

## Rural Finance Challenges in Tanzania – the case of Kibaigwa Financial Services and Credit Cooperative Society (KIFISACCOS) in Kongwa District

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**Abstract:** This case gives some insight into the challenges that a rural community faces with regard to access to financial institutions. Interviews and discussions were held with the members of the community-based Kibaigwa Financial Services and Credit Cooperative society (KIFISACCOS). These results were combined with an institutional review of the co-operative. It was concluded that improved financial management and more tailored lending services would improve rural community livelihood.

**Keywords:** microfinance - rural financing – challenges – Kongwa – Tanzania

### *Rural financial supporting services*

Rural economic development requires, among other things, well-functioning financial supporting services. The Kibaigwa Financial Services and Credit Cooperative society (KIFISACCOS) was established to support the rural community of Kongwa district in Tanzania. This study attempts to identify whether this bank-linked financing system meets the needs of its rural clients. The research method used was a cross sectional and descriptive research strategy for which information from sampled respondents and selected key informants was collected through structured interviews, semi-structured interviews and discussions. Additionally, a SWOT (Strengths/Weaknesses/Opportunities/Threats) analysis was conducted as well.

### *KIFISACCOS-established and owned by a farmers' network*

The KIFISACCOS society resides in Kibaigwa village at about 50 km from Dodoma Municipality. It was established in 2000 by a farmers' network from six villages including 200 founder members. The initial capital consisted of TZS 5 million obtained from members' contributions. Up to 31 August 2009, KIFISACCOS had 2125 members, with 1572 men, 480 female, 70 groups and a total shared value of TZS 50 493 138. It is one of the twenty-five SACCOS's in Dodoma region that are in partnership with the CRDB Bank Public Limited Company (PLC). The partnership agreement was signed in 2001. It includes a financial linkage comprising, among others, material support, capacity building and technical assistance .



## **KIFISACCOS: partners, products & services**

### **Partner financial institutions**

KIFISACCOS partners with different financial institutions and Non Governmental Organizations (NGOs) interested in rural community economic development. These include the CRDB Bank Public Limited Company (PLC), Lutheran World Relief (LWR), the Savings and Credit Cooperative Union League of Tanzania (1992) Ltd (SCCULT) and Small Enterprise Loan Facility (SELF). Every partnership has its own agreement and conditions which are clearly stipulated in the memoranda of understanding (MOU). The CRDB Bank partnership differs from the other partnerships as the CRDB Bank sensitized the Kibaigwa community into establishing KIFISACCOS, and was as such involved from the beginning. Apart from giving credit, it also provides material and technical support.

### **Products & services**

KIFISACCOS provides a total of ten products including a savings account, a fixed account, a junior (children) account, a contract account and a cumulative account. And, it offers different types of loans: a farming loan, a business loan, a social loan, an agricultural inputs loan and a business emergency loan. Agricultural businesses involved were mainly the buying and selling of crops. Loan products were supposedly designed after considering the needs of the members and the community of Kibaigwa Ward at large.

### **KIFISACCOS performance**

Despite the mentioned partnerships and material and technical support from established Microfinance Institutions (MFI's), KIFISACCOS is in a weak condition with a very poor loan recovery performance, high defaulting rates and a large loan amount in arrears. As of June 2009, KIFISACCOS had a total of 1461 bad debts (see Tables 1 and 2). The repayment period for these loans was long overdue ranging from 120 days to more than three years (Table 2). KIFISACCOS creditors' profile by November 2009 indicated a total outstanding loan portfolio (interest accrual included) of TZS 762 492 609. Table 1 indicates the principal amounts of loans, interest accrued and the penalties (fines) for

late repayments. Table 2 indicates loan ageing, where for instance, group six represents loans of which repayments have been behind for more than 120 days, i.e. 1461 loans.

### **KIFISACCOS members' opinions**

A survey among KIFISACCOS members was carried out to gain insight into the society's functioning. A sample size of 60 respondents should provide a realistic and representative picture of its performance. Fifty-two percent of the respondents were aware of all the products and services offered by the SACCOS while 48.3% out of the sample size of 60 were not. The latter rather high percentage raises concern on the way the products were developed and their overall suitability for the intended clientele. However, unawareness is not necessarily a reason for poor performance since one does not need to know all the products in order to repay his/her loan. Nonetheless, ignorance on the available products may affect people's choice for more suitable alternatives, e.g. some members involved in farming were not aware of the availability of loans for agricultural equipment. Members also indicated that they were not happy about the way the agricultural loans were given in terms of repayment period and timing of disbursement. Since most KIFISACCOS members are farmers, it is logical to have a sustainable tailor-made agricultural credit line next to other products, e.g. credit designed for a specific agricultural crop. This should be administered in a way that reduces risk to both the borrowers and the institution. One can hardly expect a borrower to repay an agricultural loan immediately after harvest. It should at least be taken into account that a farmer needs time to sell the crops so that s/he gets the maximum profit possible. Custom-made loaning might stimulate timely loan repayments. Institutions like KIFISACCOS have to offer a variety of financial products and flexible services that suit their rural clients. In a nutshell, the study concludes that KIFISACCOS' products do not sufficiently suit the members' cash flow cycles.

**Table 1: KIFISACCOS Loan portfolio as of 31 June 2009**

Particular	No. of Loans	Principal amount	Interest accrual	Penalty (fines)
Previous Loans	6	1,698,700	305,766	15,270
New Loans	9	13,780,000	2,480,400	
Total	15	15,478,700	2,786,166	15,270
Repayments		21,130,000	384,400	
Balance		13,348,700	2,401,766	15,270
Bad Debts	1461	824,317,885	395,672,585	
Total		837,666,585	398,074,351	15,270

Source: KIFISACCOS, 2009

**Table 2: Classification of outstanding loans as of 31 June 2009**

Group	Days	No. of Loans	Principal amount	Interest accrual	Penalty (fines)
Group one	0	9	11,650,000	2,097,000	
Group two	01 to 30	5	1,541,500	277,470	
Group three	31 to 60	1	157,200	28,296	15,270
Group four	61 to 90	0	0	0	0
Group five	91 to 120	0	0	0	0
Group six	more than 120	1,461	824,317,885	395,672,585	0
Total			837,666,585	398,075,351	15,270

Source: KIFISACCOS, 2009

## Factors affecting loan repayment

As already briefly touched above, the lending modality is one reason influencing loan repayment. There are more factors, that have an effect on settling loans, e.g. inadequate loan follow-ups by the management, inadequate collateral verification bad repayment system members' failure to honour their obligations and insider dealings, all of which are discussed in more detail below.



Fig 1. One of the houses indicated as collateral

## Bad repayment system

Often, people get a loan refinanced before the outstanding balance on their previous loan was fully refunded. If so allowed, people do not feel compelled to timely repayment. They will time and again wait for the repayment time to expire falling into the trap of mounting debts (making them poorer in fact). The borrower eventually completely fails to repay his/her loan as s/he ends up with a larger loan with no corresponding economic undertaking to service it. Sixty one percent of the respondents (Table 3) said that they have either followed such lending procedure themselves or at least knew a member who has been allowed by the KIFISACCOS management to do so.

Table 3: Renewing of loans on unsettled previous loans

Refinancing on unsettled previous loan	Percent n=60
Yes	61.7
No	38.3
Total	100.0

## Inadequate collateral verification

Collateral verification is one of the very important issues in the credit business. KIFISACCOS staff and management confirmed to have never gone into the villages to verify collaterals before disbursing the loans. Almost all borrowers declared to have offered their houses as collaterals. But most of these were mud houses located in remote areas thus not valuable enough to cover the loans sanctioned (see for instance fig 1). This has contributed to loan defaulting as the collaterals are highly inferior when compared to outstanding loan amounts. These examples may indicate staff inadequacy on how to register different charges like mortgages, liens, guarantees, etc.

## Inadequate loan monitoring by KIFISACCOS management

There was a management leniency in making loan follow-ups. Records did not show any security liquidation as all that was confiscated from loan defaulters, was only stored at the SACCOS headquarters waiting until owners would repay their loans and collect their collaterals. Some of the properties were dubiously returned to the owners before loan repayment commitments were met. Management leniency on loan follow-ups seems to have been going on for some time. In 2006 the Board extended the repayment time for a year to all agricultural loan debtors. The reason given was severe drought. However, in 2007 there were adequate rainfalls but no positive changes in repayments were noted.

It is not only KIFISACCOS' management that affects the performance of the SACCOS, the members also play their part. They did not feel responsible for the SACCOS and subsequently forsaken their obligation to repay their debts. Eighty-three (83%) percent of the respondents agreed to have defaulted at one time or another. Physical observations during the field work, showed that some members proved to be economically and financially capable of repaying their loans if they wanted to, when looking at their material possessions and income generating activities. For instance, bad debts amounting to TZS 23 017 600 out of the total bad debt portfolio of TZS 837 666 585.00 were due from civil servants. Their defaulting could be attributed to negligence and lack of pressure from KIFISACCOS and their attitude to debt. An analysis beforehand

on people's accountability could avoid such situations.

## Over-capitalization of borrower projects

Often, over-financing of projects leads to loan defaulting as debtors lack corresponding investments to service loans. KIFISACCOS records indicated a prevalence of multiple loans to some individuals of which some were obtained through insider dealings.

## Loan fraud

Cases at hand include one person having a total debt amounting to TZS 17 million obtained through faked names of his family members. He acknowledged his debts but lacked any viable economic activity or asset to repay the debt. Another person had a total of more than TZS 15 million in debts outstanding for similar reasons. In an apparent confirmation of this malpractice, his daughter was astonished to find herself listed among the defaulters for a loan purported to have been obtained when she was still schooling and had never applied for it. A good part of bad debts within KIFISACCOS was due to such malpractices and leaders lacked moral authority to fight it.

## Impact of bank-linked SACCOS financing system

The CRDB Bank loan to a community based SACCOS requires that 25% of the loan be deposited in a fixed deposit account as security prior to disbursement. SACCOS are asked to raise this amount from their members' savings and deposits and not otherwise. However, SACCOS often request the banks to deduct the amount from the loan itself, and though not allowed, sometimes credit staff of a bank accept this procedure from time to time in order to improve their credit portfolios. Borrowers are in such case fully aware that they will have to repay the whole loan amount plus interest at the end of the repayment period. Also KIFISACCOS follows similar ways of lending. Likewise, SACCOS choose to settle outstanding loans with a new loan for their members when they fail to repay their loans in time. This is done by deducting the outstanding loan amount on the new loan. Interest earned on loans to members is the major source of the much needed income for SACCOS to expand capital and cover for other expenses. If part of the loan is not

invested, it becomes the biggest hindrance to the growth of the SACCOS. However, the banks cannot actually be blamed for this. Therefore, the causes for SACCOS financial problems are internal rather than external.

## KIFISACCOS SWOT analysis

After the previous description of the way in which KIFISACCOS' operates, their loan products and services, and a more narrative explanation of its performance, here the results of a SWOT (Strengths; Weaknesses; Opportunities; and, Threats) analysis will be presented. The SWOT was carried out to identify favourable and unfavourable factors to either elaborate or eliminate these so as to work towards an optimal functioning of the SACCOS.

### Success factors (strengths)

#### *Qualified personnel*

KIFISACCOS has capable employees in terms of educational qualification and skills i.e. both the interim manager and the coordinator had advanced diplomas in accountancy, whereas the agricultural extension officer had a diploma in agriculture. The assistant credit officer was a form four leaver. Such qualified personnel is rarely found in most rural SACCOS in Tanzania.

#### *Availability of physical infrastructure*

The SACCOS has its own building of 300 square meters and an undeveloped plot of 128 sqm which can allow further expansion.

#### *Outreach capacity*

KIFISACCOS has a good outreach in terms of numbers of members reached. Demand for its services is also high despite the poor service, since there is no other MFI in the area that has sufficient capacity to serve the community in need of financial services.

#### *Supportive government policy and infrastructure*

The existence of formal policy documents, guidelines, and operational procedures gives SACCOS and other microfinance stakeholders guidance in their own policymaking. These government documents include the cooperative development policy of 1997, the national microfinance policy of 2000, the Cooperative Societies Act No. 20 of 2003 and Cooperative rules and regulations of 2004.

### Weaknesses

#### *Poor management and leadership*

The overall managerial capacity on the part of KIFISACCOS board is poor. Despite the presence of qualified personnel and proper equipment, e.g. computers, loan follow-up does not take place and record keeping is poor. Further, misuse of office motorcycles being used for ex-officio matters was reported. Decision making is affected by the fact that ideas and situations are poorly conceptualized by the board.

#### *Dependency on rain fed agriculture*

Clustered under the heading of weaknesses but maybe rather something that is beyond people's control is the fact that the majority of the members depend on rain-fed agriculture as a major source of income. Unreliable rainfall hampers the harvesting of crops which in turn affects the members' cash-flow and hence the SACCOS performance. Over 66% of the respondents mention the selling of food crops as their main source of income with only 26.7% claiming to be involved in other businesses not related to agriculture. Selling involves mostly arbitrage of maize and sunflower seeds.

#### *Inadequate management information system (MIS)*

KIFISACCOS has a poor record keeping system, e.g. some ledger cards could not be located in the office. Besides, almost all records are in hard copies despite the availability of computers.

### Opportunities

#### *Maize bulking market*

Kibaigwa ward is strategically located and has potential for economic growth and if the SACCOS were properly exploited, the population can likewise benefit from this strategic location. The close proximity to the Kibaigwa maize bulking market, with a capacity of 100,000 tons turnover per year, could create good business opportunities to KIFISACCOS through increased cash turnover from its operations. For instance, at the time when KIFISACCOS was still solvent, middlemen and maize buyers used to deposit their cash at the SACCOS for security purpose, also a POS (point of sales) was installed by CRDB Bank were businessmen used their debit cards instead of travelling to Kongwa or Dodoma to visit banks.

#### *Goodwill*

Because of the presence of established

financial institutions such as CRDB Bank PLC, Lutheran World relief (LWR), Small Enterprise Loan Facility (SELF) and the Savings and Credit Cooperative Union League of Tanzania (1992) Ltd (SCCULT) the SACCOS (can) benefit(s) from the willingness of these institutions to provide financial and technical support. Despite failure to repay loans in time, funding MFIs have been agreeing to restructure their loans so as to give more repayment time to KIFISACCOS.

## Threats

### *Insolvency problems*

The imminent threat for KIFISACCOS is the eventual collapse due to insolvency. Insolvency may come from increased loan defaulting by members which will automatically lead to lack of internal and external financing. External financiers will eventually shy away if the SACCOS' poor performance continues unabated.

## Prospective future improvements

The development of better/improved access to rural microfinance is seen as a dynamic and ongoing process that guides the lending institution towards meeting specific demands of the rural clientele (Friedman, 2003). These could for instance be tailored to agricultural or social loans. The KIFISACCOS case shows that there is a world to win and therefore we have the following recommendations.

### *Capacity building*

Capacity building to MFIs management should be intensified so as to be able to make reasonable decisions and adhere to institutions' constitutions, policy and regulations. Capacity building trainings in various managerial and technical aspects, though expensive, will be more effective if they pinpoint and address prevalent weaknesses in such organizations, KIFISACCOS being no exception (Statham, 2008).

### *Tailored products*

A proper need assessment will ensure appropriate product design. For rural areas, there is not a single product that universally suits each and every situation. Products will depend on the socio-economic undertaking of a community. Thus, MFIs need to provide tailored lending services that match their clients' demand instead of rigid loan products

(Brau and Woller, 2004). It is not enough to offer, for example, the earlier referred to agricultural loans under a condition that the borrowers should repay immediately after harvest. The loan should be properly structured to ensure that borrowers are not derailed from their prime objective of maximizing profit on their investments. This will also be an incentive for borrowers to continue working with the SACCOS.

### *Incentives*

In order to encourage borrowers to repay their loans on a regular basis, KIFISACCOS may develop a policy that gives discount on interest to regular and long time borrowers who show a good previous repayment performance. This will benefit the SACCOS not only in reducing its Non-Performing Loans (NPLs) but also in increasing the saving of its clients. Such a system has benefited MFIs in other countries like Pakistan (Khan et al., 2007), where regular borrowers with good repayment performance history received discount on interest.

### *Promotion of savings*

Members should be encouraged to make savings. These will enlarge SACCOS liquidity and increase availability of cash which, on its turn, could be used to extend loans to members for various projects, improving members' livelihoods. Ideally, the SACCOS can then expand and become a self-sustained fund that will not be solely dependent anymore on external financing. Currently, KIFISACCOS' members only save as they are required to do so for obtaining a loan. For employee-based SACCOS, the situation is even worse as for this type of SACCOS savings are not even a prerequisite to get a loan.

### *Improved partnership*

Although SACCOS for the time being still rely on the financial support of banks, they could invest in their relationship with the bank by regularly partnering up to make sure that both partners can benefit of the relationship they have. Banks could go beyond loan advancement and support the SACCOS in other areas as well. They could advise on and assist in product development, collateral verification and loan monitoring strategies as these are the fields in which SACCOS encounter their major problems. It is further recommended that cooperative trainings need to be given to the community (members), for them to understand their rights and hence their role as SACCOS owners.

## Concluding remarks

The title of the study already says it: there are quite some challenges when it comes to the provision of financial services in rural areas. The case of Kongwa district shows that it takes more than the presence of banks and SACCOS to improve rural community livelihood. People must be made aware of the services offered and the

requirements to be met. Creating a savings culture, capacity building with regard to financial management, linking up with partners and tailor made provision of loans following the annual agricultural growth cycle are among the recommendations given. The KIFISACCOS case demonstrates that there is still a world to win to have rural economic development supported by well-functioning financial services.

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## Colophon

“Rural Finance Challenges in Tanzania – the case of Kibaigwa Financial Services and Credit Cooperatives Society (KIFISACCOS) in Kongwa District” is the second of a series of case studies published by Business Minds Africa to be used for training professionals in agricultural entrepreneurship for the East African job market. Business Minds Africa is an international collaborative network composed of partners from Europe and East Africa, thus combining development expertise with educational capabilities. The case can be downloaded from <http://businessmindsafrica.org/>. The case was brought in by Karumuna Leonidas (Relationship Manager CRDB Microfinance Services Company Ltd Musoma Branch) and Akyoo, Adam M. (lecturer & supervisor) from the Department of Agricultural Economics & Agribusiness, Sokoine University of Agriculture, Morogoro, Tanzania.

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