THE UNITED REPUBLIC OF TANZANIA

MINISTRY OF FINANCE

NATIONAL MICRO-FINANCE POLICY

MAY, 2000

PRINTED BY THE GOVERNMENT PRINTER
DAR ES SALAAM—TANZANIA

NATIONAL MICRO-FINANCE POLICY

TABLE OF CONTENTS

1.0 INTRODUCTION

1.1 Financial Sector Reforms

In 1991 the Government initiated financial sector reforms in order to create an effective and efficient financial system. The lynchpin of those reforms was the Government's "commitment to allow banking institutions to operate on a commercial basis, making business and management decisions free from outside intervention 11within the norms of prudential supervision." (Financial Sector Reform: A Policy Statement).

1.1.1 To implement this commitment, the principal elements of the financial sector reform included: liberalization of interest rates, elimination of administrative credit allocation, strengthening of the Bank of Tanzania's role in regulating and supervising financial institutions, restructuring of state-owned financial institutions, and allowing entry of private banks (both local and foreign). These reforms were embodied in the Banking and Financial Institutions Act, 1991. In the same year, the Cooperative Societies Act, 1991 provided the basis for the development of Savings and Credit

Co-operative Societies (SACCOS) as equity-based institutions.

1.1.2 Since 1991, much of the financial sector reform agenda has been implemented and has had an appreciable impact. Two of the state-owned commercial banks in existence prior to the reforms, namely the National Bank of Commerce (NBC) and the Co-operative and Rural Development Bank (CRDB), have been restructured, and restructuring of the People's Bank of Zanzibar (PBZ) is underway. Local and foreign private banks have also been established. As at end of March 1999, there were 31 institutions: commercial banks, non-bank financial institutions (NBFIs), rural community banks and a cooperative bank. Competition is inducing the development of new and more efficient financial services.

1.1.3 Despite this progress in the mainstream banking system, micro-finance services have been slow to develop because although micro-finance institutions (including donor and Government programs and schemes) have been in existence even before the reforms, they have remained weak due to a number of factors including the following:

- Interest rates are not set by the organizations/programs/schemes themselves and as such, in most cases they are set at levels that are too low to cover operational costs;
- Non-Governmental Organizations (NGOs) providing micro-finance services have continued to depend on donor funds for their operations instead of building their own internal capacity;
- There has been no procedures for coordination, tracking and analysis of micro-finance operations;
- NGOs and other micro-finance schemes operate under different laws which render it difficult to monitor them and develop common standards; and
- Operational problems with respect to SACCOS include poor administrative systems and weak financial control within the societies as well as lack of effective supervision of the SACCOS as financial intermediaries.

Furthermore, the impact of some of the reforms, such as the closure of branches during restructuring programs and the abandonment of directed credit, have actually reduced the services available to low income people. The Government realizes that while the financial market principles enshrined in the 1991 reforms retain their guiding force as the basis for sound financial sector development, additional focus must be placed on the expansion of financial services to micro-level clients. The restructuring of NBC and the resulting establishment of the National Micro-finance Bank (NMB) illustrates the Government's vision in this area. Micro-finance systems are, and will increasingly become, integral parts of the country's financial sector.

..2 The Need for Micro-finance

1.2.1 For the majority of Tanzanians, whose incomes are very low, access to financial services offers the possibility of managing scarce household and enterprise resources more efficiently, protection against risks, provision for the future, and taking advantage of investment opportunities, for economic returns. For households, financial services allow higher standards of living to be achieved with the same resource base, while for enterprises and farmers, financial services can facilitate the pursuit of income growth.

1.2.2 Savings services are among the most beneficial financial services for low-income people. Nearly all households need to save to protect themselves against periods of low income or specific emergencies and to cover large anticipated expenses (like school fees). Enterprises also need to store the value they accumulate from their profits until they can invest them to earn a higher return. Moreover, savings in financial form provide funds for investment by others. Thus, savings services can have a very broad outreach and value.

1.2.3 Credit services can perform some of the same services as savings and can allow enterprises and families to make some important investments sooner. Enterprises use credit as a source of short-term working capital and longer term investment capital. Households use it to meet consumption needs, particularly during periods when income flows are low, such as during the off season before crops are harvested, and to make investments, such as housing improvements.

1.2.4 Payments and other related services are also valuable to low income people and to the residents and institutions in rural areas. Payments services can play an important supporting role in the overall profitability of the financial institutions that offer them.

1.2.5 In short, micro-finance addresses the financial needs of major sectors of the Tanzanian population. They are primarily facilitators rather than creators of the underlying economic opportunities that lead to widespread economic prosperity. Micro-finance services are financial in nature. They differ materially from social welfare and resource transfer policies, although they can contribute to the reduction of poverty and improvement of income distribution.

2.0 OBJECTIVE AND SCOPE OF THE POLICY

2.1 Overall Objective

The Government considers micro-finance system as an integral part of the financial sector that falls within the general framework of its Financial Sector Reform Policy Statement of 1991. The overall objective of this policy is, therefore, to establish a basis for the evolution of an efficient and effective micro financial system in the country that serves the low-income segment of the society, and thereby contribute to economic growth and reduction of poverty by:

2.1.1 Establishing a framework within which micro-finance operations will develop;

2.1.2 Laying out the principles that will guide operations of the system;

2.1.3 Serving as a guide for coordinated intervention by the respective participants in the system; and

2.1.4 Describing the roles of the implementing agencies and the tools to be applied to facilitate development.

2.2 Coverage

The policy covers the provision of financial services to households, small holder farmers, and small and micro enterprises in rural areas as well as in the urban sector. It covers a range of financial services, including savings, credit, payments, and other services. Clients use these services to support their enterprises and economic activities as well as their household financial management and consumption needs. Financing for all types of legal economic activity is included, e.g. commerce, trade, manufacturing and agriculture. For policy purposes, the definitions of small and micro-enterprise cannot be determined through arbitrary limits such as the number of employees, or the value of assets or sales. Rather, the policy is directed at services for low-income families and their enterprises that have lacked access to financial services from mainstream financial institutions.

3.0 POLICY PRINCIPLES FOR MICRO-FINANCE.

3.1 Vision for Development of Micro-finance

This policy is guided by a vision of achieving widespread access to micro-finance throughout the country, made possible by institutions operating on commercial principles. A wide range of institutions will be involved in the provision of services, including specialized and non-specialized banks, non-bank financial institutions, rural community banks, cooperative banks, SACCOS, and NGOs. Some providers will focus on credit, some on savings, and others on both. Micro-finance will be integrated with the mainstream financial system with the flexibility that ensures that their special features are not compromised. The institutions will use a variety of methodologies, each adapted for its particular market niche. Competition will ensure that service providers operate efficiently and provide high quality services. The system as a whole will provide financial intermediation without necessarily relying on injections of external donor or government funds. Subsidies will no longer be needed, except perhaps for organizations pushing the frontiers of the system out to the most remote or poorest clients.

While this vision remains in the future, it has immediate value in guiding choices about decisions today. Support to micro-finance should be compatible with and should contribute to the realization of this long-range vision. This vision favors building long-term sustain ability over immediate distribution of funds on an unsustainable basis. Only through a focus on long term sustain ability will the majority of low-income people have a chance of gaining access to financial services. In more operational terms, best practice principles are compatible with the achievement of building strategies towards the vision.

3.2 Best Practice Principles

Around the world, lessons of experience in providing financial services to low income people have converged in a consensus about how to provide such services effectively, efficiently, and sustainably. The resulting best practices combine commercial financial principles with a variety of ways to adapt service delivery techniques to the circumstances of low-income clients[1]. The Government expects institutions involved in micro-finance to apply these practices or to develop the capability to do so.

---

[1] BRI of Indonesia and BancoSol of Bolivia are good examples of successful micro-finance institutions that follow best practices when delivering their services to low income people.

Donors and others who provide support for micro-finance operations should insist on the application of best practices.

3.2.1 Pricing

Pricing is one of the most important determinants of the potential of micro-finance services to become sustainable. Prices should be set by the micro-finance organizations themselves, not by the Government, the Bank of Tanzania or donors because it is only the institution that has the full knowledge of its costs, the market it faces, and its own business strategy that forms the basis for pricing decisions.

3.2.2 Delinquency Control

Among the most basic competencies required of any micro-finance provider is that of getting loans repaid. Best practices in this area include:

(a) maintenance and active use of accurate, up-to-date information on portfolio status (at various levels of the organization) including aging of arrears;

(b) implementation of appropriate provisioning and write off policies; and

(c) delinquency management that involves prompt and active follow-up with delinquent clients.

Delinquency and loan loss should be maintained at a level that does not threaten the viability of the operation.

3.2.3 Financial Reporting and Information Management

As financial sector operations, micro-finance programs applying best practices need to produce relevant financial and operational information that give a clear picture of the status of the organization, including outreach, profitability (or loss) and portfolio quality. Such information should show subsidies explicitly, so that the prospects for subsidies to be eliminated can be assessed. Programs would use such information in managing their operations, e.g. as part of an overall system of internal control.

3.2.4 Appropriate Techniques and Products

Micro-finance programs use techniques and products adapted to the circumstances of low-income clients. Particular techniques may vary widely. A variety of collateral substitutes and repayment incentives can be used so that loans are not secured in a conventional sense, but are adequately protected against risk.

3.2.5 Gender Equity

Access to financial services should be available to both men and women. In order to achieve gender equity in the delivery of services, it may be necessary to make special efforts to incorporate features that make the services accessible to all.

3.2.6 Governance

Institutions should have sound governing structures suitable to their institutional types. Governance may occur through various corporate forms of organizations or through cooperative ownership. Participation by clients may in some instances be a fundamental principle of the governance structure. However, the Government and political interference in governance should be avoided.

4.0 TOOLS FOR POLICY IMPLEMENTATION

4.1 Regulation and Supervision

In regulating and supervising micro-finance operations, the Supervisory Authority will apply the same fundamental principles it applies to other parts of the financial system. These principles involve protection of depositors and of the financial system through the application of prudential financial norms. However, adjustment in the regulations will be required in order to accommodate the special characteristics of micro-finance operations. A framework for regulation and supervision will be developed to address among others the following issues:

4.1.1 There is little need to regulate institutions (like micro lending NGOs) that are not deposit-takers. Accordingly, only those institutions licensed to accept deposits from the public or from other financial institutions will be subject to regulation and supervision.

4.1.2 As a practical matter, it is difficult to supervise very small organizations. Moreover, when such organizations are organized cooperatively among people who know each other, many of the risks that regulation protects against do not arise, particularly risks to the broader financial system. Accordingly, supervision will only be applied to organizations above a certain size, to be determined by the Supervisory Authority.

4.1.3 One of the main differences between micro-finance and other forms of finance is the prevalence of loans that are not secured in a conventional manner. It will be necessary to develop specialized regulations and methods of supervision to allow for such lending to take place. These regulations will focus on overall portfolio risk rather than on legal security for each loan, and on the quality of management systems for maintaining portfolio quality.

4.1.4 Minimum capital and other entry requirements for successful operation of micro-finance institutions may differ from those required for full service commercial institutions. The Supervisory Authority, after further investigation of the needs and issues, will decide on the licensing requirements for such institutions.

4.2 Development and Application of Standards

Standards of performance are an important tool for helping institutions advance, especially for those institutions outside the regulatory framework. For micro-finance institutions, standards need to address mainly three broad areas: outreach to clients, institutional development, and financial performance. Standards can provide clear signals about what institutions need to accomplish in the course of their development. They allow comparison of institutions to assist donors in directing support to institutions that are most likely to grow and become sustainable. In the country today, some programs of donor support to micro-finance institutions use standards of this sort to determine eligibility for funding. Practitioners and other private entities (such as rating agencies) are best placed to develop such standards, both because the expertise lies in private hands and in an evolving setting such as Tanzania, standards may change over time. The Government encourages practitioners to work together to create self-regulatory mechanisms, to define standards, and to help organizations improve their operations to meet the standards. The Government will not be involved in administering standards, although the Bank of Tanzania may contribute to efforts to develop them.

4.3 Capacity Building

Most of the micro-finance institutions currently operating in the country are small and/or new. A great deal of capacity building is required to bring them to the level at which they can operate with large outreach, quality services and profitable operations. Much of the capacity building will take place within institutions, through their development of systems, training of staff, and building of management and governance capabilities. Other types of capacity building will take place across institutions. For example, there is a need for professional service providers in accounting, audit and computer information systems who understand micro-finance and can work with institutions. Efforts to train and build capacity will need to be centered on the standards addressed immediately above. The Government considers this area a priority and donors are encouraged to do the same.

5.0 ROLES AND RESPONSIBILITIES UNDER THE POLICY.

5.1 Government

In micro-finance, as in other aspects of financial sector development, the Government's major role will be to create a supportive macroeconomic setting and a regulatory environment that allows sound financial institutions offering micro-finance services to emerge. The key Government functions with direct benefits for such services will include keeping inflation low, allowing interest rates to be set freely, developing rural infrastructure to allow access to remote areas, building a healthy credit culture through public awareness programs, providing high-quality and independent banking supervision, and developing a legal framework supportive of financial institutions' operations.

It has been shown in many countries, that direct involvement by the Government and political entities in financial service provision is usually counter-productive. Among the most salient lessons in this area is the negative effect on credit discipline, and hence sustain ability of loans offered by the Government or perceived to be politically motivated. Accordingly, neither the Government nor political parties will be direct providers of micro-finance services. This applies to both Central and Local Government. The Government will avoid putting its budget at risk through exposure to unsustainable micro-finance institutions.

Nevertheless, because of its interest in seeing that all Tanzanians have access to financial services, the Government will at times take on a promotional role. For example, it may encourage and guide donors in establishing programs to support micro-finance institutions in building internal capacity, it may promote the adoption of best practices and standards by service providers and it may support capacity-building efforts. In its promotional activities, the Government will leave it to the institutions to make their own choices on matters that properly belong to the institutions themselves, such as product development, delivery methodology, loan terms and pricing, geographic location, and target clientele.

5.1.1 Ministry of Finance

The Ministry of Finance has the overall responsibility of the Government finances and is responsible for the development of the financial system on the part of the Government. It oversees all official donor assistance coming into the country, including programs planned jointly with other Government Ministries. In this role, it will ensure that all such programs are consistent with this policy statement and based on best practices.

5.1.2 Bank of Tanzania

As the Government entity vested with oversight of the financial sector, the Bank of Tanzania will have overall responsibility to coordinate the implementation of the micro-finance policy.

5.1.2.1 The Bank of Tanzania will ensure that a regulatory and supervisory framework that is supportive of micro-finance operations and consistent with financial prudence is developed.

5.1.2.2 The Bank of Tanzania will coordinate implementation of this policy. It will collect and disseminate relevant information, monitor the progress of the sector, examine key technical issues relevant to service providers, and advise other Government organs or departments on the appropriate structures for their efforts in supporting micro-finance. In all these activities, it will liaise closely with donors and the service providers. Specifically, the Bank of Tanzania will advise the Ministry of Finance on the technical aspects of such Government programs in micro-finance.

5.1.3 Other Government Entities

Micro-finance appears in various policy and strategy documents issued by the Government ministries as an element in their programs. It is the responsibility of each of these entities to ensure that the design and implementation of their programs is in accord with best practices and with the policy statement. These entities will consult with Bank of Tanzania regarding the consistency of their programs with the policy and on related technical issues.

5.2 Providers of Micro-finance Services

The institutions that provide micro-finance services are the real driving force behind the achievement of the ultimate goal stated in this policy statement. The Government's goodwill will accomplish little without the effort and commitment of financial institutions, NGOs, SACCOS, and other service providers. Such institutions are free to develop micro-finance services on the basis of their own internal objectives, whether profit, poverty alleviation, self-help, or other motivations. They will not be required to support the sector, but will be encouraged to learn about such services, to make informed choices about the fit between their organizational objectives and services to the rural sector and micro enterprises. The Government expects institutions that decide to become micro-finance service providers to fulfill their responsibility to learn best practices and to apply sound financial principles in the delivery of their services.

5.2.1 Banks and Non-Bank Financial Institutions

A variety of licensed, regulated and supervised financial institutions currently operating in the country, include commercial banks, non-bank financial institutions, community banks, a cooperative bank, and a micro-finance bank (the recently established National Micro-finance Bank – NMB). As deposit-taking institutions, these entities are required to meet prudential norms. Where possible, the Government might provide incentives for these institutions to enter the micro-finance markets. It, however, recognizes the fact that not all of them will enter such markets. Some lack the comparative advantage in this area.

5.2.2 SACCOS

These institutions operate under the Co-operative Societies Act, 1991 in offering savings and credit services to members. They are also covered under the Banking and Financial Institutions Act, 1991 as financial intermediaries but the Bank of Tanzania does not supervise them.

The Government recognizes the following important guidelines for efficient sustainable operations of SACCOS:

- As savings-based institutions, regulation and supervision is necessary once the institutions reach more than a small group of members.

- As savings-based institutions, it is important to ensure that lines of credit for loanable funds do not undermine incentives to promote savings.
- Pricing policies for SACCOS should promote savings and allow sufficient interest rate spread for the profitable operations of the SACCOS.
- Promotion of SACCOS is best separated from their supervision in order to ensure that supervisors apply standards objectively.

To date the responsibility for the supervision of SACCOS has been placed in the hands of the Ministry of Agriculture and Cooperatives. The Banking and Financial Institutions Act, 1991 provides for the Bank of Tanzania to have overall responsibility for financial sector regulation. The Bank of Tanzania, therefore, has the authority to ensure that SACCOS are supervised in accordance with prudential financial norms. In the process of strengthening SACCOS, it is important that they either become or are linked to professionally managed financial institutions. Thus, it is envisaged that stronger SACCOS will evolve into community banks, join together to form other cooperative banks or form alliances with other financial institutions.

5.2.3 NGOs

NGOs are particularly important in reaching very poor or difficult-to-serve clients and in developing and testing innovative products and service delivery mechanisms. NGOs will not be subject to financial regulation and supervision as long as they do not accept voluntary deposits. NGOs wishing to gain permission to accept deposits will have to become licensed regulated institutions with appropriate shareholding and governance structures, adequate capitalization and profitable operations. This will require their transformation from NGOs into other organizational forms. It is their responsibility to learn and apply best practices in micro-finance, and to structure their operations so as to reduce and eliminate their dependence on subsidies and donor funds, to the maximum degree compatible with reaching their targeted population.

This responsibility includes the provision of accurate and complete financial information.

5.2.4 Donor Community

Currently donors are the main sources of capital, particularly start up capital, for the provision of micro-finance services to NGOs. They also provide funds for capacity building. The Government expects all donor programs supporting micro-finance in the country to comply with this policy. Donors will coordinate with each other and with the Government to ensure that their programs embody common standards and complement other Government and donor activities.[2] Care will need to be taken by donors to ensure that NGOs that they support develop sustainable operations so as to ensure the latter's existence after donor support ends.

[2] Donors are already bound by the guidelines contained in "Micro and Small Enterprise Finance: Guiding Principles for Selecting and Supporting Intermediaries." These guidelines, which have been officially adopted by nearly all-bilateral and multilateral agencies, cover institutional characteristics, forms of donor support, and financial reporting standards.

6.0 POLICY MONITORING AND REVIEW

Systematic Monitoring and Evaluation (M & E) is essential for policy assessment. The Government will from time to time undertake systematic monitoring and evaluation, to assess the effectiveness and efficiency of this policy to the sector.

7.0 CONCLUSION

This policy, has been based on the perception of the current socio-economic environment. As such, it is also related to a number of other government policies and strategies. One of these is the Cooperative Development Policy of 1997, which provides guidelines for operation of the SACCOS. A number of other policies include micro-finance as one of the strategies within their scope: The National Employment Policy (1996), the Community Development Policy (1996), the National Poverty Eradication Strategy (1998), the National Non-Governmental Organizations (NGOs) Policy (in formation) and the Small and Micro-enterprise Development Policy (in formation). The Government will ensure that the micro-finance aspects of these policies and strategies are compatible with this policy.

For the policy's successful implementation and review, the Government will ensure that consultations with the different stakeholders are necessary steps of the process.