businesses.

Commercial banks, which were traditionally perceived to be powerful catalyst of economic development through the mobilization and provision of credit to profitable ventures do not offer credit to the rural poor or small business. Stringent lending policies and collateral requirements, cumbersome procedures and their perception of small business and the rural poor as risky, often leads to exclusion of MSEs in the loan portfolios of these banks (Kuzilwa and Mushi, 1997).

The introduction of MFI's in Tanzania was seen to be the best alternative source of financial services for low income earners and their MSEs and was deemed as effective means for reducing their poverty level and enhance economic growth (Kessy and Urio, 2006). Other benefits associated with these services include managing resources and enterprises more efficiently, hedging against financial risks through tapping into investment opportunities and enhancing their earnings (Chijoriga, 2000). Micro finance also enables clients to diversify their sources of income, accumulate wealth and assets and become more resilient to income and consumption shocks (Robinson, 2002).

Although microfinance is vital for MSE survival its operations is often associated with several transactions cost imposed not only by time spent in the application process but also complying with monitoring and supervision rules (Chijoriga and Cassimon, 1999).

The high Transaction Cost (TC) associated with these loans has always been a concern of both researchers as well as policy makers. A significant reduction in TC for clients has been advocated as the main mantra of microfinance. Transaction costs include real cost such as to attend training or group meetings, get the individual photograph, buy the stamp paper/revenue stamp, photocopying the documents (resident proof, and card) and travel expenses incurred in visiting bank branch for opening the group saving bank. Other charges include getting loan and repayment along with opportunity cost which include cost related to the time spent in group trainings, meetings and travelling to training place as well as time spent at MFI/Bank branch.

Transaction cost varies across lending methodologies (individual loan v/s group loan). This cost can also vary across locations (remote or rural area v/s semi-urban area), and main occupation of the targeted beneficiaries/clients. The present study estimated the transaction cost of MFIs clients' across different microfinance models. The rationale was to assess the differential impact of this cost on the performance of target MSEs in Mafia District.

In Mafia, microfinance conducts all financial transactions (savings and credit) at group level. Accordingly, groups incur all transaction cost on behalf of the individual members. The cost incurred at group level includes the opportunity cost which is shared by members.

1.2 Statement of the Problem

While MFI services are seen as cheaper means to finance the establishment and operation of the MSEs, very little is known about the actual cost that beneficiaries incur to access these services apart from interest rates. Interest rate is not the only cost of credit incurred by MSEs as there are other costs related to the process of obtaining information about the services and the whole process of applying for loan (e.g. the cost of transportation, reconciliation and time) herein referred as transaction costs. It has been established that loan application is often associated with several transactions and opportunity cost imposed not only by time spent in the application process but also complying with monitoring and supervision rules (Chijoriga and Cassimon, 1999). Some scholar have estimated these costs to be as high as 6.78% of the borrower capital (I I M, 2014)

However, despite the high transaction costs, MSEs in Tanzania continue to borrow from MFIs in groups/jointly and the number of beneficiaries has been reported to be increasing over time (Temu, 200 and Liheta, 2014). It is not known whether: (i) these costs differ across means of financing and; (ii) have differential impacts on the income of the owners of the MSEs. No study has so far examined the impact of these transaction costs on the MSEs. This study therefore seeks to fill this knowledge gap.

1.3 Objectives of the Study

1.3.1 General objective

The main objective of this study is to analyze effects of MFI services and transaction cost on the income of MSEs owners in Mafia.

1.3.2 Specific Objectives

Specifically the study attempts to:

- i. Characterize socio-economic of MSEs owners and financial institution in the study area.
- ii. Analyzing direct and indirect transaction costs incurred by MSEs when accessing microfinance services.
- iii. Analyzing effect of MFI loans on income of MSEs owners.

1.4 Research Questions

1. What are socio-economic characteristics of MSEs owners?
2. Which institutions are providing microfinance services within the study area?
3. What are financial services offered by MFIs to MSEs?
4. What are the direct and indirect costs that Tanzanian micro and small enterprises incur when accessing microfinance services?

1.5 Hypotheses

MFI loans have no impact on income of MSE owners.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Definition of Terms

Micro enterprise: Micro- enterprise is the informally organized business activity undertaken by entrepreneurs; excluding crop production by convention, employing less than ten people and having assets worth less than 5 million excluding land and building (MSEDAN, 2007).

Small enterprise: Small enterprise is any enterprise that employs between ten (10) to forty-nine people and has asset worth between 5 million and 50 million (excluding land and building) (MSEDAN, 2007).

Medium enterprise: Medium enterprise is any enterprise that employs between fifty and one hundred and ninety-nine people and has assets worth (excluding land and building) between 50 million and 500 million (MSEDAN, 2007).

Microfinance Banks: Microfinance Banks are licensed financial institutions meant to serve the un-served, but economically active clients in the rural and peri-urban areas by providing diversified, affordable and dependable financial services to the active poor, in a timely and competitive manner. The support offered is meant to enable them to undertake and develop long-term, sustainable entrepreneurial activities and mobilize savings for intermediation (CBN, 2005).

Microfinance Institutions: Microfinance Institutions are organizations whose activities consist wholly or in significant part, of the provision of financial services to micro entrepreneurs.

Microfinance: Microfinance denotes the provision of financial services adapted to the needs of low income people such as micro-entrepreneurs, especially the provision of small loans, acceptance of small savings deposits and simple payment services needed by micro-entrepreneurs and other poor people (USAID, 2003).

Microcredit: Microcredit is commonly defined in terms of loan amount as a percentage of average per capita income (USAID, 2003).

Transaction cost: Can be defined as any costs that arise due to the existence of institutions and the appearance of an economic exchange (Balabello, 2013).

2.2 Micro and Small Enterprises

The MSE is sometimes referred to as micro, small and medium enterprises (MMSEs). The Micro and Small Enterprises both cover farm and non-farm economic activities (URT, 2003). The Tanzanian government defines MSEs according to sector, employment size, and capital investment in machinery. A Micro-Enterprise is one with fewer than five employees; a small enterprise has 5-49 employees, a medium enterprise has 50-99 employees and a large enterprise has more than 100 employees. Capital investments range from less than Tshs 5 million to over Tshs 800 million. This definition would exclude a number of informal enterprises, peasant

farmers, and Tanzanians engaged in lower-level income-generating activities (URT, 2003).

The World Bank Group (2008) proposed that Micro Enterprises should include enterprises employing 10 or less people with total assets worth \$100 000 or less and business turnover of \$100 000 or less. Small Enterprises should include enterprise employing 10 – 50 people with total Assets worth \$100 000 - \$3million and business turnover of \$100 000 - \$3million. Medium Enterprises include enterprises employing 50 – 300 people with total assets worth \$3m - \$15million and business turnover of \$3m - \$15million (World Bank, 2007).

2.3 Importance of Microfinance Institutions to Micro and Small Enterprises

Financial services provided by Micro Finance Institutions (MFIs) are crucial to low income and economically active people with an end objective to alleviate poverty (Ledgerwood, 1998). Microfinance is also frequently combined with the provision of social and business development services, such as training, education on health issues and management or accounting. It is recognized as an effective tool to fight poverty by providing financial services to those who do not have access to commercial banks and other financial institutions. Financial services provided by the MFIs may include one or any combination of savings, credit, insurance, pension/retirement and payment services (Chijoriga, 2000).

Microfinance institutions (MFIs) provide an alternative means for poor people to access basic financial services in a way that seeks to help them to improve their lives. The term microfinance covers a wide range of financial services offered to poor

people. Microcredit involves issuing small loans to people who do not have the necessary collateral to obtain credit from the formal banking sector. Microcredit is sometimes supported with training and advice to help micro-entrepreneurs to run successful businesses.

Rubambey (2001) describe microfinance as a critical element of effective poverty reduction strategy. It enhances the access and delivery of credit, savings, and insurance facilities to people in developing countries. The main features of a microfinance institution which differentiate it from other commercial institutions, are such that it requires no collateral, associated with simple procedures and less documentation, has easy and flexible repayment schemes, offers financial assistance to members of group in case of emergency and allows the most deprived segments of population to be efficiently targeted and members to interact with each other.

2.4 Village Community Bank

Village Community bank (VICOBA) is community-managed credit and savings association established either by NGOs or community members themselves to provide financial services, build community self-help groups and help members to accumulate savings (Nichols, 2004). These associations have been in existence since the mid-1980s. The associations have 25 to 30 members who are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect repayments (Ntenda, 2010). The loans are backed by moral collateral i.e. the promise that the group stands behind each other's loan (Global Development Research Centre, 2005).

The sponsoring MFI lends loan capital to the village bank, who in turn lend to the members. All members sign a loan agreement with the village bank to offer a collective guarantee. Members are usually requested to save twenty percent of the loan amount per cycle, the cycle usually range 12 to 18 months depend on their constitution (Ledgewood, 1998). Members' savings are normally tied to loan amounts and used to finance new loans or collective income generating activities. No interest is paid on savings but members receive a share of profits from the village bank's re-lending activities. Many village banks predominantly target women. The thrust is that female participation in village banks will enhance social status and intra household bargaining power (Holt, 1994).The finding also refiled that VICOBA were potential compare to other microfinance in the study area.

2.5 Impact of Microfinance on Income

The impact of microfinance on income has been analyzed at the individual, household and enterprise levels. Hulme and Mosley (1998) studied different types of microfinance programmes and found strong evidence of the positive relationship between access to credit and the borrower's level of income. The authors indicated that the middle and upper poor received more benefits from income-generating credit initiatives than the poorest. McKernan (2002) evaluated three microcredit programmes in Bangladesh and established that the profit for self-employed households could be increased through programme participation. The analysis of microfinance at the village-level showed that loans have net positive impact on average households 'annual income, especially in the rural non-farm sector (Khandker, 1998). Copestake *et al.*, (2005) estimated the effect of urban credit in

Zambia and found that microcredit has a significant impact on the growth of enterprise's profit and household's income.

2.6 Transaction Cost and Microfinance

Transaction cost (TC) can be defined as any cost that arises due to the existence of institutions and economic exchange involving these institutions. Literature shows that there are two parties involved in microfinance exchange namely, the poor clients having financial needs on the one hand, and the lender (bank or MFI group) on the other. These two parties face difficulties in conducting the financial exchange due to problem of information asymmetry. Thus, TC is the cost the lender and the borrower incur over and above the direct interest cost in reaching out an agreement between them for financial transaction.

Transaction costs measure the functioning of financial market. The higher the transaction costs the higher is the cost of intermediation and thus the less efficient the performance of the financial sector (Cuevas, 1988). There are three types of costs that a lending institution incurs when it provides loan. First, the cost of the money that it lends; second, the cost of loan defaults and; third, the cost of the transaction namely the transaction cost which includes the cost of identifying and screening the client, processing the loan application, completing the documentation for the loan, disbursing the loan, collecting repayments and following up on non-payments (Shankar and Shankar, 2006). Unlike the cost of funds and the cost of default, transaction cost, is not proportional to loan amount since there is invariably a minimum amount of time that each loan require for appraisal, processing,

disbursement, repayments and monitoring. This cost is normally high when the average loan size is small as transaction costs are likely to be higher than the interest on loan/credit. Some other factors that may contribute to higher transaction cost for loan from microfinance are initial training cost for the borrowers (social intermediation), higher degree of supervision, documentation procedures, frequency of installment payments (weekly or bimonthly), higher cash handling and distance of client's group from nearest banking center. The costs related to the transaction cost the clients' incur when accessing services include time to walk to meeting place, time spent on meeting, time spent on training, travel cost, cost of photograph, fines for late or missing meeting, time spent to bank and stationary costs.

2.7 Theoretical Framework

The theoretical frame work for this study is based on transaction cost theory. Transaction cost approach is mainly based on the theory of the firm (Coase, 1937). 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 the loan. The cost incurred by the lender include; cost of searching for source of funds for lending, cost of designing credit contracts, cost of screening borrowers, appraising investment, cost of scrutinizing loan application, cost of providing training to staff and borrowers, and the cost of monitoring. On the other hand, the borrower may incur various cost including those associated with screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling application forms, transportation to and from the financial

institution, cost of time spent on project appraisal and cost of attending meetings (Bhatt and Shui-Yan, 1998).

2.8 Conceptual Framework

The conceptual framework developed to guide this study incorporates the MFI credit facilities and target MSEs. This framework allowed the assessment of effects of MFI services on the performance of MSEs. Note that MFI services have impacts not only on the MSEs performance but also on the owners and community at large, therefore the conceptual framework was developed to reflect the outcome of MSEs performance based on the assumption that improved enterprises performance leads to improved wealth and overall standard of living of the targeted beneficiaries. Coase (1960) suggest out that financial intermediation involves transaction cost, which increases the gross cost of credit for the borrower. The conceptual framework reflects the effect of transaction cost on MSEs when accessing and offering MFI services to members. In this perspective high transaction cost can potentially limit entrepreneurs' performance and the realization of expected outcomes (Figure 1).

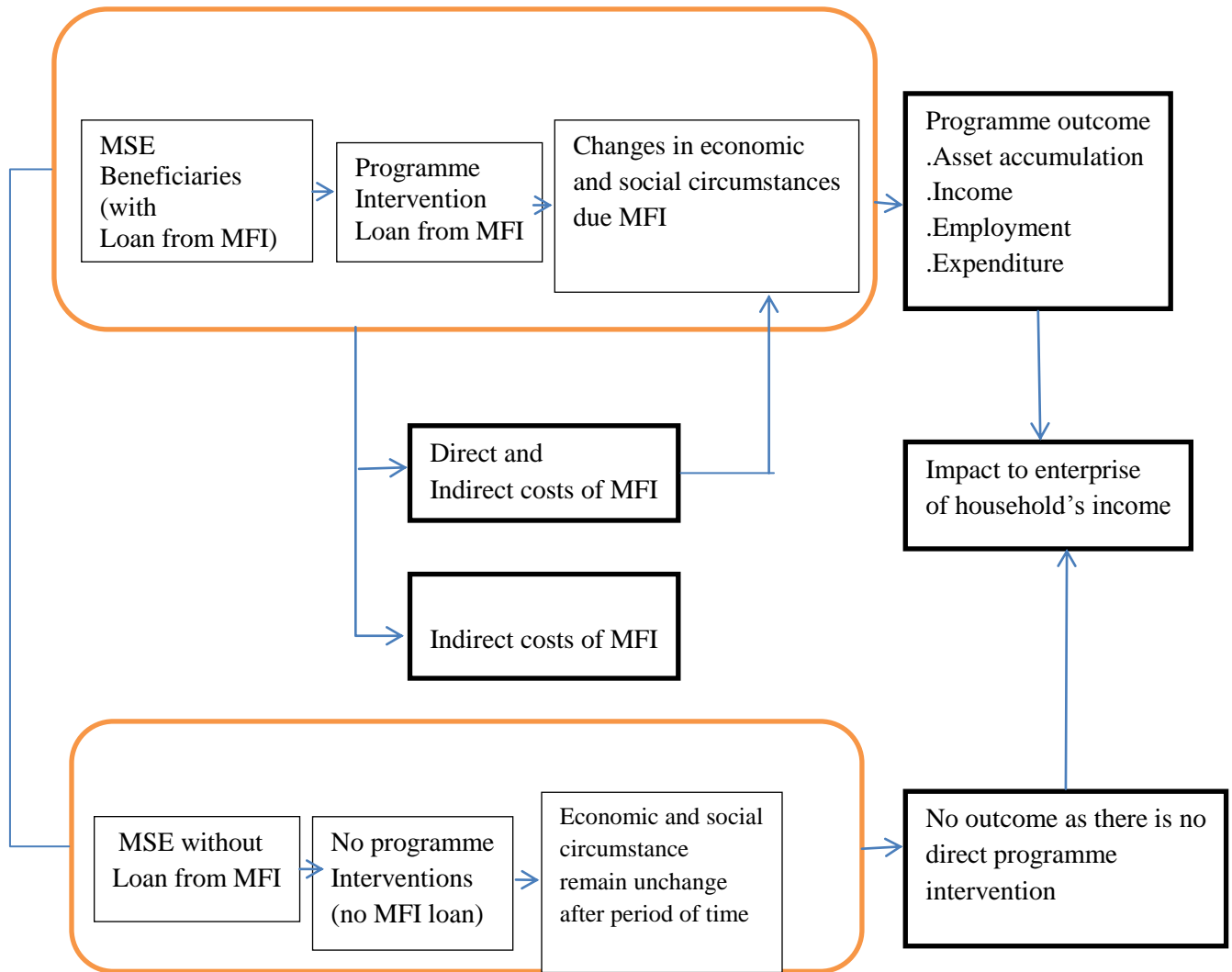


Figure 1: Link between Microfinance, Micro and Small Enterprise, transaction cost and household income.

CHAPTER THREE

3.0 METHODOLOGY

3.1. Study Area

The study was conducted in Mafia District in Pwani region. The District was purposely selected for study because it was ranked as the poorest district in the Region (World Bank 2008; Tanzania Poverty and Human Development poverty, 2012). The report shows that Mafia District has 43 percentage of the population below the poverty line while the proportional of people below the poverty line in Kisarawe, Bagamoyo, Mkuranga, Rufiji and Kibaha districts range between 32 and 41 percent.

3.2 Data Types and Sources

Both quantitative and qualitative data were used. Primary data were collected through interviews involving the use of structured interview questions (Appendix 1).

3.3 Sampling Frame

The sampling frame for this study consisted all microfinance institutions in Mafia District. This frame was used to generate a random list of beneficiaries of microfinance. To facilitate comparison another list of non-beneficiaries of MFIs credit (here in referred to as a control group) was randomly selected among those household living in close proximity to the household with access to MFIs credit.

3.4 Sample Size and Interview

The sample for this study included 110 respondents; out of those 60 are beneficiaries and 50 non-beneficiaries of MFIs credit. These respondents were interviewed using the structured questionnaire (Appendix 1).

3.5 Estimation of Clients' Transaction Cost

The study estimated the transaction cost as per monetary units incurred by microfinance clients' under different business models and across the space. The study computed the following components of transaction cost

(a) Indirect Transaction Cost (opportunity cost of time)

- I. Opportunity cost of training time: cost related to the time spent attending group trainings;
- II. Opportunity cost of group promotion time: cost related to the time spent attending group promotion and formation;
- III. Opportunity cost of meeting time: cost related to the time spent attending group meetings;
- IV. Opportunity cost of time spent in travelling to training places and;
- V. Opportunity cost of time spent in MFI/Bank branch.

The opportunity cost of time per hour for the MFIs clients was calculated on the basis of actual wages received in a day when engaged in other routine duties.

(b) Direct Transaction Cost

- I. Travel cost to meeting: cost of return trips to attend training or group meetings;
- II. Travel cost to get individual photograph for identification;
- III. Travel cost for photocopying the documents (forms, and other documents);
- IV. Cost of photograph and photocopy, training manual, individual books for documentation and other related document and;
- V. Travel expenses incurred in visiting Bank branch for opening the group saving bank account.

All the components of direct transaction cost were quantified on the basis of actual expenses.

3.6 Data Analysis

Objective 1: Socio-economic characteristics of MSEs owners and financial institutions operating in the study area

This objective involved profiling of the sample according to socio economic and description of financial institutions existing in the study, membership in the financial institutions and amount of savings and credit offered from each type of financial institution.

Descriptive statistics (percentage) were used to describe socio economic characteristics of MSEs who are members and non-members to MFI. The characteristics which were analyzed included household size and age, sex, marital status, economic activity, education level and locations of the village. These statistics

were also used to assess the proportions of members and non-members of MFI and test whether these proportions were statistically different using a C-square test.

In determining number of existing financial institutions and their membership, the measure of central tendency including arithmetic mean and range were used. Similarly, measures of central tendency were used in determining savings and credit offered. These measures included mean and median.

Objective 2: Analyzing direct and indirect transaction costs incurred by MSEs when accessing microfinance services

Transaction cost incurred by MSEs when accessing loans was estimated as shown in equation 1.

$$TTC_i = DR_{TC_i} + IND_{TC_i} \dots\dots\dots(1)$$

Where,

TTC_i = Total transaction cost incurred by i^{th} MSE

DR_{TC_i} = Direct transaction cost incurred by i^{th} MSE

IND_{TC_i} = Indirect transaction cost incurred by i^{th} MSE

Direct transaction costs were computed by summing all direct cost which MSE incurred during the process of accessing microfinance. It includes all fees required, all materials used, transport cost during the processing of loan. Indirect transaction costs were computed as sum of all opportunity costs incurred during loan application.

From the literature transaction cost which was identified included group formation costs, group training costs, loan approval and disbursement cost and group meeting costs. The transaction costs were presented using percentage and bar graphs. In addition to that, pie chart were used to show amount of loans eroded by (in terms of percentage) transaction cost. The calculation was done by finding a ratio of transaction costs incurred to loans amount issued to individual MSEs.

Objective 3: Analyzing effect of MFI loans on income of MSEs owners

In analyzing the effects of MFI loans on the income of MSEs owners *t-test* and ANOVA were used.

The formula used to compute *t-test* is given in Equation (2).

$$t = \frac{INC_1 - INC_2}{\sqrt{\frac{(n_1 - 1)S_{INC_1}^2 + (n_2 - 1)S_{INC_2}^2}{n_1 + n_2 - 2}} * \sqrt{\frac{S_{INC_1}^2 + S_{INC_2}^2}{2}}} \dots\dots\dots(2)$$

Where

INC_1 = Income of MFI members

n_1 = Number of MFI members

$S_{INC_1}^2$ = Income standard deviation of MFI members

INC_2 = Income of non-MFI members

n_2 = Number of non-MFI members

$S_{INC_2}^2$ = Income standard deviation of non-MFI members

In addition ANOVA was used to analyze the magnitude effect of MFI loans on the income of MSEs owners. The effect of MFI loans on the income of MSE owners was determined from the partial eta squared obtained from Equation (3).

$$INC_{ij} = \mu + \gamma_j + \varepsilon_{ij} \dots\dots\dots(3)$$

Where,

INC_{ij} = Income of MSEs measured in Tanzanian shillings

μ = Grand mean of combined groups

γ_j = Group fixed effect

ε_{ij} = Error term

j = j^{th} where $j= 1$ and 2 where 1 =membership to MFI 2 =non-membership to MFI

i = i^{th} MSE

Table 1 shows the rule of thumb used to interpret partial eta squared.

Table 1: Interpretation of Partial Eta Squared

Value of partial eta squared	Interpretation
Less than 0.02	Small effect
Greater than 0.02 but less than 0.26	Medium effect
Greater than 0.26	Large effect

CHAPTER FOUR

4.0 RESULTS AND DISCUSSION

4.1 Characterization of Socio-economic of MSEs owners and Ffinancial Institutions in the study Area

4.1.1 MSEs Owners' socio economic characteristics

Table 2 shows that MSE owners' who are located in rural are are about 55% while those who are located in urban areas are about 45%. About 36% of MFIs members live in rural and 18% live in urban while about 18% and 27% non-members of MFI live in rural and urban respectively. The proportion of members of MFI and non-members who live in rural area was statistically different at 5% level of significance.

MSE owners who were males are 38% while females were 62%, whereas MSE owners who were members of MFI; 25% were males and 29% were females while for non-members of MFI 13% were males and 33% were females; the difference between sex of respondents between members of MFI and non-members is statistically significant.

MSE owners who were married are 92% while unmarried are 8% whereas members of MFI who were married are 54% and unmarried are only 1% while for non-members married are 38% while unmarried are 7%. The marital status between members of MFI and non-members is statistically significant.

MSE owners who are involved in agriculture are 47%, civil servant 3% and business are 50%. In the case of members of MFI, 27% were involved in agriculture, 2% were civil servant and 25% were in business while for non-members of MFI, 20% were in agriculture, 1% civil servants and 25% were in business. However, the main economic activity of individuals between members of MFI and non-members is not statistically significant.

MSE owners who have no formal education were 5%, 92% with primary education, secondary education 2% and college/university 2%. In the case of members of MFI, 52% has primary education, who has no formal education, secondary and collage education are 1% each while for non-members of MFI 5% has no formal education, 92% has primary education while secondary and college/university both are 2% each. Education level between members of MFI and non-members is not statistically significant difference.

MSE owners who were below 35 years of age are 22% while those who are 35 years and above are 78%. For those below 35 years MFI members are 2% while those who above 35 year are 45%. For non-members of MFI, 20% were below the age 35 years while 33% were above 35 years. The difference between age groups and being member or non-member of MFI is statistically significant.

MSE owners who have households with less than members 4 are 41% while those with members more than 4 are 59%. For MFI members households with less than 4 members are 15% while with members more than 4 are 33%. For non-members of

MFI, households with less than 4 members are 26% while with more than 4 members are 26%. The difference between age groups and being member or non-member of MFI is statistically significant.

Table 2: MSE Owners social-economic characteristics for qualitative variables

Respondent characteristics		Members of MFI Percentage	Non-Members MFI Percentage	Total	P-Value
Location of the village	Rural	37	18	55	0.005
	Urban	18	27	45	
	Total	55	45	100	
Sex	Male	25	13	38	0.040
	Female	30	32	62	
	Total	55	45	100	
Marital status	Married	54	38	92	0.006
	Not Married	1	7	8	
	Total	55	45	100	
Main economic activity	Agriculture	27	20	47	0.186
	Civil servant	2	1	3	
	Business	26	24	50	
	Total	55	45	100	
Education level	Informal education	1	3	5	0.343
	Primary education	52	40	92	
	Secondary education	1	1	2	
	College/university	1	1	2	
	Total	55	45	100	
Age	Less than 35 years	2	20	22	0.000
	35 years and above	53	25	78	
	Total	55	45	100	
HH Size	4 members and less	22	19	41	0.041
	More than 4 members	33	26	59	
	Total	55	45	100	

4.1.2 Financial Institutions Operating in the Study Area

Financial institutions operating in the study area are presented in Tables 3 and 4. These financial institutions were Village Community Banks (VICOBA), Savings and Credit Cooperative Society (SACCOS) and only one bank (National Microfinance Bank). As Table 3 shows there were 102 Village Community Banks (VICOBA) operating in Mafia District with 2 770 members (1 824 female and 946 male). On average female members in each group were about 18 while on average males were 9. The size of members in VICOBA ranged from 14 to 30 members. The zero implies that some the VICOBA groups had single sex (male only or female only).

Table 3: The Village Community Banks members

Size of members	N	Total	Mean	Min	Max
Female		1 824	18	0	26
Male		946	9	0	21
Total		2 770	27	14	30
Total number of VICOBA	102				

In the study area there were about 20 Savings and Credit Cooperative Society (SACCOS) as shown in Table 4. However, only 5 were active and 15 were inactive societies. For the 5 active SACCOS the average number of males was around 29 per group while the average female members were 13 per group. On average each group had 42 members, with the smallest group having about 25 members and the largest having 67 members. Similarly, within the 15 inactive SACCOS the average number of males was around 34 members and the average number females was 29 in a group. On average, the smallest group in the inactive SACCOS had 26 members while the largest group had 117 members.

Table 4: Members of Savings and Credit Cooperative Society (SACCOS)

Items	Total	Mean	Min	Max	N
Active					5
Male	67	29	17	37	
Female	145	13	7	30	
Total	212	42	25	67	
Inactive					15
Male	515	34	16	74	
Female	440	29	10	65	
Total	955	64	26	117	

According to key informant interview (Cooperative District Officers) most of the members of VICOBA were mainly engaged in MSEs and the loans issued to them by this institution were considered more important in generating income compared to loans from SACCOS. Many of these members had no access to loans from a commercial bank due to not have collaterals to secure the loans (Appendix 2).

4.1.3 Savings and credit offered to MSEs in the study area

Amount of savings and loans within VICOBA in the study area is shown in Table 5. Up to March 2015, VICOBA in Mafia District had a total of TZS 35 million as saving by members TZS 49 million as seed money from social fund and TZS 125 million as contribution from other contributions. On average each group had a total amount of TZS 3 482 032 as members' savings, TZS 494 368 as seed money from social fund and TZS 1 254 241 as other contributions from other parties. While average amount of loans offered was approximately TZS 5 million with a total loan of TZS 508 million.

Table 5: Amount of Savings and Credit Offered by VICOBA members

Capital structure and Loan Issued	Total	Mean	Min	Max
Amount of Share (Savings) (TZS)	355 042 897	3 482 032	125 000	33 458 300
Amount from Social Fund	49 305 531	494 368	75 000	3 060 050
Other Contribution s(TZS)	125 433 350	1 254 241	0	7 960 000
Total Amount(TZS)	529 781 181	5 193 933	125 000	35 053 300
Total Loan (Credit offered) (TZS)	508 393 986	5 308 739	0	24 741 630

Amount of savings within SACCOS in the study area as shown in Table 6, can be grouped into fixed shares and deposits where in active SACCOS the amount of shares was approximately TZS 2 million which ranged from TZS 220 000 to TZS 5.6 million while shares range from TZS 220 000 to 5 600 000 and deposits ranged from TZS 445 000 to TZS 2.8 million. This implies that the operation of SACCOS in the study areas was not impressive.

Table 6: The amount Savings and deposit held by SACCOS

Amount	Mean	Min	Max	N
Active				5
Share (TZS)	2 000000	220 000	5 600 000	
Deposit (TZS)	1 149400	445 000	2 800 000	
Inactive				15
Share (TZS)	637 633	27 000	1 795 000	
Deposit (TZS)	2 127743	0	7 762 750	

4.2 Direct and Indirect Transaction Costs Incurred by MSEs when Accessing Microfinance Services

4.2.1. Transaction costs incurred when accessing microfinance

The transaction costs incurred by MSEs when accessing microfinance services are categorized into four groups as shown in Fig. 2. The first cost incurred was group formation cost which involves mobilization and constituting a group which accounts for 6.5% of all the transaction cost. The second cost was group training which includes training fees, group formation expenses and opportunity cost for time which accounts for 9.3% of all transaction cost. The third cost is loan approval and disbursement which includes loan processing costs, fees and other requirement which accounts for 8.7% of the total transaction cost. The last cost is group meetings which accounts for 75.4% of all the transaction costs. Group meeting cost is high due to the weekly group meeting hence the opportunity time cost is high.

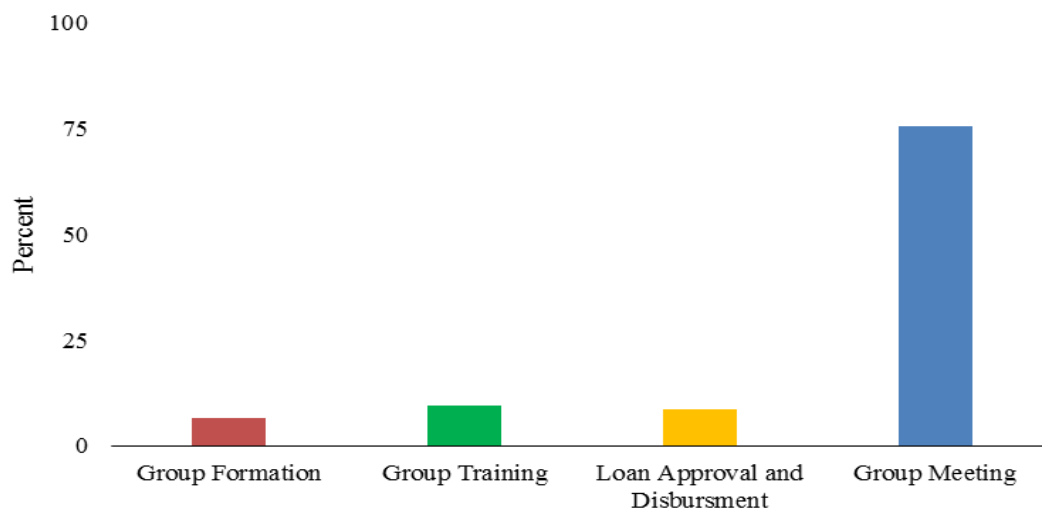


Figure 2: Transaction cost incurred during loan processing

4.2.2 Proportion of transaction cost to loan received

This section shows the proportion of transaction cost identified above to the total loan received by the MSEs. From Fig. 3 it can be seen that transaction costs eroded about 28% of the total loans received where group meetings took about 21% while loan approval and disbursement accounted for 2% whereas group training accounted for 3% and group formation accounted for 2% of the total loans. The findings of IIM, (2014) reveal that transaction cost incurred during loan processing was approximately 7% this implies that in the study area transaction cost was high and made the process of accessing loans to be expensive.

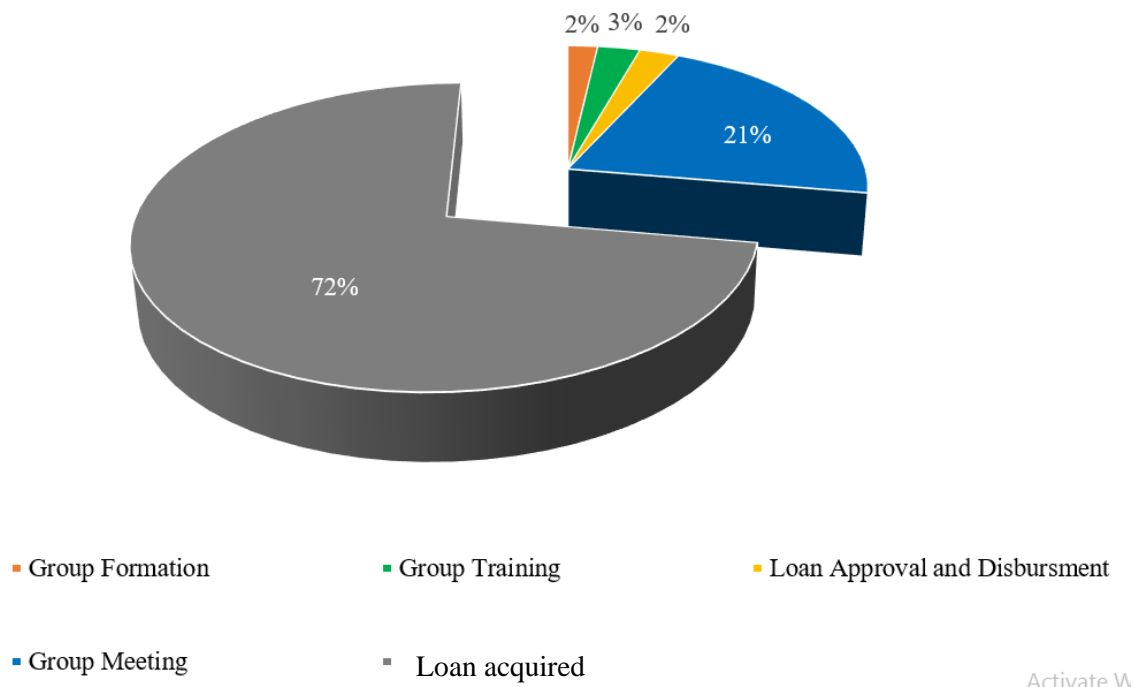


Figure 3: Proportion of transaction cost to loan received

4.3 Analysis of the Effects of MFI's Loans on income of MSE Owners

The results of the effect of MFIs loans on income are presented in Tables 7 and 8. Table 7 presents *t*-test results where it can be seen that the average total income for members of MFI was about TZS 5 million while for non-members of MFI was about TZS 3 million and the difference was statistically significant implying that members of MFI had higher income compared to non-members.

Table 7: Test for difference between the income of MFIs Members and Non-members

Items	Members of MFI		Non-Members of MFI		P-Value
	Mean	n	Mean	n	
Total Income	5 023 017	60	3 000 000	50	0.0000

To determine the magnitude of effect, ANOVA was used to obtain the values of eta-squared as shown on Table 8 which shows that membership in microfinance institutions had a partial eta squared of 0.18 ($p < 0.0001$). The result implies that 18% of the variability in the income of individuals in the study area is accounted for by being a member of MFI.

According to the rule of thumb, the obtained value of eta squared is greater than 2% but smaller than 26%, this implies that MFIs have a significant medium effect on the income of MSEs owners' (Musyoki, N 2010 and Klein, P,G 1976).

Table 8: Tests of Between-Subjects Effects**Dependent Variable: Total Income**

Source	Type III Sum of Squares	d.f	Mean Square	F	Sig.	Partial Eta Squared
Corrected Model	114975840254849	1	114975840254849	23.73	0.000	0.180
Intercept	1742312687854847	1	1742312687854847	359.54	0.000	0.769
Member of Microfinance	114975840254849	1	114975840254849	23.73	0.000	0.180
Error	523367379563333	108	4845994255216			
Total	2478188828000000	110				
Corrected Total	638343219818182	109				

R Squared = 0.180

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The study analyzed the effect of microcredit on the income of MSEs. The results of the study showed that microfinance had significant medium effect on the livelihood of owners of MSEs which can be geared towards improving self employment opportunities.

The results also show these microfinances face a significant transaction cost on credit; the average transaction cost on loan is about 28% which is higher compared to IIM (2014) where transaction cost is around 7%.

The findings show that VICOBA are financial institutions which play a significant role in the study area compared to other MFIs such as SACCOS and banks.

5.2 Recommendation

In view of the above discussion, this study recommends the following.

Policy makers should put more emphasis on VICOBA as they have shown a significant impact on income.

More emphasis should be put on how to reduce transaction cost; group meetings could be organized on a monthly instead of weekly, identification of borrower could be based on digitalized photographs instead of printed photos. A significant transaction cost could be achieved through introduction of ATM and bank agency in rural areas.

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APPENDICES

Appendix 1: QUESTIONNAIRE

A. Basic Profile:

- 1.1 (a) Village.....(b) Ward.....
 - 1.2 Location.....(rural-1,semi urban-2, Urban -3)
 - 1.3 Gender:.....(male-1, female-2)
 - 1.4 Marital status:.....(married-1, unmarried-2, Widower
3,Separate-4)
 - 1.5 Age:(years)
 - 1.6 Education.....(No formal school-1, Std 4-2, STD 7-3, Form iv -4, Form vi -
6, college -5)
 - 1.7 Number of household size
 - 1.8 Number of dependent (Below 18 year and above 55 year)
 - 1.9. Average monthly income:
- Source of income:-
- a) Agriculture(Tsh)
 - b) Petty business (biashara ndogondogo)(Tsh)
 - c) Fisheries (Tsh)
 - d) Remittance (Tsh)
 - e) Salaries(Tsh)
 - f) Dividends (gawio) (tsh)
 - g) Wages(Tsh)
 - h) Revenue from

- i. Motorcycle
- ii. Car
- iii. House rent
- iv. Land rent
- v. Boat
- vi. Other source

2.0 Number of employee in your business.....

2.1 Age of your business

2.2 Amount saves per month

2.3 Household expenditure

a) Education for last 12 month

- i. School fees
- ii. Books
- iii. Uniform
- iv. Food
- v. Other contribution

b) Health expenditure for last 12 month.....

c) Food expenditure per day in household.....

d) Non food expenditure

- i. Electricity
- ii. Beverages
- iii. Fuel, charcoal and other source of energy.....
- iv. House rent
- v. Land rent

vi. Other expenditure,

2.4 Asset own by respondent (cycle for response)

Na	Asset	Number	Value	Total
1	Motorcycle			
2	House			
3	Land			
4	Boat			
5	Phone			
6	Radio			
7	Farm			
8	Car			
9	Plot			
10	Bicycle			
11	Other ...mention			
12				
13				

2.5 What is your main economic activity:(Farming-1, Service-2, Business-3, Labourer-4, House Wife -5, Retired-6, Others-7)

- a) If involved in service, then how much monthly salary.....
- b) If involved in business, then how much daily profit
- c) If involved in farming/Labour work, then how much daily wage.....

2.6 Are you a member of any microfinance organization (yes -1, no-2)

If yes (a) categories of the organization (VICOBA-1, SACCOS -2, Credit organization -3)

(b) Name of the organization

© Date of joining this organization.....

(d) saving amount in the organization

(e) Did you receive any loan from your organization...(yes-1, no-2)

- If yes (i) Amount of loan borrowed.....
- (ii) Purpose for the loan (1-business, 2-spent on food, 3-spent for education , 4-spent for health, 5-spent for assert, 6-spent for house construction, 7-Other specify.....)
- (iii) Actual use of the loan (1-business, 2-spent on food, 3-spent for Education , 4-spent for health, 5-spent for assert, 6-spent for house construction, 7-other specify.....)
- (iii) Amount of loan spend in business(Tsh)
- (iv) Amount of loan spent in food(Tsh)
- (v) Amount of loan spent in health services(Tsh)
- (vi) Amount of loan spent in House constructionTsh)
- (vii) Amount of loan used in purchasing the asset(TSH)
- (viii) Repayment period for the amount of loan borrowed.....
- (ix) Interest rate(Specify in term of percent and duration).
- (x) Time used in processing the loan.....

B. Nature of Transaction Cost-

B 1.Promotional Phase:

- a) Promotional meeting is conducted for how many days.....
- b) How much total time spent in attending all promotional meetings conducted by organization (Hours).....
- c) What are the total expenses incurred in travelling for attending all the promotional meeting?.....

- d) What are the expenses incurred in arranging the promotional meeting at a public place?.....

B 2.Group Training phase:

- a) Training is conducted for how many day
- b) How much total time is spent in attending all trainings?(HRS).....
- c) How much total travelling expense incurred while visiting the training place?.....
- d) How much total time is spent in travelling to the training place?.....
- e) What are the extra expenses incurred in visiting training place?.....
- f) What are the stationary expenses required during training period?.....

B.3. Borrowing Phase:

- a) How many times is it required to visit the bank for opening an account?.....
- b) How much total travelling expense incurred in visiting the bank for opening the account ?.....
- c) What is the 1-Cost of photograph.....2-Travel cost

- d) How much time is spent in visiting the bank for borrowing loan
(hours)?.....
- e) How much travelling expense incurred while visiting bank/group for
borrowing ?

B.4. Repayment

- a) How much total travelling expense incurred in visiting bank?/group for loan
repayment.....
- b) What is the total travelling time spent in visiting bank for repayment of
loan?.....
- c) How much fine is paid for non -payment of loan installment on
time?.....
- d) How much fine is paid for not attending the
meeting?.....

B 5.Group meeting phase:

- a) Meeting is conducted for how many day in week
- b) How much total time is spent in attending
meeting?(HRS).....
- c) How much total travelling expense incurred while visiting the meeting
place?.....
- d) How much total time is spent in travelling to the meeting
place?.....
- e)What are the extra expenses incurred in visiting meeting
place?.....

Appendix 2: Checklist for key informant

1. Existence of the Microfinance in the District
2. Types of the microfinance operate in the District.
3. The potentiality of the different type of microfinance in the district.
4. Distribution of this microfinance in the district