DOWNSCALING OF COMMERCIAL BANKS AND ITS IMPACT ON THEIR PERFORMANCE

A case study of Akiba Commercial Bank (ACB) in Tanzania

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LIST OF ABBREVIATION

ACB	Akiba Commercial Bank
BOT	Bank of Tanzania
CGAP	Consultative Group to Assist the Poor
CRDB	CRDB Bank
DANIDA	Danish Development Agency
LC	Letter of Credit
LRF	Loan Revolving Fund
MFIs	Micro Finance Institutions
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
NGOs	Non Governmental Organizations
NIC	National Insurance Cooperation
NMB	National Micro Finance Bank
PPF	Parastatal Pension Fund
SACCOS	Savings and Credit Associations
SDI	Subsidy Dependence Index
SME	Small and Medium Enterprises
SSA	Special Savings Account
TDFL	Tanzania Development Finance Limited
TISS	Tanzania Interbanks Settlement System
TPB	Tanzania Postal Bank
TRA	Tanzania Revenue Authority
TZS	Tanzanian Shillings
USD	United States Dollars

1.0 INTRODUCTION

1.1 Background

Financing micro and small enterprises (MSEs) is a powerful means to poverty alleviation as it aims at empowering individuals through the generation of sustainable livelihoods (JCR, 2003). It caters to micro entrepreneurs and usually operates within a subset of a local population whose economic status falls below a pre defined level of poverty. Therefore many governments in developing economies are encouraging the setting up of micro finance programmes.

Tanzania, being one of developing economies has experienced a rapid establishment of a number of programmes with the aim of supporting the provision of financial services to MSEs (Mwaniki, 2006; Kimei, 2001). Many of these programmes have been focusing on providing micro credits to micro enterprises. The programs lend amounts ranging from USD 50 to USD 2,000 and very few go up to USD 5,000 (Some, 2001; World Bank, 2003). This leaves small enterprises seeking to grow and those starting up with difficulties in accessing finance. Most of these enterprises need between USD 6,000 and USD 50,000(Some, 2001), which is outside of existing scope of micro finance programs. At the same time, few commercial banks are interested in financing the micro and small enterprises and small farmers due to the real or perceived high risks and associated transaction costs. Almost all commercial banks provide credit on traditional collateral basis, which the majority of MSEs lack. Few enterprises are able to provide the marketable collateral, with the result that MSMEs lacking such requirements have not been able to obtain credit from banks. In addition, the formal banks are faced with lack of reliable information on small borrowers. Inadequate legal frameworks and inefficient court systems in the event of contract enforcement and generally the appropriate instruments for managing risk make matters even worse. This problem is further compounded by supervisory and capital adequacy requirements that penalize banks for lending to enterprises that lack traditional collateral (Mwaniki, 2006; Wolday A., 2002; Chijoriga, 2000).

Most commercial banks lend Tshs.100 million shillings or more. This leaves a big gap between what commercial banks are offering and what Micro finance programmes are offering.
However a growing number of commercial banks have successfully entered this market since they have seen an enormous potential market for financial services among low income clients. These banks not only are filling the gap of lending to MSEs but also they take this as an opportunity in mainstreaming the banking process (Isern and Porleous, 2005). In Tanzania the banks serving MSEs include Akiba Commercial Bank (ACB), Tanzania Postal Bank (TPB), CRDB Bank and National Micro Finance Bank (NMB). (Satta, 2002; Bikki and Joselito, 2003). These banks have the most explicit orientation towards micro finance. They have well defined strategies to expand their operations in this market (Randhawa and Gallardo J, 2003; Facet, 2001). It is obvious that these banks do not use the famous commercial lending models like the credit scoring models, Neither do they use the micro finance models like the grameen models.[1] They have their own perspective of serving this segment.
The table below summarizes the commercial banks which practice micro financing in Tanzania, their target market, legal status and sources of funds.

[1] One exception is Akiba Commercial Bank which, in addition to individual loans, it also operates a solidarity group lending product.

Table 1: Institutional Providers of Microfinance Services.

Commercial Banks				
Type / Name of Institution	**Microfinance Products offered**	**Market / Area of Operation**	**Basis for status as Legal Entity**	**Main Sources of Funds**
National Microfinance Bank	Savings deposits / SME individual loans	Nationwide	Act of Parliament	Deposits / Capital
Akiba Commercial Bank	Savings deposits; Group and individual micro enterprise loans	Nationwide	Companies' Act	Deposits / Capital
CRDB Bank	Microfinance department / SME loans	Nationwide	Companies' Act	DANIDA /Deposits/ Capital
Tanzania Postal Bank	Savings / Fixed Deposits, individual SME loans	Nationwide	Act of Parliament	Deposits / Capital

Source: Micro Finance Regulation in Tanzania.[2]

Critical questions which this study is addressing are:

- What are the credit models which are used by these banks in providing loans to MSEs?
- What are challenges that these banks face when serving this segment?
- What are the critical factors for successful downscaling to micro finance in the context of Tanzania?
- What impact does downscaling have on the performance of banks.
- What are lessons to be learnt by other commercial banks who are hesitating serving this segment?

I have selected Akiba Commercial Bank as a case study in which these questions are addressed and analysed. The study takes an exploratory approach which includes in - depth interviews with selected actors within and outside the lending institution and review of related literature on the bank.

[2] This table is extracted from page 7 of the document namely Microfinance Regulation in Tanzania: Implications for Development and Performance of the Industry. Africa Region Working Paper Series No. 51, June 2003.The document was prepared by Bikki Randhawa and Joselito Gallardo.

2.0 AKIBA COMMERCIAL BANK

2.1 Background

Akiba Commercial Bank was established with the aim of providing financial and banking services to Tanzanians. It was licensed by the Bank of Tanzania to carry out banking business in 1997. Prior to that all existing banks were either interested in corporate/large enterprises or trade service and they were not oriented towards medium and small enterprises.

The founders' mission was to support the emergence of Tanzanian businesses through the provision of financial services by a Tanzanian-owned commercial bank that understood Tanzanians and was committed to Tanzania. This was the beginning of Akiba commercial Bank whose idea was first mooted in 1992. It took 5 years of hard work and sacrifice on the part of the founding members for this dream to become a reality. They covered the entire country selling the idea to people and urging them to invest in the bank as this was the only road that would lead them to the path of prosperity.

Then, over 300 local Tanzanians invested in the bank by buying shares. These investments were made out of a strong conviction that the Akiba model provided a good chance for many people in the country to access banking services particularly in the form of credits as they were unable to offer any tangible collateral as security for loans which was a basic requirement from the other banks.

2.1.1 Vision and mission

The bank's vision is "To become the Tanzania bank of choice in the provision of financial services to the micro, small and medium sized enterprises.

In realizing the above vision, the bank is guided by the following mission: to provide appropriate financial services to the micro and small and medium sized enterprises in the most efficient and sustainable manner always embracing social and environmental interests of all its stakeholders.

2.1.2 Coverage

Akiba Commercial Bank headquarters are in Dar-es-Salaam. It has six branches and marketing offices located in Dar-es-salaam, in Kilimanjaro, Mbeya, Tanga and Zanzibar.

2.1.3 Objectives

When started, the objectives of the bank were to provide financial services to the corporate Tanzanians clients. The objective changed to providing appropriate financial services to micro, small and medium enterprises (MSMEs) in the most efficient and sustainable manner, always embracing environmental and social interest of all stakeholders. Also, it provide structured training programs for its microfinance customers covering basic record keeping, entrepreneurship, business management, leadership, marketing, networking with non-financial services providers and other relevant areas.

2.2 Products Offered

2.2.1: Savings Products

Currently there are varieties of saving products as follows:

Zawadi Account:

This is a special savings account for children below 18 years of age. Parents and guardians save small amounts of money over a prolonged period into this account which enables them to pay for school fees and other needs of their children.

Biashara Account

This is a non-cheque book current account for Micro, small and Medium Enterprises (MSMEs). It inculcates a banking culture to the MSMEs and the account holders are able to access loans through this account.

Special Savings Account (SSA)

SSA is a tailor-made savings account for micro and small entrepreneurs. It provides opportunity for customers to choose among different savings profiles. There are no service charges. SSA is specifically opened for group loan client which form part of security for loan taken. No withdraw is allowed to this account until when a client wants to exit from the group.

Savings Account

This is like any other normal savings accounts. Large amounts can be withdrawn with a notice of only one day. It earns interest at the end of the year. Account holders can deposit and withdraw from any of the bank's branches.

Fixed Deposit Account

This account is opened for a fixed amount, fixed period and fixed interest. Once it is opened for a fixed period no withdraw is done until the maturity, otherwise, if drawn prematurely the interest earned is withheld. Usually fixed deposit account earns high interest compare to other deposit accounts.

Current Account

This is a chequing account where by account holders can easily access their deposit and withdrawal facilities. This account does not earn interest and therefore it is assumed to be operated by a corporate customer.

2.2.2 Credit Products

Generally the credit products are in two folders. One folder for the Micro finance credit products and the other for the corporate credit products. Micro finance credit products are categorised in two models which are individual based and group based loans. The corporate credit products are in the form of term loans and overdraft facility. Micro finance credit folder has various products as follows;

Akiba "Vikundi" (Group) loans

This in other words is a solidarity group lending. It targets small groups of six members each. Two to seven groups form a larger group. Group members must know and trust each other enough to agree to guarantee each other. Members undergo 4 weeks pre-loan training. Members have weekly savings and loan repayments. Loans last between three and twelve months. Generally the bank is offering these loans with a desire for developing the business and thus improving the living standards of its clients and gain access into other different banking facilities of savings and loans.

“Mavuno” (Harvest) Loans
This is basically group loans tailored for member of groups of MSMEs operating under the auspices of religious or any other recognized institutions. It is currently operating as a pilot product.

“Juhudi” (Efforts) Loans
This is group loans tailored for micro and small business women who are based in the rural areas. These women should be in the same locality, should own a business for at least six months before joining the group. Groups should have five members each and large groups of 25-30 members. The loan given under this category is between USD 50 and USD 500 for individual member in the group. Types of business financed are dairy farming, Poultry, Cloth selling, Retail shops and Horticulture.

“Daraja” (Bridge) Loans
Daraja is an intermediate group-based loan product between group loans and individual loans. Groups have five to ten members. Securities used are group guarantees, savings and household chattels.

Individual loans
These provide short term working capital for MSMEs. Loan amount is between USD 500 and USD 20,000. Securities for this category are household chattels and equitable mortgages. The services are less procedural in accessing subsequent loans than other loans.

Consumer Loans
This targets salaried customers who are employed in various organizations. No security is required apart from employers’ guarantee unless the loan amount exceeds USD 10,000. Maximum loans amount is 12 x employee’s net salary. Loan term is 3-36 months. These loans are used for business start-up capital, purchase of household equipment and house renovation.

Taxi Loans
This is a tailored loan product for the taxi drivers. Beneficiaries must be members of Tanzania Taxi Drivers Association. Loan securities are Personal guarantee, group and Association guarantee. Applicant has to pay a down payment of 25% as per the proforma invoice. The car is co-owned by the borrower and the bank until he repays the loans fully. Currently taxi loans have been suspended due to poor performance.

Vehicle Loans to Salaried Employees/None-employees
This is a credit scheme for salaried employees to cater for their needs of purchasing vehicles. Employees’ minimum salary must be USD 250. Payments are done monthly in a maximum of 36 months. The employer deducts the instalments from the client’s salary and pay directly to Akiba Commercial Bank. Maximum loan amount is TZS 10,000,000. Loan security is Employers’ guarantee, and the purchased vehicle.

For the none-employees, a 30% down payment has to be paid; client has to have additional security in the form of either immovable or movable assets. The borrower has to have a strong source of income (business) to enable him/her repay the loan smoothly.

The corporate credit products are in the form of term loans and overdraft facility. These operate as follows;

Corporate Loans

These are loans for sole proprietors or companies which need a working capital of over USD 20,000. They are usually given to existing businesses. Borrowers must operate a current account for at least six months before applying for the loan. Borrowers must submit a business license, copies of audited financial statements for the last three years, business plans supported with twelve months, cash flow projections chart, Letters of Credit, Management Accounts, and other business documents such as contracts, orders, tenders in hand, invoices for goods/materials to be purchased, photocopies of titles to the proposed collaterals with their respective valuation reports from the banks approved valuers.

Overdrafts

Overdrafts are meant for financing working capital only. Beneficiaries must have an account with AKIBA for at least six months. Consideration may be given by looking into history of a client who operates an account with a competing bank. The account turnover must demonstrate the capability of serving the facility (o/d) in the ratio of 4:1

2.2.3 Other Services

Other services also have an impact in the revenue of the bank. The revenue is obtained when the bank charges commission for the services offered. These services are as follows:

Money transfers

This Involves sending, as well as receiving, money from one bank or branch to another. This transaction takes place either within the same bank branch network or across other banks' branch networks. There is local money transfer and international money transfer, where the local banks sends/receives money abroad it has to do so using correspondence bank based in abroad. At ACB money transfer is also offered through methods such as Telegraphic money Transfer (TT), or Tanzania Interbanks Settlement System (TISS). When the ACB sends money abroad it is through its correspondence bank, Standard Chartered Bank (UK), corresponding sterling ponds and Euros currencies, also the Citibank (USA) is the ACB international correspondence in USD currency. For some one to send money to ACB from abroad s/he has to quote the transferring code, known as swift code, which is unique to every bank.

Trade Finance, e.g. letters of credit, bills discounting and bills negotiation.

This is a bank undertakings that cut across transactions involved between the supplier and the buyer. Trade finance takes place between two different banks which are located into different countries, At times trade finance might involve same bank if is undertaken by a multinational bank where the same bank is the banker for supplier and the banker in question. Under trade finance the bank considers Letter of Credit (LC), and Documentary Collection.

Foreign exchange transactions

This involves selling and buying of foreign currencies versus Tanzania shilling. Like other banks, ACB does not sell foreign currency to anyone in need. It is until he/she submits the evidence to the bank that there is genuine use for the currency.

In foreign exchange, a customer might agree with the bank today to buy foreign currency sometimes on near future, under the terms such as forward curve, to cover him/her against future currency appreciation, or payment of premium, if the currency depreciates at the date of concluding such transaction.

Performance bonds

This is a sort of guarantership which the bank provides to only its good clients on demand. Performance bond is the bank's guarantee issued to its customer as an assurance to the employer of that customer that the work/product/service rendered to him (the employer) by the ACB customer, will be effective and will perform as per requirement of the contract. The performance bond has time limit; once it expires the ACB is not liable for any default.

Status report on account holders

A report on the status of account holder might be in form of bank statement, showing all transactions affecting his/her account in particular period. Also the status report might be in the form of giving information on enquiring made on the performance and trustfulness of the account holder.

Cheque guarantee

This is a sort of guarantership demanded by those who issue tenders. Whereas those tenders are bids by a client of ACB, then ACB issues a cheque guarantee (on demand), by issuing a banker's cheque, as guarantership, the cheque is drawn in favour of the tender holder. The amount to be on the cheque guarantee depends on the tender requirements.

Bid Bond guarantees

This is another type of guarantee, but this does not differ much from the cheque guarantee. The only difference is, once ACB client applies for such guarantee, ACB issue such guarantee in form of a commitment which is legal binding to the employer of ACB customer.

Dealership

It involves the dealings between the banks, and individuals or other banks on the issues of lending and borrowing from the money markets including treasury bills, negotiation on fixed deposit rates and terms. The dealership caters for overnight placement / borrowing ensuring that the bank is in accepted liquidity ratios. Dealership also informs the bank on favourable rates for selling and buying of foreign currencies.

TRA (Tanzania Revenue Authority) Agency

TRA agency is the service where by ACB agreed with the Tanzania Revenue Authority to receive tax revenue from tax payers on behalf of TRA. In this case the bank will get a commission for revenue collected.

Insurance Agency

ACB is a collecting agent, collecting the insurance premiums from customers of insurance companies, such as Heritage insurance company. As an agent, the bank gets its commission on each premium collected on behalf of the Insurance Company.

Loan Revolving Fund (LRF)

A Revolving Loan Fund (RLF) was one of the components of the project "titled "Promoting Gender Equality and Decent Work Throughout All Stages of Life." The project was under International Labour Organization, Dar es Salaam office and was implemented from May 2004 to June 2006. The RLF was used to enable target women groups access financial services, specifically building savings, capacity and promote access to flexible loans. The RLF was administered by the Akiba Commercial Bank and the Women Executive Committee. The project has ended and after being evaluated, it has been seen to have contributed to women empowerment and poverty alleviation.

Performance wise the project has been able to reach out to the poor, using a commercially oriented organisation (ACB). It has been able to have significant impact on poverty, empowerment, and quality of employment for the women involved. All indications showed that the RLF was economically viable and sustainable and that the services which started under the scheme are being expanded by the ACB.

Other Projects

Currently the bank is getting technical support from various international development organisations. These organisation and partners are ACCION International and Swiss Contact. The support they are getting mainly is in terms of capacity building.

2.3 Ownership and Organisation Structure

2.3.1 Ownership

Akiba Commercial Bank is owned by a combination of local and foreign investors (66% by 34%). Local investors are about 300 individual Tanzanians entrepreneurs and public investment institutions which are Tanzania Development Finance Limited (TDFL), inter-consult Ltd, National Insurance Corporation (NIC) and Parastatal Pension Fund (PPF). Foreign investors came in for the purpose of strengthening the capital base. These are Triodos bank and FMO both from Netherlands. Others are SIDI of France, and INCOFIN of Belgium.

The criteria applied in selecting these overseas investors was that they had to share the vision of a commitment of uplifting the MSME sector of Tanzania and they would invest in the bank by providing capital to any Tanzanian with entrepreneurial skills without the hindrances inherent in the banking system as it was then.

2.3.2 Organisation Structure

The organizational structure is composed of Managing Director and three general managers: General Manager Finance, General Manager Operations and General Manager Commerce who is yet to be recruited. Currently the ACCION resident advisor has been operating as General Manager Microfinance a position that will be subsumed by the General Manager Commerce title once the incumbent is in place. The senior management team comprises of Company Secretary, Human Resources Manager, Marketing Manager and Treasury Manager, all of which report directly to the Managing Director. Besides, there are also Finance Manager, IT Manager and Microfinance Manager, who report to General Manager Finance, General Manager Operations and General Manager Commerce, respectively. The Chief Internal Auditor and Risk & Compliance Manager report to the Board of Directors and perform an advisory role to the Managing Director. [3]

2.4 Client Outreach

Akiba is firmly rooted in Dar es Salaam as a major retail financial services provider for the lower end of the market (Ordinary Tanzanians). Today the bank serves approximately 68,000 customers, the majority of whom are in the informal sector.

Akiba loan disbursement have reached a record TZS 1 Billion (USD 1,000,000) per month to the micro and small enterprises customers. These are customers who borrow as little as TZS 45,000 (45 USD) and up to a maximum of TZS 10 million (10,000 USD). The loan portfolio was TZS. 17 billion (USD 17 million) as at 31st December, 2006. Out of that micro finance portfolio stood at around TZS.13 billion (USD 13 million). Active borrowers stood at 14,000.

[3] The Organisational structure is attached in the list of annexes

3.0 DOWNSCALING

3.1 Background

Downscaling expresses the involvement of commercial banks in microfinance, which implies reducing the loan sizes by opening to a new even if more risky market niche: poor people and micro entrepreneurs. Starting from the assumption that microfinance is a development tool which is very effective to fight poverty but cannot address the poorest of the poor and be utilized in cases of extreme poverty, it is possible to find some intersection between the clients usually served by MFIs and those served by traditional banks, who broaden their market and at the same time offer new products (Segrado, 2005).

Downscaling can be seen as a way to commercialize microfinance, together with commercial investing and transformation.[4] Also downscaling can be seen when a bank or other formal financial institution expands its services to work with clients traditionally served by MFIs. Such an expansion can mean serving microfinance clients in one or many financial areas.

Isern (2005) pointed out that for any commercial bank to downscale, they need;

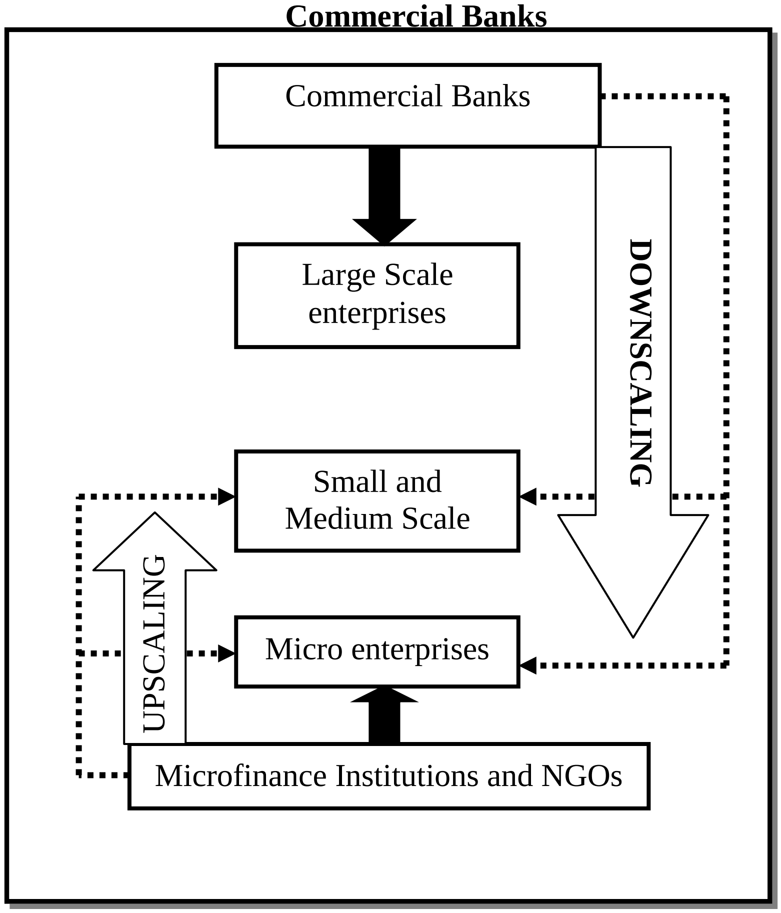
- Sound macroeconomic policies and appropriate regulatory framework.
- Reliable credit information on micro entrepreneurs, for example information on past payment history, level of indebtedness, and default information.
- A good understanding of the markets in which micro entrepreneurs operate. For example, primary and secondary market researches on the types and size of businesses run by micro entrepreneurs and the characteristics of the industries they operate.

It is fundamental to underline that commercialization (includes downscaling and up scaling) can be considered both as a process to be sought after in microfinance and as a means that foster great competition. This is why it is viewed as a tool to promote sustainable operations at the same time providing a larger number of people with access to better financial services.

[4] Siddartha H. Chowdri "Downscaling Institutions and Competitive Microfinance Markets: Reflections Case Studies from Latin America", August 2004 Edited by Alex Silva, Omtrix Inc., Commissioned by CALMEADOW

The process of commercialization can be summarized in the figure below;

Figure 1: Diagrammatic Presentation of Downscaling in Commercial Banks



3.2 Approaches of Downscaling

Most of downscaling is done by commercial banks, with few exceptions in Latin America where consumer finance companies also took part in downscaling process (Isern, 2005). There are many innovative processes employed in downscaling. The current approaches can be divided into two main categories: direct and indirect based on how the bank makes contact with the client.

3.2.1 Indirectly

Some banks provide technical support to microfinance institutions such as institutional capacity building so as to prepare them to take over microfinance tasks. Alternatively corporate banks or NGOs may finance microfinance institutions to enable them to be well equipped with sufficient loan fund to on-lend. Examples in Tanzania are CRDB Bank and TASAF. The third option of indirect involvement is by equity participation in microfinance. In this case the bank becomes a part owner of the microfinance institution (Porleous, 2005).

3.2.2 Directly

This is a downscaling style whereby the bank bears all the responsibilities from development to the implementation of the whole program of downscaling. The direct involvement turns around the following areas:

The bank may be involved in the creation of the products and services for microfinance. Thus the bank can start from scratch to research on the product and need assessment and then end up with product development. The process may proceed also into segmenting the market for the service.

Secondly, the banks may venture into downscaling by creating territories that end up in creation of branches that are specifically dedicated to microfinance services (Isern and Porleous, 2005). Both areas are practised by ACB.

CGAP has identified six discrete approaches banks use to enter the microfinance market.[5]

Provide services directly through:

- An Internal Microfinance Unit or
- A specializes financial Institution
- A microfinance service Company.

Work through existing providers by:

- Outsourcing retail operations or
- Providing commercial loans to MFIs or
- Providing infrastructure and systems.

3.3 Problems Encountered in Downscaling Process

The process of downscaling is not a smooth move. The banks which are involved in this process face problems such as:

i. Staff and management of the banks that sought downscaling were not well equipped with the necessary skills, culture and required technology for small loans scattered to many borrowers

ii. Microfinance methodology conflict with customs and operation procedures of typical corporate banks hence conflict of the rules of banking operations as per central banks policies.

iii. Slow rate of progress of financial sector may create heavy snag for downscaling to take place smoothly.

3.4 Solutions to the encountered problems

There are various solutions which may be taken into consideration in order to reduce problems encountered when the bank decide to downscale. Some of them are:

i. Committed and effective leadership.

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[5] Focus Note number 28 of the CGAP. Commercial Banks and Microfinance: Evolving models of Success. The Authors of this focus note are Jennifer Isern and David Porleous.

This is essential to downscaling successfully. First and foremost, senior managers have to believe in the commercials potentials of microfinance and be committed to start such a program.

ii. Microfinance methodology

If microfinance methodology is to be effective it must go against the operations and culture of corporate banks.

iii. Training

Training to loan officers, loan supervisors is done on the new methodologies and operations.

3.5 Reasons that made ACB to downscale

ACB was registered as a commercial bank with the aim of providing financial services to small and medium-size enterprises (SMEs) and corporate clients. The idea of founder members was to serve low income people, but when registered they started as a typical commercial bank serving SMEs and corporate clients. This mission met stiff competition from other commercial banks and NGOs who were well established in the country and have gained the trust of people. After few years of operations ACB experienced a very tough situation in this market and the bank did not perform well.

Therefore they decided to change the mission in August 1999 to providing a range of banking and financial services to micro and small businesses (MSMEs) on a commercial basis and hence the downscaling process commenced and ACB officially started the microfinance business.

However stiff competition was not the only reasons which made Akiba downscale its services, other reasons are:

- Risk distribution (larger number of clients in a wider geographical area).
- Profit making, even when dealing without traditional guarantees, but utilizing social capital as collateral.
- Presence of a market. The bank realized that there was a market niche of micro enterprises who needed financial services.

Currently ACB offer 80% micro finance services and 20% corporate services. Their targeted corporate clients are the ones who have graduated from the micro finance services.

4.0 LENDING METHODOLOGY

Lending involves the process of delivering financial services with an intention to finance the matter for which the loan is meant for. The lending methodology can be categorized as lend to individuals singly or lending to individuals via group guarantee.

At Akiba Commercial Bank, lending methodology for microfinance loans falls in both categories of group based lending and individual based lending.

4.1 Group Lending

In group based loan, there are solidarity group centres. This is a system where by clients come together and form their own groups of six people and come to the bank for loan application. The groups formed by the prospective clients have the following features; members should not be related by blood, they shouldn't be living in the same house, members must know each other beyond any doubt, and every group member should be running his/her own business.

Prior to loan application the group has to attend the four weeks training. These four weeks are divided into sessions of two hours per week. The training covers the basics of accounting, record keeping, marketing and a bit of human resources.

After the first week training, customers arrange with loan officer, so that the officer is able to visit the business and residence of each of them. Thereafter the customers are allowed to open their accounts for deposit savings and the group is officially registered.

4.1.1 Loan application

Loan application provides information about the client's intent of accessing a financial product, the amount and the purpose. It is on the basis of the information obtained in the application that appraisal is done.

A loan application process starts from the group meeting. The customer fills application form then the "senta"[6] members discuss his/her application, which is approved once the members are satisfied with ability to repay and ability to accommodate the loan amount in their group guarantee.

New members are not allowed to apply for the loan until after four weeks. The four weeks are for familiarization. Then, two members out of six are allowed to apply in every month until all members in a group receives a loan. The loan application of the last two people will be acceptable on 11th week of group age, whereby all members will have already made savings 11 times. For the existing groups every successful repayment of the first loan qualifies for the subsequent one.

4.1.2 Loan processing

For the loan application of above Tshs. 300,000/= (USD 300), its processing should involve a loan officer. The officer is responsible in loan appraisal by assessing the business of the applicant.

[6] A senta is Small groups (a group of 6 small groups of 2 to 6 individual members), from same locality, join together to a maximum of 10 small groups and form one *senta*. A *senta* may have members in between 30 to 50 members. Centre is the second level of loan approval, after going through the first level of approval that is the small group members. Every *senta* should have its own leadership, i.e. chairman, treasury, and secretary. *Senta* have powers accept any new group or reject, and also have powers to expel any member of any group, or the whole group

Below Tshs. 300,000/= (USD 300) the members themselves undertake the task of loan appraisal. This process takes about 2 to 3 days. Before the approval is made, the *senta* leader has to seek the permission of other group members concerning the application. After the group collectively guarantee and approve, the offer letter/contract is prepared for customer's disbursement consent. Then the application has to be thoroughly checked by the loan officer, before being submitted to the loan supervisor, then to the branch manager for sanctioning or rejection. This process is completed within two weeks time.

4.1.3 Loan disbursement

Once the loan is approved, it is disbursed into customer's personal account. The disbursement process takes less than a day

4.1.4 Repayment rate

At the beginning the repayment rate was almost 100% with exception of very few cases of defaulting. It is only recently, that there have been a drop of the repayment rate but it is still encouraging, since in aggregate of ACB branches it is still above 90%
The motive for timely repayment is embedded on loan officer's commitment in observing the banks rule in recruitment procedures. The supporting reasons are; since every client maintains the Special Savings Account (SSA), thus the account balance can serve to off-set the missed instalment. The group guarantee in this case is what really matters. Once the SSA is not sufficient to off-set the difference, the balance is recovered from group members. Still senta members also take the responsibility of loan repayment as well. Therefore the group guarantee and peer pressures are the main repayment enforcement mechanisms.

How ever, for lending institution defaulting cases are inevitable. The defaulters result from death, where by the loan is written-off. Also the dishonesty of some few loan officers, who were not there before, resulted into disbursing loans to ghost clients, in fictitious groups. Also some unfaithful loan officers colluded with some unlawful clients who applied for the loan with a clear intention of not repaying. Such clients vanish after receiving their loans. The above cases have contributed to the downfall of the repayment rate.

4.2 Individual Lending

This occurs when an individual (Business person) approaches the bank or the bank approaches him/her.

4.2.1 Requirements for Individual Lending

Before the customer applies for the loan, the following requirements must be met;

- The customer must have operated a licensed business for more than 12 months, within the regions where ACB has branches
- Must open account with ACB and operate for 3 months before applying for the loan
- Should prepare to pledge collaterals (movable and immovable) as security for his/her loan. The collateral value should be 150% of the loan amount. All collaterals should be in the same locality with the business whom the loan is applied for.

Other requirements:

- First loan is payable within 6 months but subsequent loans are payable for a period not exceeding12 months
- ACB issue a loan equivalent to 70% of the working capital of the business of the applicant.
- Minimum loan size is Tshs. 500,000 (five hundred thousand) and maximum is Tshs.20,000,000 (twenty million)

4.2.2 Loan Procedures

After opening an account the loan officer must arrange a visit for a business assessment and collateral certification and registration. The credit officer should obtain the duly signed legal document for mortgage from the loan applicant. If married both parties should sign. After the loan assessment and submission of legal documents, the application is sent to the Credit Committee for final decision where a loan is rejected or approved. The Chairman of credit Committee is always the Branch Manager[7]. Approved loan is disbursed and the customer signs the offer letter for acceptance of the loan contract.

4.2.3 Loan Recovery

It is the responsibility of the Loan Officer to ensure that the loan is fully recovered. S/he has to always remind the customer few days in advance before the due date. Late repayment is charged a penalty of 3% (of the delayed instalment) on daily basis. If a customer falls in arrears efforts are done to update him/her. These efforts include writing reminder letters and contacting the guarantors of the borrower. If these efforts fail, the loan officer, assisted by loan supervisor collects the collaterals pledged as loan security so as to exert pressure to the defaulter. When 14 days lapse from the date of seize of collaterals the collaterals are handled over to the bank auctioneer (Yono Auction Mart) for selling to recover the outstanding loan. Where legal actions needs to prevail in the issue, the matter is handled to the legal department for further advice and further follow up, including taking legal actions against the borrower in favour of the bank.

4.2.4 Loan Administration

Individual loans are handled by a specific officer. A loan officer handles a portfolio of up to 250 clients of different loan sizes. Individual lending as it is for group lending, must have a loan supervisor to whom the loan officer reports. All lending activities are under control of a Branch Manager, who also reports to the ACB Microfinance Manager, for all issues parting to lending. The Microfinance Manager reports to General Manager-Microfinance.

[7] Depending on the size of the loan, The Chairman of the credit committee could be a supervisor, Branch Manager, Micro finance Manager and or General Manager Micro finance.

5.0 PERFORMANCE OF THE ACB

5.1 Performance Measures

Good practice requires that any institution offering micro credit should be measured in terms of its efficiency, effectiveness, financial performance and operational performance. According to Consultative Group to Assist the Poor (CGAP) guidelines, any MFI should be measured on both the institutional performance and sustainability. Measures of improved performance include both qualitative and quantitative indicators. Under the CGAP areas assessed include the following:

- **General Profile,** which focuses on the mission, objectives, and the effectiveness of the organizational structure and management of the Micro finance providers.

- **MFI Loan Delivery Systems**, which measures the loan screening, the loan repayment enforcement, the collateral, and the monitoring systems applied. It takes into account how simple the loan-processing period is, the time it takes to get a loan, and the convenience of getting small loans, as well as the loan sizes offered.

- **MFI Services, Client Outreach and the Market:** The type of services offered, including savings mobilization, clientele outreach, and the market coverage of the MFI. The growth of outreach is measured by the increase in the number of clients and improved services, and the opening of branches and other offices in cities, towns and rural areas

- **Operational Performance:** This is measured in terms of the loan processing period, the loan delivery time, the amount of loans disbursed, outstanding loans and the loan repayment and default rates.
- **Financial Performance:** Much of the financial performance evaluation is done using financial ratios. The basic ratios calculated included: (a) Liquidity ratios, (b) Operational efficiency, (c) Capital adequacy, leverage and structure, and (d) Profitability ratios.

5.2 Financial Performance

Generally, the financial performance of the bank for the past four years is good. There is a positive trend in all key indicators as tabulated below (Figures in TZS billions):

Table 2 shows the summary financial ratios and performance for four years, from year 2002 to 2005.

Table 2: Financial Performance of ACB

Particulars	2002	2003	2004	2005
Interest Income	1.4	2.1	3.7	6.0
Interest Expense	0.2	0.3	0.7	0.9
Net Interest Income	1.2	1.8	3.1	5.0
Operating Income	1.5	2.4	4.2	6.2
Operating Expenses	1.1	1.6	3.0	4.2
Profit After Tax	0.2	0.4	0.1	0.7
Loans and Advances	4.9	9.2	16.4	17.4
Customer Deposits	9.6	14.2	22.0	29.4
Shareholders funds	1.9	2.8	2.9	3.3

Since the bank started its operations to year 2005, the bank making profit. The profits are increasing year by year. Generally since the bank started to downscale its services the financial performance has grown substantially.

5.3 ACB Sustainability

Three types of overall financial sustainability indicators are used: profitability, default rate, and an indicator of the degree of subsidization. In addition an indicator of income of the beneficiary is additionally needed in order to control the target group's achievement. Sustainability is usually understood as a process involving two stages. Stage one is the operational sustainability, whereby the Institution (In this case ACB) covers its administrative costs and loan loss expenses from its client revenues. The second stage is the financial sustainability, whereby an Institution is operationally sustainable and able to cover the costs of funding, including inflation.

An internationally accepted standard for measuring the subsidy content and self-sufficiency of an MFI is the" Subsidy Dependency Index'" (SDI) as developed by Yaron (1992). An SDI of zero means that the MFI achieves full self-sustainability; an SDI of 100% indicates that a doubling of the average on-lending rate of return on funds is required if subsidies are to be eliminated. A negative SDI indicates that the MFI not only fully achieves self-sustainability, but its annual profits, minus the cost of equity at market rates, exceeds the total annual amount of subsidies.

Stage one of accessing financial sustainability is the operational part, which assesses whether the cost related to the lending process are well covered. At the financial sustainability stage, all operating costs are covered by the MFI, and the institution is making some profits. At full financial sustainability the MFI is independent and is financed by both equity and debt. The MFIs can participate in the capital markets to assess financing.

From the ACB perspective the bank is both operationally and financially sustainable. Because of the initial costs the bank in the beginning was not operationally and financially sustainable. However since 2003 the bank started to be operationally and financially sustainable.

The bank uses its own source of funds for disbursing the loans or to increase the loan portfolio. The bank is not dependent on any other source. Where a micro credit organization does not use grants then the organization can reach its financial sustainability within a short time, and this has happened to ACB when the clientele increases to reduce the operating costs and hence generate some retained funds for further reinvestments.

Socially it has shown that low-income earners also need assistance and benefit both economically and socially. Poor women have also access to credit.

Also, expansion to new areas demonstrated the bank's sustainability in terms of replicability to other areas beyond the targeted areas. ACB is having partnership with SACCOs for those areas they have branches or an agency.

6.0 CHALLENGES FACED BY THE BANK AND HOW SOLVED

Akiba Commercial Bank faces a number of challenges when servicing the micro finance clients. But despite these challenges, the bank is doing its best to overcome them though sometimes it is difficult to overcome them completely. The challenges are as follows:

6.1 Bank of Tanzania (BOT) Regulations

ACB is registered as a commercial bank and regulated as a commercial bank and as a micro finance due to the nature of its products. Some of these regulations limit the operations of the bank to go smoothly. For instance, the regulation on Loan provisions. The regulation of the BOT stipulates as follows:

Provision for Loans

Corporate Commercial Bank Regulation		Micro finance Companies and Micro credit activities Regulation	
1 – 30 Days	0%	Total Loan Outstanding	2%
31 – 60 Days	5%	1 – 15 Days	25%
61 – 90 Days	10%	16 – 30 Days	50%
91 – 180 Days	50%	31 – 45 Days	75%
Above 180 Days	100%	Above 45 Days	100%

This shows that when the corporate loan is overdue for 181 days it should be written off while for micro finance when it is overdue for 45 days it should be written off. This is not realistic, as micro finance clients pay even after 45 days. Also the bank is required to provide 2% as provision for bad debts in the total loan outstanding where by the bank does not expect to have any bad debts. These whole regulations reduce profit of the bank.

To overcome this challenge, the bank is insisting and putting more emphasis on delinquency management so as to comply with BOT regulations on the provision for loans and more importantly the bank negotiate with BOT in order for them to understand how the micro finance market operates.

6.2 Multiple Borrowings

Many clients are taking loans from various Micro finance Institutions. The problems arise when the repayment period is due. Clients find themselves in problems because they have to repay more than one loan at the same time. This makes some of them to borrow in one institution and pay another. This challenge is faced by many Micro finance providers. ACB has decided to make a lot of follow-ups to make sure that their clients pay on time despite of having other loans from other providers.

6.3 Competition

The bank faces a lot of competition from other MFIs. There are many MFI which serve the same clients. Also the process of downscaling is now starting to be done by bigger banks. Some corporate banks have started microfinance windows where by they give wholesale finance to small groups for them to distribute at retail level. The bank is taking this as a positive challenge to them and they are working and making sure that they compete with others by improving their operations often.

6.4 Staff Turnover

There is high staff-turn over due to high aspirations of the young employees. Most prefer to work in banks with higher pay. The 24 hours resignation notice makes it difficult to hold the officer responsible for all his/her bad loans before exits. Last year the bank set an objective of enhancing its human resources from various levels. This is part of its Five year Strategic Plan (2006 – 2010). Currently the bank is working on incentive schemes for loan officers, and has introduced the staff appraisal schemes so as to motivate staff to work harder and stick to the bank. The Bank is as well working in reviewing its recruitment criteria, in order to avoid the possibility of recruiting wrong staff.

6.5 Capital Base Limitation

Initially when the bank was starting its operations, the minimum requirement for opening a commercial bank was one billion Tshs. In year 2006, the BOT increased the minimum requirement to be five billion Tshs. This has been difficult for the bank since they have to increase their capital base to meet the one required by the BOT. The deadline for that requirement was April, 2007. The bank management have asked its shareholders to find means of soliciting funds in order to meet the required amount. Also the Management made negotiations with the BOT in order to be given more time to collect those funds. Meanwhile the bank has been given a grace period of up to April, 2008 to solicit funds and increase their capital base. Because of this regulation, the bank can not expand its operations (by opening more branches) until they have increased its capital base.

6.6 Dishonesty of some loan officers

Some loan officers are not honest. They register ghost clients. They take the money themselves and disappear. This is expected to be overcame when then bank has manage to review the recruitment criteria because there will be a low chance of recruiting wrong staff.

6.7 Soft Ware Experience

The bank has had several software problems. In the last few years, the bank installed new software called micro bank which was supposedly to improve working performance of its operations. The soft ware installed has many disadvantage one being the limitation of capacity. It had an access limit of only twenty people. Other disadvantages were as follows:

- Increased customer irritations and complaints

- Staff got tired because they had to work for many hours in order to wait to sign in the software
- Operational costs increased which resulted in low profit. The bank had to hire software specialist in order to operate the installed soft ware.
- Some customers run away.

In year 2004, the bank installed software in order to overcome problems brought by the micro bank soft ware. The new software is called bankers rim. This was a window based software and therefore user friendly. It is a good software for micro finance products. It is currently used by the bank and has reduced a lot of problems.
One disadvantage of it is that, it is not compatible for corporate loans which are offered by the bank. The bank is working on looking for other software which may be of better performance than the currently used.

7. CONCLUSION

Serving the MSME sector has been a great experience to the ACB. Despite of several setbacks, the bank is currently performing well.

The study aimed at addressing the objectives on;

- Identifying and Understanding the credit models which are used by these banks in providing loans to MSEs
- Identifying the challenges that these banks face when serving this segment
- Determining the critical factors for successful downscaling to micro finance in the context of Tanzania
- Analyzing the performance of the banks after downscaling and
- What are lessons to be learnt by other commercial banks who are hesitating serving this segment?

The following sections summarize what has been observed in the whole study;

The credit models identified were solidarity group lending and individual lending. Both of these methodologies have proven to work efficiently with the bank. The repayment rate is high, operational costs are low and hence the bank is profitable.

Challenges; ACB as mentioned earlier, face some challenges when serving the micro finance segment. The Bank is taking them positively and is utilising its resources to overcome them and to make sure the challenges do not affect the performance negatively. These challenges may also apply to other commercial banks which downscale their services. Some of the key challenges faced by the bank are as follows:

Soft Ware Experience; the ACB bank has had several software problems. The soft ware installed which was supposedly to improve working performance of its staff and keep right records of their many clients turned out to be a problem. This however has been partly overcome by the installation of software which it has minor problems comparing to the first one. This has an implication for other banks when they decide to down scale to micro finance. Downscaling means the banks will start serving many small clients. When serving many small clients, Information Management is very important and it become sophisticated. The banks should make sure that they get sophisticated software in order to manage information of many clients accordingly.

Multiple Borrowings; this happens especially in solidarity group lending. Many of ACB clients are also clients of MFIs. Because the loans offered (especially the first loans) are low, the clients take several loans from different providers. The problems arise when the repayment period is due. Clients find themselves in problems because they have to repay more than one loan at the same time. This makes some of them to borrow in one institution and pay another. This problem may be reduced if Micro finance providers and policy advocates are able to put mechanisms which will assist in the information sharing between the micro finance providers. For example if a person applies for a loan in ACB, the ACB officials should have mechanisms of getting previous information about this person from any other Micro fiancé provider.

Shortage of experienced staff; Many of staff dealing with micro finance provision are not well trained in that area. They are experts in other fields but have been employed by banks. Because of this problem, banks have to training them in order to equip them with necessary skills of serving MSME sector. How ever for some staff , when they understand how to serve the sector they move for other jobs and this creates a gap again of which a bank has to refill and to train again. The government in collaboration with other development agencies may train many people in servicing this sector in order to have many qualified staffs. Sometimes banks fear investing in them because of the risk of loosing them.

Bank of Tanzania Regulations; the banks are regulated as a commercial bank and not as microfinance Institution (MFI). And therefore some regulations limit the operations of the bank in serving the MSME sector smoothly. The government through the BOT may create environment of which will support commercial banks which offer micro finance services.

Poor infrastructure; this happens especially in rural areas; Micro finance services are needed highly in the rural areas since most activities are conducted there. Reaching clients in rural areas is a challenge to banks. Access to roads is bad; there is no reliable communication, water or power. Banks need to continue forming collaboration with SACCOS which most of them are in rural areas where banks can not reach.

Performance wise; the experience of ACB demonstrated that downscaling can be profitable. Any commercial bank can do it and make profit. Other commercial banks should no more hesitating in servicing the MSME sector. These are good clients and they are not good defaulters.

Furthermore, most Tanzanians are employed in the MSME sector. This sector needs finance to improve its operations, and because the sector pays, other banks will benefit from servicing it. For those commercial banks which can not downscale directly they can do so indirectly by supporting other banks like ACB in order to reach the rural or by working with SACCOS and SACAs which work in the rural areas.

In Tanzania, just as how it worked out with ACB, The critical factors for successful downscaling can be related with the banks' objectives. The common factors a bank should take into consideration are as follows;

Commitment and effective leadership. ACB has had a very supportive senior management who believed in the commercial potential of microfinance and they were committed to start a downscaling process. This is consistent with positioning of CGAP (2002) that the leadership must be willing to withstand setbacks and overcome opposition within and outside the institution for downscaling to succeed.

Strategic Fit. According to CGAAP, (2000); banks should be strategic in offering variety of services to varieties of niches. Dedicated banks pushed by market forces to look for new niches are more likely to participate in downscaling programs than solid, corporate banks. If a commercial bank is doing well in its traditional market segment, the drive to commit the necessary resources and energy to a new market may not be helpful. For a bank that faced stiff competition in the area they are serving its very possible for it to look for and exploit any other opportunity available. This is what happened with the ACB, Competition was one of the most important reasons as to why it decided to look for the niche of offering micro finance

Support. This is crucial to effective downscaling. Commercial banks which promote microfinance through downscaling must tailor support to make it effective. Infrastructure, information technology and human resources are crucial to downscaling successfully. ACB cited all these as challenges it is facing. This shows how important a support in these areas is needed in order to make downscaling effective.

Appropriate Regulatory Framework; to create an enabling environment for downscaling to microfinance services, Governments need to promote appropriate regulatory reform which enables profitable micro lending. Government and development agencies can play a key role promoting supervisory and regulatory frameworks which are not biased against micro lending. Appropriate regulatory reform should lead attempts at "downscaling." The main concerns of financial regulations include minimum capital requirements, capital adequacy, loan risk classification, portfolio auditing techniques, loan documentation and operational restrictions. ACB is getting regulatory support from the Bank of Tanzania, but there are still challenges it faces especially on regulations regarding loan repayments.

If these factors are clearly taken into consideration, downscaling can be provided by many if not all commercial banks whether directly or indirectly. This will highly contribute to solving a problem of many MSME operators of not having enough access to finance. This is a good business and any bank can do it profitably.

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LIST OF ANNEXES

Annex 1: Checklist for interview with Akiba Commercial Bank selected Staff

Checklist of Questions for Akiba Commercial Bank staff

1. Coverage;
    - What is the current coverage of the bank, how many branches in Tanzania?

2. In the category of other products, there are products like TRA Agency and Insurance agency, are these commercially driven?
    - Do they help in increasing income and profit?

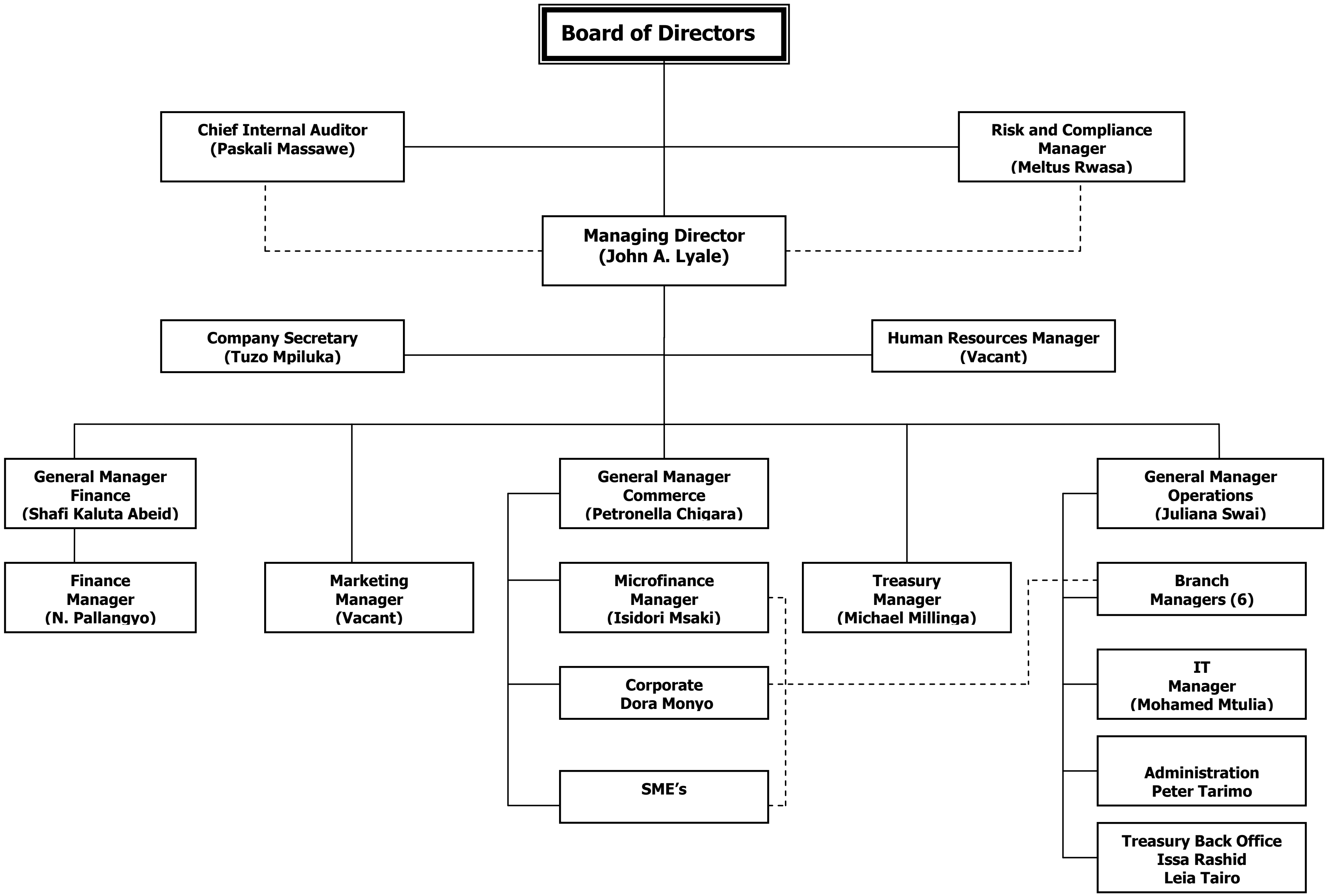
3. The bank has been engaging itself in some projects like the ILO Loan Revolving fund (LRF).Are there any benefits of the project?

4. Are there other projects which assist in reaching the rural in terms of financial services? (Swiss Contact projects??)

5. Challenges faced by the bank:
    - BOT regulation, the bank is regulated as a commercial bank and not as an MFI. What is the bank and other stakeholders doing to address this problem
    - Staff turnover, what is the bank doing to address this?
    - Capital base limitation. The bank is not able to go to upcountry? Have it considered borrowing as an alternative to increase its capital base?
    - ACB has had terrible experience with software. How did it affect it, How did the bank learnt from this experience?

6. Lessons Learnt by the Bank
    - What would the bank do different if it was starting today
    - What strategies work? Which do not work and why?
    - What are critical factors for success
    - How did the bank operate in an environment with no regulatory framework for MF for a number of years
    - How do rural / small town operation experiences differ from large cities?

Annex 2: Organisational Structure


Board of Directors
Chief Internal Auditor (Paskali Massawe)
Risk and Compliance Manager (Meltus Rwasa)
Managing Director (John A. Lyale)
Company Secretary (Tuzo Mpiluka)
Human Resources Manager (Vacant)
General Manager Finance (Shafi Kaluta Abeid)
Finance Manager (N. Pallangyo)
Marketing Manager (Vacant)
General Manager Commerce (Petronella Chigara)
Microfinance Manager (Isidori Msaki)
Corporate Dora Monyo
SME's
Treasury Manager (Michael Millinga)
General Manager Operations (Juliana Swai)
Branch Managers (6)
IT Manager (Mohamed Mtulia)
Administration Peter Tarimo
Treasury Back Office Issa Rashid Leia Tairo