Data Collection Survey on Small and Medium Enterprise Finance in the United Republic of Tanzania

Final Report

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Abbreviations & Acronyms

AfDB	African Development Bank
BOT	Bank of Tanzania
CRDB	CRDB Bank
CRB	Credit Reference Bureau
DANIDA	Danish International Development Agency
DFI	Development Finance Institution
EIB	European Investment Bank
FSDT	Financial Sector Deepening Trust
FYDP2	Second Five Year Development Plan
IDA	International Development Association
IFC	International Finance Corporation
IRR	Internal Rate of Return
MITI	Ministry of Industry, Trade and Investment
MFI	Microfinance Institution
MOFP	Ministry of Finance and Planning
MSME	Micro, Small and Medium Enterprises
NBC	National Bank of Commerce
NMB	National Microfinance Bank
NPV	Net Present Value
PMU	Project Management Unit
SIDO	Small Industries Development Organization
SME	Small and Medium Enterprises
TADB	Tanzania Agricultural Development Bank
TCCIA	Tanzania Chamber of Commerce, Industry and Agriculture
TIB	TIB Development Bank
TPSF	Tanzania Private Sector Foundation
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
WB	World Bank

Executive summary

1. In support of industrialization in Tanzania, it is significant to provide effective cooperation to satisfy long-term financing needs of small and medium-sized enterprises (SMEs). The reasons are included below:

(1) Achieving a per capita income of around US$1,000 is a goal. Tanzania has great potential for continued growth through increasing exports of processed goods and through promoting import substitution. To realize this potential, it is important to support the growth and expansion of SMEs in light of the fact that they account for 30% of the country's GDP and comprise the majority of its jobs;
(2) The Government of Tanzania announced that industrialization through infrastructure-based development and SME growth is the core of its economic development strategy in the Second Five-Year Development Plan (FYDP2).
(3) Access to finance is the key to the growth and expansion of SMEs. Long-term financing of capital investment by SMEs is still an area for large commercial banks to develop although they have been increasing lending to SMEs. Medium-sized commercial banks have to expand and diversify their services so that they can maintain the growth of their customer base and ensure their competitiveness with larger banks;
(4) The prevailing interest rate on loans to SMEs is well over 20%. This is not a normal situation, given that the inflation rate is 5% at present. In such a case, there would be a real interest rate of 17% when the lending rate is 22%;
(5) TIB — among other roles — is expected to provide long-term financing for capital investment by SMEs as a driving force of the FYDP2. However, TIB has yet to achieve success due to the constraint of its funding. TIB also needs to increase expertise in financing SMEs;
(6) There are no donor agencies which are able to respond directly to the needs of SMEs with affordable lending terms. This is also true for such multilateral agencies as the IFC and AfDB which have provided long-term credit facilities to large banks;
(7) Under all of the circumstances stated above, the proposed cooperation can be a model policy for providing long-term finance for capital investment of SMEs which currently have almost no alternative but to rely on their own capital for expansion. Various pieces of know-how in the field of financing for capital investment by SMEs, which will be brought about by the proposed two-step loan (TSL) program and technical assistance, are indispensable for successful implementation of the industrialization policy. From this perspective, the proposed TSL program can fit suitably with the government policy under the FYDP2.

2. In order to meet the long-term capital investment needs of SMEs, a reasonable cooperation approach is as below:

(1) Target company: SMEs registered under the current government definition with 5–99 employees (micro-enterprises with less than five employees and large enterprises with more than 100 employees are not eligible).

(2) Sector: in addition to the agricultural products processing industry, which is integral to Tanzania's economic structure, other promising industries, such as general manufacturing and mining, should be included.

(3) Target banks: mainly TIB, with a possibility of participation of private commercial banks.

(4) FYDP2, as one of its goals, indicates that TIB has been given the mission of developing SMEs, and stipulates that a capital increase of up to TZS 1 trillion be allotted to TIB during the planned period.

- Although TIB's general capacities are high, the number of staff is as small as 150 and requires an increase in the future—mainly for conducting credit appraisals. Since TIB has only 4 branches, it might have to cooperate with commercial banks—with their extensive branch networks—in the proposed cooperation approach.
- The fact that TIB's non-performing loan (NPL) rate has reached 30% is a grave problem. Although there is the aspect of its intentional arrangement after its transformation to the DFI under the order of the new president, the inadequately high rate of the NPLs should be resolved promptly. The NPL rate level is planned to be reduced to about 10% by the end of 2017, but its future reduction depends on timely capital injection from the government.
- Upgrading of the credit appraisal system has proceeded, including the commencement of a new training program for 50 bank employees. In preparation of the TSL program, it is necessary to further provide comprehensive technical cooperation centered on credit appraisals by drawing lessons from the successes and failures of Japan's policy-based finance. It is important for TIB to establish a system which decisively eliminates the management and projects that cannot secure the bank's profitability; and, it will also be necessary to strengthen and establish the credit appraisals and management capacity accordingly.

(5) On-lending to SMEs via commercial banks is considered an option.

- Funds will flow from the Ministry of Finance and Planning (MOFP) to the Bank of Tanzania (BOT) then be on-lent to TIB and/or commercial banks, via TIB's fund management unit (FMU).
- Funds will be provided in yen currency (JPY) from the MOFP to the BOT; and the BOT, which will take the currency exchange risks, will provide funds in Tanzanian shilling (TZS) thereafter.
- The above funds flow has the advantage in that the BOT is released from administrative work burdens, and accumulation of know-how in the field of financing SMEs will be promoted at TIB.
- As an option, the MOFP can lend yen funds directly to financial institutions without going through the BOT, a mechanism to lend yen funds directly from JICA to financial institutions based on government guarantees. In this case, since financial institutions should bear currency exchange risks themselves, the final lending rates for SMEs might end up exceeding 20%, just as in the cases of the IFC and EIB financing. This will not lead to a resolution of the high interest rate problem that SMEs currently face.
- Moreover, direct lending to TIB (instead of through the FMU) is difficult when considering the current NPL rate.

3. The following is the current situation of the industrial parks and industrial clusters development operated by SIDO.

(1) 61.7% (131.9 ha or approx. 1.3 million m^2) of SIDO's land is still underdeveloped. Although SIDO plans to construct both infrastructure and buildings for each industrial park, it is becoming more difficult to execute regional industrial park development plans due to a lack of resources in the budgets. Instead, the government expects TIB and other financial sources to provide the necessary funding.

(2) Currently, TIB and SIDO are considering the utilization of a project finance method for industrial park development based on an industrial development cooperation agreement which is still under negotiation. However, it is not easy for both sides to come to an agreement due to the difference in their mandate and business principles (TIB as a financial institution puts priority on project profitability, while SIDO as an SME support organization emphasizes the importance of generating jobs and industry value-chains). In addition, many issues need to be tackled before adopting project finance: SIDO has no experience in offering its lands as collateral in the past (as of December 2016, SIDO is inquiring the possibility to the MOFP); SIDO's rents have been much lower than the market prices; no risk-takers exist currently; and

the selection of promising candidate industrial estates by SIDO is not progressing. If an effort were made, it would not be easy to solve all these problems at once.

(3) As a prerequisite for establishing SIDO's industrial park development by project finance, many conditions have to be met, including identification of industrial estates with high asset values, profitable tenant enterprises (SME), availability of low interest borrowing, and so forth.

Chapter 1 Present Status and Issues of Small and Medium-Sized Enterprises & SME Finance

1.1 Current Situation and Challenges of Small and Medium-Sized Companies in Tanzania

1.1.1 Definition of SMEs

In Tanzania, Small and Medium Enterprise Development Policy (2003) defines small and medium-sized enterprises (SMEs) as shown in Table 1-1. Since more than 10 years have passed since the policy's enactment, the Ministry of Industry, Trade and Investment (MITI), TIB Development Bank (TIB), and private financial institutions mostly recognize the necessity of revising the definition. MITI, with no budget to conduct the revision, considers the current definition to be useful for the time being. Aside from this definition, financial institutions have defined the term SME according to size of loan and so forth.

One factor requiring a revision of the SME definition is the fact that inflation has doubled in the past decade (i.e., since 2006), causing the value of capital invested in machineries to fall below half its value. Thus, in this Survey, the number of employees at a given enterprise will be used as a basis for SME definition.

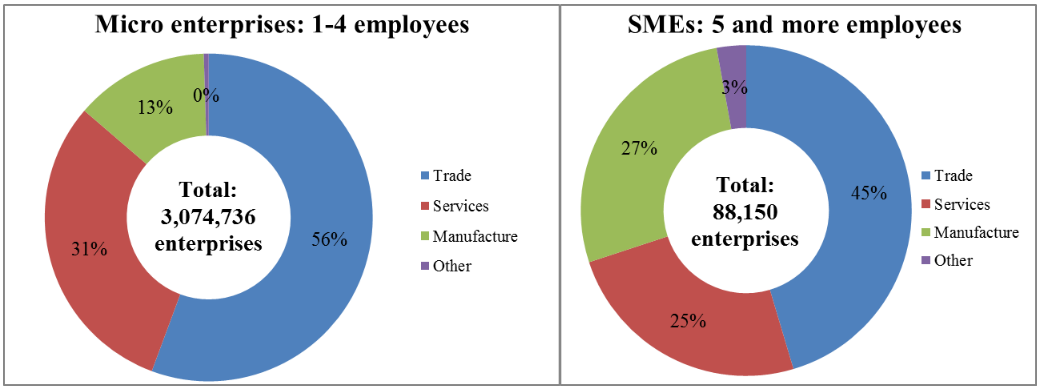
Table 1-1. Definition of SMEs in Tanzania (2003 ~)

Category	Number of employees	Capital investment in machineries (in TZS)
Micro enterprises	1-4	Up to 5 million
Small enterprises	5-49	Above 5 million to 200 million
Medium enterprises	50-99	Above 200 million to 800 million
Large enterprises	100+	Above 800 million

(Source) Small and Medium Enterprise Development Policy, 2003

1.1.2 Current Status of SMEs

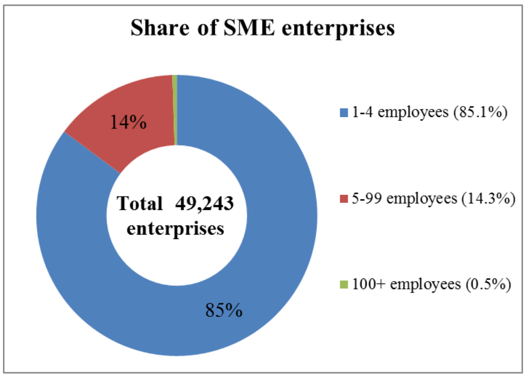
In Tanzania, there are cases where SMEs and micro enterprises are classified together as MSMEs. According to a survey published by the Ministry of Industry and Trade and Investment (MITI) in 2012, there are over 3 million MSMEs as of 2010 in Tanzania (including Zanzibar), 96.4% of which are sole proprietorships, that is, a business owned by an individual without company registration. The GDP share of these MSMEs is about 30%, and they account for the majority of the total employment in Tanzania.[1] Among them, there are approximately 88 thousand enterprises that are defined as SMEs with five or more employees, including those that are not registered. The industry breakdown of SMEs is shown in Figure 1-1.



(Material) MSME in Tanzania (Dec 2012) MITI / FSDT, Survey Team based on Table 6.2

Figure 1-1. Breakdown of micro enterprises and SMEs

On another note, according to the industrial production survey by the National Bureau of Statistics, which was conducted in 2013 in Tanzania (excluding Zanzibar), 14% (or approximately 7,000 companies) of the total 40,009 registered companies were SMEs (see Figure 1-2).



(Source) National Bureau of Statistics/UNIDO/CTI, Census of Industrial Production 2013, Tanzania Mainland, Analytical Report (September 2016)

Figure 1-2. Breakdown of registered companies (SME 14% of the total)

1.1.3 Issues of SMEs

With respect to the financing method of SMEs and the challenges they are facing, interviews were conducted with relevant parties, including MITI, the Ministry of Finance and Planning (MOFP), Small Industries Development Organization (SIDO), Tanzania Private Sector

[1] MITI / FSDT National Baseline Survey Report: MSMED (Dec 2012)

Foundation (TPSF), Financial Sector Deepening Trust (FSDT), Tanzanian Chamber of Commerce, Industry and Agriculture (TCCIA), the Central Bank of Tanzania (BOT), financial institutions (TIB and private commercial banks) and SMEs. As a result, as shown in Table 1-2, the majority of the perceived challenges were related to the issue of access to formal financing, such as those of high interest rates, collateral shortage, and failures in the credit guarantee scheme.

Table 1-2. Issues of SMEs and views of related organizations

SME issues	Viewpoints of financial institutions	Viewpoints of relevant organizations
High borrowing interest rates	• Lack of funds for long-term loans. • High lending interest rates due to high interest long-term deposits	• Because of the high borrowing interest rates, regardless of the presence or absence of collateral, long-term borrowing is difficult for SMEs. (TPSF and many others) • Gap between deposit rate and loan interest rate is too wide so that SME's savings incomes are squeezed; and they were likely to be chased by interest repayments when they borrowed. (TCCIA)
Lack of collateral	• Land and buildings used as residences, and those lands without ownership registration are considered to have no collateral value. ※ BOT stipulated that financial institutions shall collect real estate collateral equivalent to 125% of total loans.	• BOT's 125% collateral requirement is creating a moral hazard for banks to avoid sufficient credit appraisals on each individual borrower. (SIDO, DAR-RO) • In the SME Financing Program of SIDO, collateral requirements are relaxed to include personal property and personal guarantees, for meeting BOT's 125% collateral requirement. (SIDO) • The formal finance lending requirement is too restrictive (TCCIA) • SMEs cannot utilize the rented buildings and lands of SIDO's industrial parks as collateral. (SIDO)
Survey of land: incomplete	• Many lands are left un-surveyed.	• In rural areas, if the land is surveyed and approved by the village, SMEs can borrow from banks (i.e., the land can be seen as collateral). (TCCIA)
Not registered as a corporation	• Personal guarantee is approved only for corporate enterprises. • Private banks' SME loans are to sole proprietors; thus, they don't allow personal guarantees. • Leasing companies provide finance leases for corporate entities only.	• The number of registered SMEs is very small. (MITI)
Credit guarantee scheme is not working (i.e., collateral requirements are not	• Regardless of the availability of credit guarantees, real estate collateral equivalent to 125% of a total loan amount is collected from borrowers (according to BOT provisions). • Credit guarantees would generate moral hazard not to	• If credit guarantee is available, banks should relax their real estate collateral requirements. (SIDO) • Although it is not explicitly stated, banks should relax collateral requirements if sovereign credit guarantees are available. (BOT / WB-PMU)

relaxed)	repay loans on borrowers.	
Lack of company inquiry system	• BOT enabled the inquiry into borrowers' information by introducing the Credit Reference Bureau (CRB) in 2013.	• CRB is still malfunctioning due to system errors, including mistakes in registered information and input. (TCCIA)
Not knowledgeable about alternative financial tools such as finance lease (FL)	• FL is provided based on 12-month cash flow (bank account record) without collateral. ·FL is offered only for registered companies. (Alios Finance)	• There are no written rules to conduct FL. • Heavy taxation on the leasing industry (Since 2015, the industry is charged an additional 6% in addition to an 18% VAT) (Alios Finance / IFC)
Lack of business management ability	• Lack of documents necessary for bank loans such as financial statements, business plans, income and expenditure plan, etc.	• Banks need to provide loans with consideration given to the circumstances of individual borrowers. (TCCIA)
Limited market access (e.g., lack of distribution channels and method of sales)	• It is difficult to predict SMEs' business sustainability, financial soundness, and growth potential.	• The impression that "SME finance is unprofitable" as held by commercial banks in Tanzania have to be erased by supporting the improvement of banks' skills in financing SMEs. (FSDT)

(Source) Created by the JICA Survey Team based on information acquired through interviews with SMEs and various agencies (2016/10 / 31-2016 / 12/2)

1.2 SME Promotion Policy and SME Finance

1.2.1 SME Promotion and Financial Sector Support Under the Second Five-Year Development Plan (FYDP2)

Tanzania, in its long-term national development plan "VISION 2025" of 1999, has articulated its national goal to become a middle-income country and to reach a per capita GDP of 3,000 USD in nominal values by 2025. A five-year development plan had been formulated as a strategic action plan to achieve the goal. In the Second Five-Year Development Plan (FYDP2), which was enacted in May 2016, the following four policy areas were prioritized with a focus on industrialization: (i) an economic growth-oriented policy, (ii) a human development-oriented policy, (iii) a business environment improvement policy, and (iv) improve efficiency of policy enforcement.

(1) SME promotion under the Second Five-Year Development Plan (FYDP2)

In FYDP2, the following policy items are taken up from the viewpoint of SME promotion:

- In priority sectors, increase trade by strengthening SME linkage to large enterprises
- Increase the share of MSMEs in the manufacturing sector GDP
- Minimize borrowing risks of MSMEs, by introducing a guarantee system, and so forth
- Nurture industries and generate employment (especially youth employment) by constructing industrial parks for SMEs. 15 candidate sites for local industrial parks include: Mtwara, Lindi, Songea, Rukwa, Dodoma, Singida, Shinyanga, Kagera, Mara, Manyara, Njombe, Katavi, Geita, Simiyu, and Morogoro. (SIDO is the implementing agency of the industrial park development plan for MSMEs. For more information, see Chapter 4.)
- Provide venture capital for SMEs in fields using cutting-edge technology

(2) Financial sector support under FYDP2

Under FYDP2, TIB is positioned as one of the most important institutions for the implementation of the development plan, and its capital is planned to be raised to TZS 1 trillion to fulfill its mandate. The roles expected of government financial institutions (TIB, and so forth) under FYDP2 include those listed in Table 1-3.

Table 1-3. The roles expected of government financial institutions under FYDP2

Roles expected of TIB Development Bank (TIB)	Roles expected of other parties
• Make more use of TIB to promote co-financing with international and regional development financial institutions. • TIB has the mandate to achieve the purposes of FYDP2. • TIB is assigned the task of designing development projects associated with FYDP2 and linking these projects to funding opportunities. • Pillars of TIB's activities include domestic resource-based export promotion, SME development and generating employment. • To enable TIB to carry out these functions, the Government is committing TZS 1 trillion to its share in the bank. • TIB—which is expected to contribute to SME development, increase employment and enhance socio-economic human resources development and other national priorities—will be designated as an agency to manage special funds, and so forth. • FYDP2 advocates the establishment of a new Infrastructure Development Fund. Upon establishment, TIB is expected to manage the fund together with overseas sponsors.	• It is necessary to consider establishing a new DFI (MSMEs Development Bank) in the construction and SME sectors. • Utilize TIB and TADB for development projects • Make credit guarantees for MSMEs issued by National Enterprises Development Fund.

(Source) Compiled by the JICA Survey Team based on the Second Five Year Development Plan

As mentioned above, FYDP2 proposes the establishment of a government-owned development bank dedicated to SMEs. However, since establishment of new financial institutions takes a considerable amount of time, it would be more realistic for existing financial institutions like TIB to first accumulate more experiences in SME finance and eventually separate the function at an appropriate stage and time. As a precedent, there is the case of the Agricultural Development Bank (TADB) which has been newly established by separating agricultural finance function from TIB. As will be elaborated later, under TIB's new system following its transformation to the DFI, the SME Finance Department has been set up in the Development Finance Division as a specialized section of SMEs. (Refer to section “1.3.2 TIB")

Similar to this, regarding the establishment of the Industrial Development Bank─advocated by MITI—which is not included in FYDP2, it is also conceivable to eventually separate the Industrial Loan Department, newly established in the Development Finance Division of TIB, instead of establishing a new financial institution.

1.2.2 SME Promotion Policies and Measures

The basic SME policies of the Government of Tanzania are laid out in the Small and Medium Enterprise Development Policy (2003), formulated in 2003. However, 13 years have passed without legislation of them. Many of the stakeholders, including competent government authorities, pointed out that it is necessary to review the SME Policy.

The SME Policy—following a review on its general framework—identified five fields of government services for SME business development, namely, entrepreneurial development (both financial and nonfinancial), business training, information provision, technology and marketing. Regarding the financial sector, it advocated the establishment of a financial institution designated for SMEs. All of the above services seem to have already been realized to a certain extent, owing to the activities of TIB and others.

In conclusion of the recent evaluation of the SME Policy, UNIDO published its Implementation Review entitled "Tanzania SME Development Policy 2003, ten years after" in March 2013. While evaluating policies, including expansion of government organizations exclusively for SMEs (such as upgrading MITI's SME function to comprise a department), UNIDO pointed out the lack of monitoring and the absence of a policy adjustment mandate by MITI. In relation to the financial sector, it has also pointed out that (i) emphasis has been placed on financing for micro enterprises, with no emphasis on SMEs as a whole; (ii) although the Credit Guarantee Facility (CGF) has been established, actual work regarding the guarantee is still to come; (iii) although there are many new banks, SME loans, especially medium and long-term loans, to the manufacturing industry are extremely few. These evaluations are still applicable, except for credit guarantees; and, the necessity of expanding medium and long-term financing for SME capital investment continues to be high. In December 2016, MITI expected to start discussing "SME Policy Framework" as a new SME development policy. Under this framework, specific measures concerning SME finance, which were not included in the SME Policy of 2003, would be elaborated.

1.3 Current Situation and Challenges of Government Agencies Involved in SME Loans

1.3.1 Ministry of Industry, Trade and Investment (MITI) SME Directorate

The headquarters is responsible for operations including ensuring easy access to finance with the aim to create conducive environment for SMEs' graduation from informal sector financing. Specifically, the functions assigned to the SME Directorate include the following: (i) develop, monitor, evaluate and review implementation of the SME Policy and its guidelines, legislations, and standards; (ii) develop mechanisms for ensuring that SMEs comply with environmental issues and thus build environmentally responsible entrepreneurships; (iii) develop and implement strategies for enhancing graduation and formalization of the informal sector; and (iv) develop strategies for facilitating SMEs to access financial services. [2]

The number of the entire MITI staff is about 250, with 17 people assigned to the SME Directorate.

1.3.2 TIB Development Bank (TIB)

(1) Organization overview

TIB was established in 1970 as a development bank wholly owned by the government for the purpose of promoting industrialization. TIB, in the 1970s, had provided mid and long-term finance to manufacturing, agriculture, and construction sectors. After the 1980s, due to a) the war with Uganda, b) fluctuations in foreign exchange, and so forth, its business deteriorated to the extent that it had to engage in short-term finance in similar fashion to commercial banks. After government relief measures were implemented, TIB went through management reconstruction and was eventually redefined as a financial institution for development in 2005.

Currently, the Banking and Financial Institutions Act of 2006 is applied to TIB Development Bank, which is the core of the TIB Group. Therefore, the bank is no longer subject to the application and regulation of business functions by special law as before. TIB acquired a license as a development finance institution (DFI) from the BOT in 2015. The DFI license is currently only held by the Agricultural Development Bank (TADB) and TIB.

TIB's finance is centered on infrastructure, industrialization (e.g., agro processing, mining, general manufacturing industry), oil and gas, and service industries. Although TIB has no experience so far in lending to other financial institutions, the BOT as well as the Financial Sector Development Section of the MOFP believe that there is no limitation for TIB to issue loans to financial institutions. As to the possibility that the BOT would apply new regulations to the two DFIs, it is necessary to watch its progress in the future.

TIB had been granting agricultural-related loans, but as the Agricultural Development Bank (TADB) was newly established in 2015, agriculture-related loans were separated from TIB (although its agriculture loan facility "Agriculture Window" still remains in TIB as of November 2016). In the same year, as part of strengthening its scope of function as a DFI, TIB separated the commercial banking function to become a subsidiary, TIB Corporate Finance Ltd. These changes were executed due to the fact that TIB, as a DFI, became responsible for promoting industrialization under FYDP2 and was expected to supply long-term finance for equipment in priority sectors.

As a result of the separation of commercial banking functions from TIB, working capital is no longer available even for companies and projects previously financed by TIB. Instead, TIB

[2] MITI SME Department (Http://Mit.Go.Tz/pages/small-and-medium-enterprises-sme)

Corporate Finance Ltd. is providing working capital. This is not a constraint in relation to any law or DFI license; it is a matter of division of labor within the TIB Group.

(2) Organization planning

TIB's mid to long-term plan was in the finalization stage at the time of this Survey (November 2016). The plan allegedly was to be submitted to the MOFP in December 2016, and the Diet deliberations should be completed after April 2017.

Based on the national plan, Vision 2025 and FYDP 2, the TIB Board of Directors has established priority sectors. The SME sector is placed as special priority together with the following four sectors:

(i) Industry and technology (agricultural production processing, mining, general manufacturing industry); (ii) infrastructure (development of utilities (gas, water, electricity), transportation, etc. to be implemented by local governments through public-private partnership [PPP]); (iii) oil and· gas; and (iv) services such as tourism. In the SME sector, the SME Financing Program is scheduled to be implemented. In addition to SME loans, TIB plans to conduct industrial parks lending, an innovation program for SMEs, and training sessions to enhance SME growth.

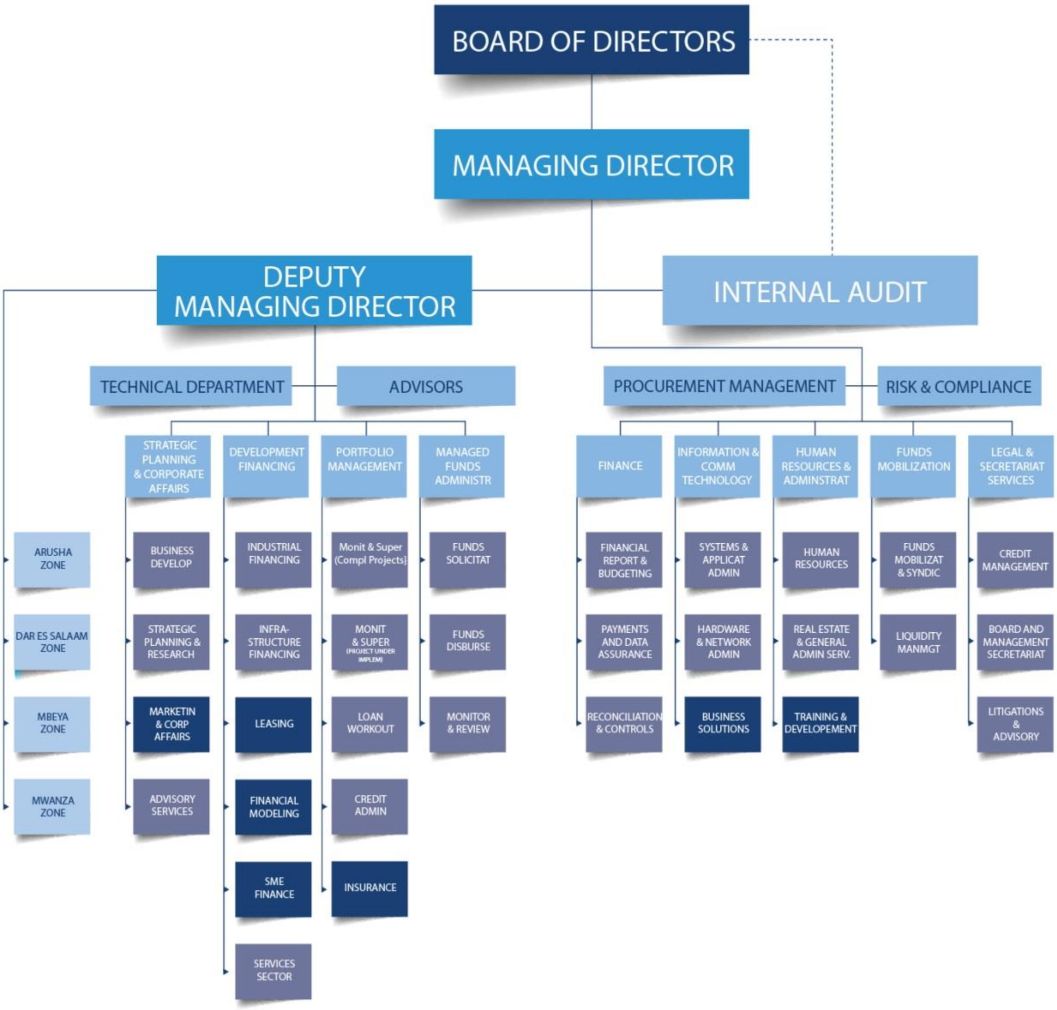
(3) Organizational structure (including branch network)

TIB's top decision-making body is the Executive Board, but the ordinary operation is conducted mainly by the president (a board member) and the vice president. Mr. Charles Singili, who became the president in 2016, was originally from the BOT, with work experiences at private financial institutions such as NBC and Azania Bank. Mr. Jaffer Machano, who assumed the post of vice president in August 2015, has extensive experience at TIB, and is thus familiar with TIB's businesses. He has a strong vision on policy-based lending. The TIB staff's general level of capability (in terms of loan knowledge, and so forth) is judged to be higher than that of commercial banks. However, the total number of staff at TIB is overwhelmingly small at around 150. Considering the overall increase in the role of TIB, considerable enhancement including the ability for SME finance is necessary. TIB has improved its nationwide operation from January 2016 by adopting a zone system, although the number of branches is still limited at four.

In addition, since TIB's customer outreach was limited due to its small branch networks, TIB Corporate Finance (a TIB subsidiary) signed a partnership agreement in 2016 with the Tanzania Postal Bank, which will allow the postal bank to execute and collect on loans on behalf of TIB—in all cases, nevertheless, credit appraisals shall be carried out by TIB.

(4) Selection of loan target

TIB's branch offices, namely, zone offices, have jurisdiction over 26 regions (divided into 4 regions) and they are in charge of identifying candidate loan projects. Each project review report submitted from the regional office will be handed over to the business committee of the headquarters. Only those projects approved by the Committee will be forwarded to the Development Finance Division, which is responsible for all the credit appraisals.



(Source) TIB (as of November 2016)

Figure 1-3. TIB organization chart

(5) Credit appraisals

1) Credit appraisal system and methods

The Development Finance Division is in charge of credit appraisals. In the Division, there are 12 officers in 6 sectors, including the following:

- SME Finance (in charge of loan amounts between TZS 0.1 billion and 2 billion)
- Industrial Financing (specialize in agro processing, mining, general manufacturing industries, and in charge of loan amounts of TZS 2 billion or more)
- Infrastructure Financing (in charge of loan amounts of TZS 2 billion or more)
- Service Sector (in charge of loan amounts of TZS 2 billion or more)
- Leasing
- Financial Modeling

Prior to the organization reform in January 2016, there were 18 employees enrolled in the division. The number of staff has decreased ever since due to job changes and natural retirement. At the same time, new employees have not been hired to date due to the government's request to freeze new recruitment, which was implemented to eliminate non-productive officials (the so-called "ghost employees"). These are the reasons why the current number of workers is down to a mere 12.

Two people are currently assigned to the SME Finance Department as of November 2016. Before the reform, five people were allocated, but three people were transferred to branch offices due to the introduction of the zone system. TIB plans to restore the number of employees at the SME Finance Department to five people as soon as the government's employment freeze is lifted.

Credit appraisals generally take 2 to 3 months per project. The review items covered are standard contents ranging from company history to industry analysis and from cash flow analysis to environmental requirements. TIB has a standard list of documents that are required from loan applicants. Regardless of the loan amount—irrespective of being an SME—credit appraisals must be conducted. And, in order to pass TIB's standardized credit appraisals, each company needs to have appropriate management skills regardless of the size of the company. A requirement of collateral is essential, and asset evaluation is carried out by TIB's Technical Section. In the case of SME loans, the conditions for the estimation of collateral values are stricter than those for large enterprises, with the forced sales value of land in cities to be discounted by 75%. It should also be noted that project profitability must be prerequisite for conducting credit appraisals.

Since TIB's credit appraisal is so exhaustive and time consuming, it is not suitable for micro enterprises (with less than 4 employees). TIB therefore plans to have microfinance institutions (MFIs), such as PRIDE and SACCO, take care of such cases.

2) Credit appraisals and credit portfolio management capacity

The Survey Team reviewed four credit appraisal reports prepared by TIB, which consisted of one successful loan case and three non-performing loans (NPLs). Items necessary for credit appraisals, such as restrictions on dividends, restrictions on stock transfer, TIB approval for new borrowings, and appropriate conditions as creditors, were mostly included. However, the following problems were identified:

- Analysis on the past and current situation of the company was not detailed.
- There was no evaluation of the management based on one's achievement; Or, a wrong evaluation criterion was used based on the past position, and so forth.
- Analysis on the target sector was too general, and more detailed analysis was required on the business surrounding the company.

3) Efforts to improve credit appraisal capacity

As will be elaborated later, TIB's NPL ratio has increased sharply, and in order to improve the situation, organizational reform was carried out in January 2016. Under the new system, all of the following relevant departments are to be involved in the credit appraisal process, and the Development Finance Division Director is to ask the directors of each department in advance to assign appropriate personnel on a case-by-case basis regardless of the loan amount.

- Financial Modeling Department
- Portfolio Management Department
- Technical Services Department
- Strategy & Planning Department

In addition, TIB recognizes its experience of NPLs as a valuable asset, and since last year, has used concrete NPL examples along with the training provided by Moody's in order not to repeat similar mistakes in the future. Contents of the training include online lectures on credit analysis and project finance, and a discussion on credit appraisal reports. Already 50 staff members have participated in the training.

(6) Monitoring

Each loan project, after its approval, is to be monitored separately at TIB before and after the end of the loan disbursement. The same applies to SME loan projects.

In the organizational reform in January 2016, it was decided that monitoring of loan projects after their appraisals would be conducted at the zone office where the loan project is located in order to strengthen the monitoring system. And many head office loan officers were transferred to the zone office accordingly. Prior to the reform, loan officers were only able to visit the local project site once per fiscal quarter. However, it became possible to pay visits monthly under the new system created through the organizational reform. Since the Portfolio Management Department is responsible for the implementation of each project, each zone office reports to the portfolio management director monthly, and in cases which problems occur, the department's personnel will pay a visit to the concerned zone office to confirm the situation.

In parallel to this, the Intelligent Management Department will also analyze and compare loan portfolios of all zone offices.

With regard to the aforementioned NPL projects, the JICA Survey Team had the chance to also review their monitoring reports. As a result, the team found that the report omitted the description of previously known facts at the time of the preparation of the credit appraisals report. Through organizational reform, therefore, it is necessary to watch TIB's progress in the improvement of its monitoring and credit appraisals capacity.

(7) Managerial finance situation

The managerial finance condition (as of the end of 2015) of TIB is shown in Table 1-4. In 2015, TIB separated TIB Corporate Finance to become a subsidiary that supplies short-term funds such as working capital, and obtained a license as a development finance institution (DFI). Therefore, it is not easy to continuously compare figures and so forth with those of the previous years; so, it is considered appropriate to only look into figures from 2015 in this report.

In terms of the size of total loan portfolio, TIB is about 15% the size of the CRDB, which is the largest bank in Tanzania. Of the TIB's loan portfolio, 57% are beyond one-year maturity. As for the breakdown of fund procurement, TZS 56 million is from long-term borrowings, while TZS 406 million is from deposits. There is an urgent need to secure long-term funding in order for TIB to expand medium and long-term lending. The debt ratio is considered to be at an appropriate level. The NPL rate was already high at 14% in 2015, but had further increased to reach 30% as of October 2016 (to be elaborated later).

The lending interest rate of TIB varies according to its funding sources, borrowers, and others. When compared with short-term interest rates of the commercial banks which exceed 20% however, TIB's lending rate is kept comparatively low. Since the level of TIB's procurement interest rate is not necessarily low, the bank's interest margins are getting thinner and thinner. Furthermore, since TIB assumes its responsibility as a government financial institution, it is assumed that its intention to maximize profits is not as strong as commercial banks. In 2015, TIB had managed to secure a certain level of net profit.

Table 1-4. Financial condition of TIB (end of 2015)

	TZS billion
Total assets	689
Loan	538
(NPL)	78
Liabilities	476
(Including long-term debt)	(56)
Capital	213
(Including paid-in capital)	(152)
Total revenue	63
(Of which)	(55)
Interest payments	26
After-tax profit	6
Bad debt ratio	14 %

(Source) TIB (2016/11)

(8) Current state of non-performing loans (NPL)

According to TIB, the breakdown of NPLs as of the end of October 2016 is as shown in Table 1-5. Of the total loan balance of TZS 593 billion, TZS 196 billion was bad debts, with the NPL rate reaching 30%. TIB reported the NPL rate to the MOFP and the BOT at the end of September 2016.

The NPL rate as of December 2015 was at 14%, and it has continuously increased thereafter. Under the policy that TIB will be restructured as a DFI, after obtaining the DFI license in June 2015 under the new president appointed in the same year, TIB had endeavored to clean out all the bad debts from the past. As a result, TIB's NPL rate has allegedly risen to 30%.

Table 1-5. NPL Breakdown (2016/11)

	Classification	Amount of debts (TZS billion)	NPL Share
A	Credit failure	60	31%
B	Implementation delay	49	25%
C	Work out (restructuring)	87	44%
	Total	196	100%

(Notes) "Credit failure" refers to the amounts of principals and interests that are decided impossible to recover in full, based on respective loan agreements by the Development Finance Division and Portfolio Management Division.

"Implementation Delay" is a loan that has been past due for three months or more due to a delay in completion of the project.

"Work out/Restructuring" is a loan which has undergone a change in lending conditions such as interest rate reduction and exemption, postponement of the payment of interests and principals, for the purpose of supporting the borrower and for its management restructuring.

(Source) TIB (2016/11)

(9) NPL disposal policy

According to TIB's NPL disposal policy, the full amount of the loans categorized as "credit failure" will be recorded as a loss by yearend 2016/2017 (June 2017). Since some of them have already been written off, it will not be necessary to deduct the entire amount of TZS 60 billion from the capital. As a result, the NPL rate is expected to drop to 21%.

By the end of 2017 some projects categorized under the "implementation delay" classification are expected to be completed. If that happens, the NPL rate is expected to drop to 13% due to the reclassification of the receivables.

In addition, some of the loans classified under the "work out" category included (1) those classified as NPLs due to their parent companies' being classified as "completion delay" (TZS 18 billion), as well as (2) those expected to be repaid through asset sales (TZS 1.7 billion). Therefore, as long as these categories are changed and repayment progresses, NPLs could be reduced to less than 10% by the end of 2017 in real terms. Moreover, a part of the TZS 1-trillion capital increases for TIB planned under FYDP2 is expected to be disbursed from the government in the middle of 2017.

In order to enable TIB to implement a new financing scheme, it is necessary to make sure that (i) TIB's NPL rate will be reduced to at least the mid-10% range, (ii) capital injection from the government will be assured, and (iii) TIB's credit appraisals and monitoring systems will be improved as compared to the level under the pre-reform system where the NPL rate was recorded at 30%.

At the same time, TIB needs to further grasp the situation regarding the capacity improvement and strengthening of personnel for credit appraisals and monitoring, and sustain its implementation. TIB executives must disseminate and consolidate a clear and enforceable management policy which minimizes the NPL rate both within and outside the organization, upon the consent of the relevant government agencies. Without this, TIB's organizational reform will merely end up an accumulation of knowledge without actions.

(10) TIB's willingness to implement SME finance and the actual situation

TIB is expected to become an implementing agency of financial aspects within FYDP2. As well, considering the fact that TIB is the only financial institution in Tanzania that provides capital investment fund of 7-10 years to SMEs, the willingness of TIB to implement SME finance is notable.

On another note, SME loans were the main business for TIB until 2009. But since then, because some small business operations were transferred to TIB Corporate Finance Ltd, in addition to the increase in other sector operations, SME loan operation has been shrinking. In fact, according to the annual report from 2015, the total outstanding loans to SMEs which were classified based on loan amount, was extremely small at TZS 26 billion (which is 5% of TIB's total loans outstanding). However, in terms of the number of clients, SMEs still account for 55% of the total.

(11) Finance lease

In 2016, TIB established a specialized section for finance leasing (an alternative financing mechanism that requires no collateral), focusing on fields such as construction, mining, transportation and aviation. The number of loans provided in 2015 amounted to 31 and the amount of loans outstanding as of year-end 2015 was TZS 16 billion. The average loan amount per investment was TZS 520 million, which was large for the scale of financial schemes that SMEs could utilize. There have been no new projects since January 2016.

Finance leases can be an option on SME loans, but TIB will be focusing more on large scale leasing in the future, and is not clear on the SME development strategy.

In addition, an increase in the use of leasing by SMEs is not anticipated for the foreseeable future since a high tax rate of 6% was added to the normal tax rate (VAT 18%) for the leasing industry in 2015.

(12) Source of financing

TIB's sources for procurement are mainly deposits from large investors, and few long-term funds. As a measure to mitigate the risk of maturity mismatch between procured funds and lending, TIB plans to increase borrowing from donors—those without currency exchange risks—in addition to the capital increase committed by the government in FYDP2. TIB is also considering the issuance of a domestic bond (worth TZS 75-100 billion) and foreign bonds (private placement bonds). It is, however, a problem that bond issuance costs are high.

(13) SME enhancement programs

Selected loan projects with small loan amounts are to be forwarded to the SME Department for credit appraisals. SME's management skills, corporate registration, collateral, capital, and so forth are measured as prerequisites for lending at the time of credit appraisals; but, the number of SMEs which satisfy these conditions are still limited. As a countermeasure to this problem, TIB, in collaboration with SIDO and others, plans to discover companies with high growth potential and provide them enrollment in the TIB Business Incubation Program for guidance on corporate registration, licensing applications, management know-how, and so forth.

TIB also plans to continuously provide training and advisory services such as those on technology, marketing, bookkeeping/accounting, project management, and so forth for companies who have completed the program as well as to its current clients.

Through these efforts, TIB intends to nurture SMEs with high growth potential to become TIB clients. However, the budget for this has not been secured. If TIB were to target only SMEs with corporate registration, SME loan targets would become very limited.

1.3.3 The Bank of Tanzania (BOT), the Central Bank of United Republic of Tanzania

The role of the BOT as the central bank of Tanzania is specified in the BOT Act 2006. The BOT has issued a DFI license, which is different from ordinary bank licenses, to the two government financial institutions, namely, TIB and the TADB. In parallel, the BOT undertakes the banking business oversight function including identifying bad loans, through the Banking Supervision Bureau.

The BOT's individual loan projects are differentiated from its ordinary lending to banks as stipulated by BOT Act, Article 39 (bill discount), Article 40 (loan), and Article 41 (function as the lender of last resort to banks at a time of crisis).

For example, although the BOT has taken on foreign exchange risks of the World Bank's loan projects, taking foreign exchange risks is not the BOT's primary task. The BOT limits itself to only taking such risks after understanding the content of individual loan projects and upon special request from the MOFP. In addition, the BOT, an implementing agency for the on-lending of the World Banks's funding, has been handling its operation independently from its core business through the establishment of a Project Management Unit (PMU) and a trust fund.

BOX. The usefulness of finance leases in SME finance and the present condition of Tanzania

Tanzania's SMEs are not able to borrow medium and long-term capital investment funds from banks. The reasons include: (i) SMEs being unable to provide real estate security enough to make them bankable; (ii) banks not accepting manufacturing machinery, and so forth. to be financed as collateral; and (iii) interest rates being too high to borrow in the medium to long term. Finance leases should be recommended as a means to solve such difficulties in financing SMEs.

Finance leases do not provide direct funding but provide assets such as manufacturing machinery and equipment. Because the leasing company (Lessor) procures funds on behalf of the borrower (Lessee), an SME itself need not borrow from the bank. Even in the case of an SME whose financial structure is vulnerable and for which bank borrowing is difficult, new facilities can be introduced without purchasing assets (thus, off-balancing assets) as well as without deteriorating cash flow (by means of deduction of lease expenses from taxable income), thereby saving bank lines of credit (for other purposes). In other words, finance leasing can be said to be an excellent alternative financial means of medium and long-term financing from banks.

Despite all these benefits, finance leasing has not been utilized for SMEs in Tanzania—the major cause of which is the government's inaction in adjusting tax and accounting systems accordingly. For example, as a special case to support SMEs, the Japanese leasing accounting system allows SMEs to treat finance leases as operating leases (i.e., to record as renting expenses and keep off of the company's balance sheet). In some Latin American countries, such as Guatemala and Jamaica where such special accounting treatment is possible as well, finance leasing has been promoted as a means of disseminating solar power generating and energy saving equipment. On the other hand, in Tanzania, following the IFC's finance lease introduction project in 2005, the finance lease law of 2008 and the banking and financial institution regulation of 2011 became the governing law. However, Tanzania still lacks a movable assets registration system, asset finance market as well as finance leasing statistics. In addition to delays in the development of tax systems and accounting systems to support finance leasing, taxation has become stricter under the new government (6% is added to the current 18% VAT for leasing business activities), thus the leasing business is largely hit. If the government intends to implement SME support and make full use of the advantages of finance leases from a long-term perspective, it needs to solve the above problems so that SMEs can make use of finance leases much easier, as well as to disseminate finance leases among SMEs.

Benefits of Finance Leasing (not an exhaustive list)

	In case of purchase	In case of finance lease
Spending	Amount of purchase	Monthly fixed lease payment
Asset entry (ownership)	Required (On-balance sheet)	Not required in some countries *1(Off-balance sheet teatment allowed)
Depreciation	Required	Not required
Book entry as expenses (cash burden)	In case of declining balance depreciation, the asset depreciated more quickly at the beginning of its useful life, therewith creating bigger cash burden at the initial stage of investment.	Leasing payment are fixed monthly. Thus the amount of book entry of leasing expense is fixed monthly (which contributes to leveling-off of cash burden)
Bank lines of credit (own funds)	Required	Not required (Bank lines of credit and own funds can be saved for other purposes)
Terms & conditions	Appraisal of business performance in the past 2-3 years: (Collaterals required)	Appraisal of business performance in the past 12 months: (Collaterals not required)

*1: The National Board of Accountants and Auditors (NBAA) stipulates that companies apply international accounting standards to leases, but there is no lease accounting standard in Tanzania. Depending on the country, as a special treatment to support SMEs, accounting standards on leasing allow book entry of finance leasing payments as expenses (off-balance sheet).

1.4 SME Finance of Commercial Banks: Current Situation and Challenges

1.4.1 Commercial Banks

(1) Three largest commercial banks

1) Financial Situation and Shareholders

Financial Situation

Table 1-6 summarizes the financial situation of the three largest banks for FY2015. The NMB is by far the best in performance. The CRDB achieved high net profit in 2015. However, it reported a loss of TZS 1.9 billion in the third quarter of 2016 although it is expected to report net profit on an annual basis. The NBC is around a third of the size of each of the first two banks in terms of assets and its performance is far less than the other two banks. The three commercial banks differ in performance, but all of them are financially sound. The total loan assets of the three banks combined is over a half of the total outstanding loans balance of the entire banking sector in Tanzania.

Table 1-6. Financial Situation of Three Largest Banks in Tanzania

(TZS billion)	CRDB	NMB	NBC
Total assets	5,335	4,580	1,692
Loans and advances	3,531	2,482	905
Deposit	4,250	3,554	1,338
Long-term borrowings*	296	266	33
Equity	672	665	257
Interest income	487	439	147
Net income after tax	122	150	12
ROA	4.2%	3.3%	0.7%
ROE	24.3%	22.4%	4.7%
Capital / Assets**	12.7%	14.5%	15.2%
NPL/ Total Loan	8.1%	2.1%	8.2%

* including subordinated debt
** core capital to risk weighted assets for TIB

(Sources) FY2015 annual reports of respective banks

Shareholders

The NBC is a member of the Barclays' group, being 55% owned by Barclays PLC. The CEO is an Englishman, sent from Barclays, and he reports directly to the regional director of Barclays Group in Johannesburg. The NMB is a listed company on the Dar es Salaam Stock Exchange (DSE). It is 34.9% owned by Rabobank, a Dutch commercial bank. The position of CEO and other major positions are held by people from Rabobank. The CRDB is also a listed company on the DSE. DANIDA, a Danish aid agency, owns 20% of the bank. It has only one non-executive director, who does not reside in Tanzania. DANIDA does not have direct involvement in the bank's management. The IFC is also a shareholder of the CRDB but its ownership is less than 5%. The CRDB is considered to be owned and managed by Tanzanians.

2) SME Finance

SMEs in Tanzania are mostly businesses run by individuals, which are not registered companies. Therefore, SME finance in commercial banks is mostly loans to those individuals, and is not under the corporate banking function. On the other hand, the clients for the SME finance division of TIB are all registered companies.

Size

The percentage of SME finance to total loans outstanding is 11% for the CRDB and 8% for the NMB and NBC. SME finance is not a main business activity for the three banks, but its presence has been increasing because of its high profitability. The non-performing loan (NPL) ratio of SME finance as of FY2015 was not necessarily high for the NMB. It was 5% for the CRDB, which is lower than its overall NPL ratio.

Table 1-7. SME Finance of the Three Largest Banks

	CRDB	NMB	NBC
SME loans	364	190	75
SME/ Total loan	11%	8%	8%
SME loan NPL ratio	5%	2%	NA

(Sources) FY2015 annual reports

Lending Terms

The tenor of SME loans is mostly less than one year. The CRDB and NBC extended three-year loans to some SMEs. The NBC basically extends one-year loans to SMEs and renews them annually. Although all three banks intend to extend loans to any creditworthy customer[3], they have never extended loans over 5 years.

SME loans are all secured by collateral. All three banks follow the BOT guidelines that require the banks to obtain collateral with a value of not less than 125% of the related loan until the total loan amount is less than 10% shareholders' equity of each bank. There is a lot of land whose title is not clear, and land registration is thus not common in Tanzania. Nonetheless, the three banks obtain properties which are not properly registered as collateral (informal security) so that they can find sufficient collateral for SME lending. The interest rates applied to SME loans are more than 20%.

Branch Network

Table 1-8 summarizes the number of branches and employees for the three largest banks as of FY2015. The CRDB had 199 branches and the NMB had 175 branches. They covered all of the main business locations in Tanzania. The NBC's branch network was less than a third of the other two banks, covering mainly major cities.

Table 1-8. Number of Branches and Employees of Three Largest Banks

	CRDB	NMB	NBC
Number of branches	199	175	52
Number of employees	2,651	3,163	1,240

(Sources) FY2015 annual reports of respective banks

[3] All three banks define SME finance in terms of lending amount. According to the AfDB's report for 2012, SME finance in Tanzania covered companies with sales up to US$2 million and a lending amount ranging from US$600 to US$8 million.

Credit Appraisal

The CRDB allows its branches to approve SME loans on their own up to a certain amount. The maximum lending limits differ among the branches and are set according to the branch size. Any loans above the limits are reviewed by the credit committee of the head office. The NMB and NBC follow similar credit approval practices.

All three banks have a standard checklist for credit appraisal for all their branches. Appraisal for short-term financing focuses on cash flows during the lending period and sufficiency of collateral. All of the heads of SME finance of the three banks emphasized that they do not rely on information from external documents.

It is not currently meaningful to compare the credit appraisal processes for SME finance between these commercial banks and TIB, since TIB's clients are registered companies while the SME clients for the commercial banks are mostly personal businesses, and not registered companies.

(2) Medium-size Commercial Banks

Following the advice of the FSDT, the mission held meetings with AKIBA Commercial Bank and DCB Commercial Bank[4]. Both banks hold less than one thirtieth the assets of the CRDB, the largest bank in Tanzania. Both banks are financially sound. AKIBA has been increasing SME finance, while DCB remains the lender to individuals mainly in the police and military.

AKIBA's clients are expanding their businesses. AKIBA's management recognizes the imminent challenge of reforming its institution to cope with the changing needs of its clients so that it can retain those clients who would otherwise shift to large banks offering diversified services. On the other hand, SME finance relating to DCB's customers is largely served by other commercial banks at present. DCB sees the future challenge of enhancing its capacity to capture SME finance from the commercial banks.

1.4.2 Bottlenecks of SME Finance

(1) Inability of SMEs to Explain Their Business and Plan

Small enterprises in Tanzania rarely have financial statements. Few of them are able to comprehensively explain their business using data. It is currently the role of banks to make such businesses translate into bankable ones.

The situation of medium-size enterprises may be different. But in general, banks do not rely on the accuracy of documents prepared by enterprises. The banks approach them cautiously through setting

[4] Azania Bank was also introduced by the FSDT, but the mission did not have a response to the request for a meeting.

up bank accounts, evaluating their credibility through their track records and regional reputation, and extending loans after securing sufficient collateral for the loans.

The NMB is engaged in customer awareness activities throughout Tanzania through the activities of 34 clubs under the NMB Business Club. Once a year, seminars are held, inviting experts from various surrounding locations where clubs are located. More than 300 people gathered at each seminar, and the NMB spends a budget of TZS 1 billion for this activity annually.

(2) Exorbitant Interest Rate and Short Tenor

Normally, long-term financing with a tenor of 7 to 10 years is required when SMEs consider their investment for expanding businesses. At present, there are no banks in Tanzania other than TIB providing such long-term financing to SMEs. Capital investment which justifies an interest rate of over 20% can hardly be considered feasible. SMEs do not want to commit to borrowing tenors of over 5 years under the situation of this exorbitant interest rate, which may perpetuate the prevalent environment of setting short-term tenors. It is always a challenge for SME finance to secure sufficient collateral. But the three largest banks have been managing to secure sufficient collateral by obtaining unregistered property (informal security), and have been increasing lending to SMEs.

(3) Extreme Short-term Nature of Bank Funding

Table 1-9 summarizes the maturity structure of assets and liabilities of the three largest banks. The funding of the banks is predominantly made up of less than one month of deposits. On the other hand, their assets are mainly loans of which substantial percentage are committed at beyond one-year maturity: 45% for the NBC, 51% for the CRDB, and 59% for the NMB. This indicates that banks in Tanzania are performing the maturity transformation function of liabilities and assets, as is normally expected of banks. Given the extreme short-term nature of the funding, asset portfolios over five years are still very small: 16% for the CRDB, 7% for the NMB and 0% for the NBC. Under this constraint, both the CRDB and NMB recently increased acceptance of long-term funding from multilateral agencies such as the IFC and EIB. It is a challenge for each bank to secure long-term funding to increase long-term lending.

Table 1-9. The Maturity Structure of Assets and Liabilities of Largest Banks

	less than 1 month	1-12 month	1-5 years	over 5 years	Total
CRDB					
Assets	26%	23%	35%	16%	100%
Liabilities	80%	13%	1%	6%	100%
NMB					
Assets	7%	35%	52%	7%	100%
Liabilities	87%	9%	4%		100%
NBC					
Assets	31%	24%	45%		100%
Liabilities	91%	7%	2%		100%

(Sources) FY2015 annual reports

1.5 Other Donors' Activities in SME Finance

Currently there is no donor in Tanzania that extends long-term financing to SMEs on a concessionary basis. Multilateral agencies such as the IFC, the EIB and the AfDB (through private sector window) extended loans to commercial banks for SME finance.

The IFC extended a ten-year credit line facility of US$ 75 million to the CRDB in 2014. 20% of the total balance of the credit line facility was aimed to finance SMEs. There is no condition relating to the interest rate applied to loans to SMEs. A rate of over 20%, similar to that of CRDB's other lending activities, was applied to loans given to SMEs. The CRDB bore the currency fluctuation rate risks for the facility. The EIB extended a 5-year credit line facility of €70 million to the NMB in 2013. The EIB also provided a credit line facility of TZS 70 billion to the CRDB. None of the proceeds from the facilities from the IFC and EIB were provided to SMEs on a concessionary basis. All of the credit line facilities from both agencies are now fully utilized.

The funding from the IFC and EIB did not impact the exorbitant interest rate on loans for SMEs, which were prevailing in the market. The interest rate of over 20% was applied to loans to SMEs like that of other lending. A local newspaper reported on 2 December 2016 that the AfDB through its private window entered into a US $120 million loan agreement with the CRDB, which will be used for infrastructure-based development and SME finance. This was also confirmed by the AfDB. Although the details have not been disclosed, lending terms seem similar to those of the IFC and EIB loans, without concessionality

USAID has been providing a guarantee scheme to cover 50% of the credit provided by commercial banks to SMEs in Tanzania. This is called the Development Credit Authority, a global program covering 74 countries. The existing commitment amounts to US $60 million. The covered loans are extended to mainly micro and small enterprises. The tenor is from one year to one and half years. There are many similar guarantee schemes running in Tanzania. The African Development Bank started a credit guarantee scheme with the Spanish and Danish governments. Similar schemes are provided by the French Development Agency (AFD) and other donors. All of the schemes provide only credit enhancement, neither creating long-term financing nor providing concessionary terms. The interest rates applied to the covered loans are the prevailing market rates at well over 20%.

The World Bank has not provided loans to SMEs through commercial banks for a long time. The World Bank is currently working under a project to improve the private sector business environment which is helping establish land titles and promote land registration by digitizing old data into a system and by utilizing drones to help delineate land titles in un-surveyed areas. According to the IFC, land titles are not clear in around 80% of Tanzanian land. The current situation with land titles is considered one of the obstacles to making land available as collateral for borrowing.

Besides providing loans to the CRDB, the IFC made equity investments in commercial banks like the CRDB, the NBC and others. It also provided technical assistances for capacity building to commercial banks in connection with its loans and equity investments.

1.6 Expectations of Government and Relevant Organizations for SME Finance Assistance

1.6.1 The Ministry of Industry, Trade and Investment (MITI)

Since over 70% of the total working population in Tanzania is engaged in the agricultural sector, MITI recognizes that agro processing is the driving force of Tanzania's industrialization. For this reason, the ministry considers that it is necessary to provide assistance to promote SME finance, mainly in the agricultural products processing industry, and it is better not to limit the size of target enterprises to SMEs (in the future) in order for the assistance to make big impact.

1.6.2 The Ministry of Finance and Planning (MOFP), Financial Sector Development Division

Similar to the opinion of MITI, the MOFP believes that the impact of job creation is greater in the agricultural product processing industry, with regards to SME finance support.

The ministry reasoned through analysis that the problem of SME finance is largely a non-finance task. Specifically, since governance and capacity problems are big, it is ineffective to simply provide highly concessional funds. When providing SME finance assistance, it would be better to limit the number of target companies and to strengthen monitoring.

1.6.3 The Ministry of Finance and Planning (MOFP), Planning Commission

The planning commission claimed that assistance in financing SMEs is important because—in addition those above—it will eventually benefit micro enterprises by creating a business environment favorable for SMEs to develop. Promoting SME's access to long-term funds and offering them low interest loans are significant. The MOFP also believes that it is necessary in the development of SMEs to shift as many SMEs as possible to formal sectors.

1.6.4 The Ministry of Finance and Planning (MOFP) Commission for Policy Analysis

The MOFP agrees to provide SME end users with long-term funds below market interest rates. When a donor provides highly concessional funds, it is considered unfavorable that the current market interest rate be applied and the concessionality of a TSL will not be given to the end user.

1.6.5 Other SME Supporting Entities

The Tanzania Private Sector Foundation (TPSF), the Financial Sector Deepening Trust (FSDT), and the Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA) pointed out that SME financial support is necessary.

The TPSF believes that promoting import substitution of agricultural processed products is very important for job creation, income improvement, and economic growth, considering the fact that Tanzania— although it is an agricultural country— exports primary products and imports processed agricultural goods.

The FSDT believes that it is necessary to capture SME finance from the borrower's point of view.

Financial institutions apply a uniform approach (such as collateral requirements and collection of financial documents) to SMEs. However—in SME finance—an approach, such as to make frequent visits to each company, is important. Full-fledged capacity building of SME finance for participating financial institutions is necessary.

The TCCIA raised multiple issues, including those of lending terms and conditions, land measurements, and the corporate information inquiry system.

- Relaxation of lending terms and conditions:

For SMEs, the gap between deposit rates (5% or less) and loan interest rates (20-22%) is too large; SMEs are not only unable to make profits by depositing their money (saving money) but they would also be deprived of business profits merely by payments on interest if they borrowed from banks.

It is a problem that formal sector banks apply a uniform lending rule on SMEs, without paying much attention to borrowers' differences. It is necessary to provide loans that consider the needs of individual SMEs (i.e., tailor-made finance), in such a way that loan officers will be required to visit companies more frequently.

-Promotion of land measurement: Prior to the land registration problem, there was the problem of many un-surveyed lands.

- Enhancement of corporate inquiry function:

The Credit Reference Bureau (CRB) established by the BOT in 2013 still has many system malfunctions and has not yet contributed to SME finance. The TCCIA itself wants to offer information as a corporate inquiry organization, for example, by issuing a letter of recommendation to banks on company credibility.

1.6.6 Small and Medium-Sized Enterprises

In this Survey, the JICA Team interviewed 12 SMEs—including those in the agricultural products processing industry—with high priority given as per the Government of Tanzania and the manufacturing industry and of which future growth potential can be expected.

The result of the interviews with SMEs, as shown in Table 1-10, revealed the fact that if there is a loan of appropriate interest rates and periods for capital investment, there will be quite a few prospective companies wanting to borrow.

Table 1-10. Interview results of 12 companies

	Current situation and issues	Financing needs
Agricultural products processing company (food 3, beverages 2, vegetable oil detergent 1)	• Cannot borrow from a bank because the interest rate is high • Reinvestment of own capital (no-cost investment) • Farmers supplying raw materials have fund procurement problems (such as not having land registration, ownership registration, or bank account). • Borrowing in foreign currency cannot be possible due to exchange rate risks. • When starting up the factory, they used the letter of credit (L / C) of the supplier.	• Long-term low interest capital investment funds are required.
Agriculture related machinery manufacturers (2)	• Cannot borrow from a bank because the interest rate is too high. • Reinvestment of own capital and utilization of customer's advance payments • Clients have financing problems.	• Long-term low interest capital investment funds are required. • Between customers and financial institutions,

		installment sales, finance leases, long-term, low-interest loans are needed
Agricultural machinery sales dealer (1)	・ Received low interest loans from suppliers ・ Provided low interest loans and finance lease to customers	・ Financing support is necessary for customers (who have no land registration, ownership registration, or bank account).
Engine repair company (1)	・ Cannot borrow from banks due to high interest rates ・ Banks would not give loans due to insufficient collateral. ・ Banks would not approve equipment to be financed as collateral.	・ Long-term, low-interest capital investment funds are required.
Plastic container manufacturer (1)	・ When borrowing from banks, the requirement to provide information, collateral, etc. is difficult. ・ Could borrow from TIB since the bank relaxed the collateral requirement	
Printing company (1)	・ Private banks do not accept printing presses as collateral. ・ Bought a printing press with a finance lease	・ Long-term investment funds are required.

(Source) Compiled by the JICA Survey Team based on information acquired from the respective companies

1.6.7 Japanese Affiliated Companies

The following are the expected benefits of SME finance promotion for Japanese and related companies in Tanzania:

- Direct benefits from the development of SME industrial parks (benefits as a resident SME)
- Direct benefits from the development of a favorable business environment for affiliated companies (procurement of long-term, low-interest investment funds)
- Indirect benefit through raising domestic companies (SMEs), such as making domestic procurement easier
- Indirect benefit through promoting the availability of finance leases for SMEs

Table 1-11 shows the results of interviews with 4 Japanese companies, including a trading company, an agricultural product processing manufacturer and an agricultural machinery distributor.

The growth of SMEs as business partners, suppliers of equipment and materials, and consumers of goods is of great interest to Japanese companies. At the same time, it was pointed out that the effect of financial methods, such as loans and finance leases, is greatly affected by SMEs' fund management capacity, and that the benefit of moving into an industrial park depends on the incentives given to it.

Table 1-11. Benefits of SME promotion for Japanese companies and allied companies
(○ = fully agree, △ = half agree)

Expected advantages	Japanese trading company	Agricultural products processing manufacturer	Agricultural machinery distributor	Supplementary remarks
Support for business development of affiliates	○			
Improvement in domestic procurement	○			
Support for suppliers	○			
Customer support			○	
Procurement of long-term, low-interest funds	△ * 1	○		* 1: It depends on the borrower's ability to manage funds.
Becoming industrial park tenants	△ * 2	○		* 2: It depends on available incentives.
Promotion of finance lease	△ * 1			* 1: Same as above

(Source) Based on the company interviews, compiled by the JICA Survey Team

Chapter 2　Justification for Proposed Cooperation to SME Finance

Tanzania has a huge need for long-term financing for SME capital investment. The proposed cooperation should be justified for the following reasons:

- Achieving a per capita income of around US $1,000 is a goal. Tanzania has great potential for continued growth by increasing exports of processed goods and by promoting import substitution. To realize this potential, it is important to support the growth and expansion of SMEs in light of the fact that they account for 30% of the country's GDP and comprise the majority of its jobs;
- The Government of Tanzania announced that industrialization through infrastructure-based development and SME growth is the core of its economic development strategy in the FYDP2;
- Access to finance is the key to the growth and expansion of SMEs. Long-term financing of capital investment by SMEs is still an area for large commercial banks to develop although they have been increasing lending to SMEs. Medium-sized commercial banks have to expand and diversify their services, including provision of long-term capital investment loans, so that they can retain their growing customer base and ensure their competitiveness with larger banks;
- The prevailing interest rate on loans for SMEs is well over 20%. This is not a normal situation, given that the inflation rate is 5% at present. In such as case, there would be a real interest rate of 17% when the lending rate is 22%;
- TIB — among other roles— is expected to provide long-term financing for capital investment by SMEs as a driving force of the FYDP2. However, TIB has yet to achieve success due to the constraint of its funding. TIB also needs to increase expertise in financing SMEs;
- There are no donor agencies which are able to respond directly to the needs of SMEs with affordable lending terms. This is also true for such multilateral agencies as the IFC and AfDB which have provided long-term credit facilities to large banks;
- Under all of the circumstances stated above, the proposed TSL program can be a model policy for providing long-term finance for capital investment of SMEs, which currently have almost no alternative but to rely on their own capital for expansion. Various pieces of know-how in financing for capital investment by SMEs, which will be brought about by the proposed TSL and the technical assistance, is indispensable for successful implementation of the industrialization policy. From this perspective, the proposed TSL program can fit suitably with the government policy under the FYDP2.

Below are further explanations for the points mentioned above.

(1) Tanzanian Economy Now and in the Future

Following high economic growth since the beginning of this century, Tanzania is likely to achieve a per capita income of US $1,000. However, the level of industrialization is still low: exports are mostly unprocessed raw materials while many goods for consumption are imported. Tanzania's economy has great potential for continued growth by increasing exports of processed goods and promoting import substitutions. In order to transform its economy, Tanzania needs to increase long-term financing for capital investment.

(2) Constraints of Long-term Lending of Commercial Banks

The financial sector has been expanding as its economy has been growing. Loan portfolios of commercial banks have been increasing at around 20% annually over the last decade. SME finance has been growing under this circumstance, but it is mainly working capital financing and very little financing has been extended for capital investment by SMEs. It is indispensable to provide long-term financing to SMEs for the country's industrialization. Commercial banks' funding is predominantly less than one-month of deposits. Deposits also have grown over the last decade, but only at around 14%, which is far lower than the lending growth. As a result, the ratio of deposits to GDP has been declining over the last few years.

It is very unlikely under this circumstance that long-term finance for capital investment by SMEs will grow in the future if reliance on financing is simply from commercial banks. The banking sector accounts for around 70% of the country's financial assets. Capital markets are too immature to respond to the needs of commercial banks and private investors. TIB has been extending long-term financing for capital investment by SMEs, but the magnitude has been limited due to the constraint of its funding. TIB can offer an interest rate of a little less than 20% since its funding cost is higher than the government one-year note (16% at present). The offered interest rate is far from what SMEs need for their capital investment.

(3) Donors' Activities

Despite this situation, there aren't any donors responding directly to the needs of SMEs and providing long-term finance on a concessionary basis. Multilateral agencies, such as the IFC and EIB, have been providing long-term funding to large commercial banks, but all at the prevailing market rates. Therefore, the interest rates applied to loans for lending to SMEs are well above 20%. The lending from the multilateral agencies has so far only helped the funding of banks, but has not led to long-term financing of SMEs. This is one of the obstacles for SMEs when deciding to undertake capital investment. There are many donors providing credit guarantees which cannot lead to increasing long-term financing.

(4) Government Policies

One of the core strategies for industrialization under the FYDP2 is to promote infrastructure development and SME expansion through financing of TIB. For that purpose, the Government of Tanzania decided to provide an equity contribution of TZS 1 trillion, which is five times as much as TIB shareholder's equity. Once parliamentary approval is obtained, this size of the government equity contribution will be provided to TIB over five years.

MITI is currently drafting a new SME policy framework, in which finance will be designated as one of the key areas. In order for this framework to function, the need for enhancement of TIB's loan processing capacity will be imminent, considering the fact that TIB has yet to be successful in the area of SME finance.

(5) Importance of SME Finance Support and Future Picture of SME Finance

First of all, securing a channel for long-term financing of capital expenditures by SMEs is important in that such a proposed cooperation would help the funding of SMEs, which have almost no alternative but to rely on their own capital for business expansion.

TIB, which is assumed to be an implementation agency of this SME finance support program, has to effectively utilize the government funding of TZS 1 trillion which is to be provided. The proposed program will supply TIB with a model of how concessionary loans can be utilized to finance the capital expenditures of SMEs. If TIB can implement the program successfully, this will show the government the importance of TIB in the financing of capital expenditures of SMEs. Moreover, this will encourage the government to come to the decision of continuing support for TIB's funding even if TIB cannot continue finding long-term funding in the bond market at a reasonable cost.

Expertise in the area of long-term financing of the capital expenditures of SMEs, which is still a new business area in Tanzania, will be developed through technical assistance to TIB and large commercial banks. Large banks can increase operations in this area once they find sufficient funds available for mobilization under a maturing financial environment in the future. If medium-sized banks started to operate in the field of financing capital expenditures of SMEs, it would contribute to the normalization of the long-term capital financing market through an increase in participants.

The cooperation proposed above can initiate—as a model case—the series of events above which will reform long-term financing of capital expenditures of SMEs and support the growth and expansion of SMEs which is considered a priority challenge by the Government of Tanzania. This proposed cooperation implies an intention to support an area that donors have yet to touch, and its successful implementation will provide a large impact on the development of SMEs.

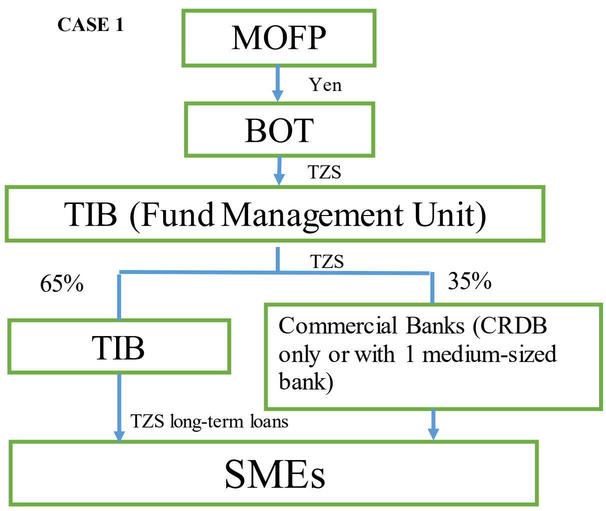
Chapter 3 Proposed Cooperation Approach

3.1 Proposed Arrangement for the Two-Step Loan (TSL) Program for SME Finance

3.1.1 The Implementation Agencies of the Proposed Lending Scheme

The proposed lending scheme is shown in Figure 3.1. The parties involved in this scheme are the Ministry of Finance and Planning (MOFP), the Bank of Tanzania (BOT), TIB, commercial banks and SMEs borrowing under this scheme. The lending scheme is similar to that under the Housing Finance Project financed by the World Bank[5]. The currency fluctuation risk in the project is born by the Bank of Tanzania.

In order to make capital investment by SMEs feasible, it is indispensable for long-term financing to be provided on a concessionary basis with an applied interest rate that falls well below 20%. The Government of Tanzania (GOT) has to bear yen currency fluctuation risks to realize concessionality within the scheme. In cases where (i) the MOFP lends yen funds directly to a financial institution (TIB or a commercial bank) without doing so through the BOT or (ii) there is lending of yen funds directly from a donor agency to a financial institution based on sovereign guarantees, financial institutions will have to bear the currency risks. In such cases, the interest rate applied to the loans to beneficiary SMEs will remain the same as the prevailing lending rates of above 20%, as are found in the cases of lending by the IFC and the EIB. Direct lending to TIB from JICA is not feasible given the situation of TIB's high NPL level. It is only the BOT under the GOT that can bear currency fluctuation risks, as is stipulated in the World Bank project.



(Source) Created by the JICA Study Team based on the proposal from TIB

Figure 3-1. Lending Scheme

[5] The World Bank approved a US $40 million credit facility in February 2010 to provide long-term and inexpensive housing finance. The bank decided to extend additional loans of US $60 million in February 2015 for this project.

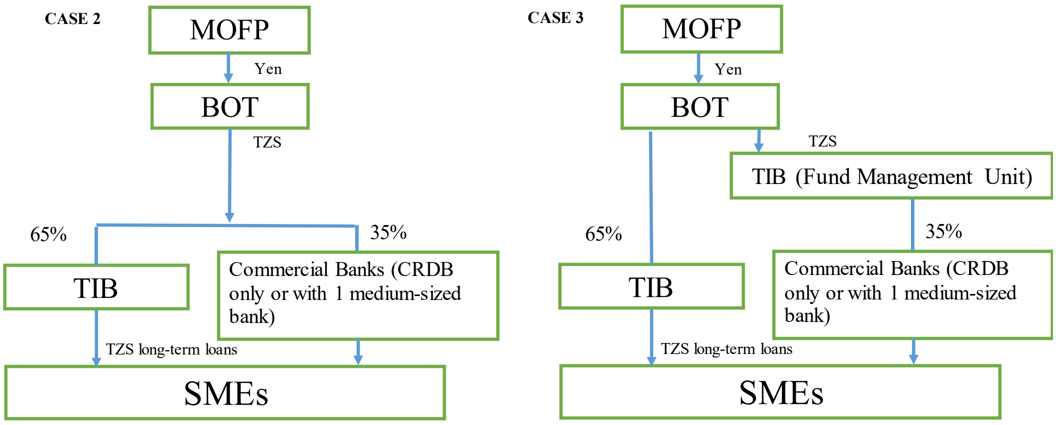
Following a financing scheme similar to the World Bank Housing Finance Project, there are three alternatives available for consideration and are to be utilized according to the different roles of TIB's Fund Management Unit (FMU). Table 3-1 and Figure 3-2 summarize the roles of each implementing agency and the merits and demerits of the three alternatives.

Figure 3-1 above shows Case 1, in which all TSL funds go through FMU. The major merit for this case is to keep the BOT from having to monitor individual lending cases under the TSL. The BOT, which has to be in the scheme, strongly desires to be released from this onerous work which it had experienced in other projects. Another merit is that this case makes it easier for knowledge and know-how to be accumulated at TIB systematically. The funding cost for the participating banks is the same under this case. The demerit is that a 1% management fee is charged.

Table 3-1. Alternatives of implementation arrangements according to role of FMU

Role TIB fund mgmt. unit (FMU)	BOT	TIB	Commercial Banks (CB)
Case 1: All TSL through FMU	TZS lending foreign exchange risk taking	Loan processing and monitoring reporting to FMU	Loan processing and monitoring reporting to FMU
Case 2: Not through FMU	Roles of Case1 plus compiling individual data and managing cash transfer	Loan processing and monitoring reporting to BOT	Loan processing and monitoring reporting to BOT
Case 3: Only CB through FMU	Roles of Case1 plus compiling TIB data and managing cash transfer	Loan processing and monitoring reporting to BOT	Loan processing and monitoring reporting to FMU

(Source) Created by the JICA Survey Team (November 2016)



(Source) Created by the JICA Survey Team (November 2016)

Figure 3-2. Lending schemes（CASES 2&3）

Table 3-2. Comparison of the alternatives

Role of TIB fund mgmt. unit (FMU)	Merits	Demerits
Case 1: All TSL through FMU	No workload for BOT to compile individual lending case and managing cash transfers; Accumulation of TSL knowhow at TIB	Around 1% fund management charge incurred (whether it is additional cost depends on BOT)
Case 2: Not through FMU	No fund management fee unless BOT requires	Onerous workload for BOT; Accumulation of TSL knowhow at each bank ; More expensive if BOT requires more than 1% fee
Case 3: Only CB through FMU	No workload for BOT to compile CB's cases and manage cash transfer; Accumulation of TSL know-how at TIB	Workload for BOT to compile TIB lending cases; Different funding costs to TIB and CB; More expensive if BOT requires more than 1% fee

(Source) Created by the JICA Survey Team (November 2016)

In Case 2, the FMU is not included in the scheme. The BOT has to monitor individual lending cases and manage cash transfers of each case. It is likely that the BOT will not accept this case due to its experience in other projects. Even if the BOT accepts this case, it may choose to charge expensive fees to cover the management cost of the TSL program.

In Case 3, the FMU is only included in the portion of the scheme relating to commercial banks. Funding costs for TIB and the commercial banks would be different under the condition of this case. The BOT can charge a management fee on the lending rate to TIB. This arrangement is possible in theory, but will only create an arising of complexity in the BOT's operation. TIB will not create a new department dedicated to TSLs. Under this situation, it's most likely that each department of TIB handling TSLs will report to the FMU, which will communicate with the BOT. Although this might initially work, some personnel transfer may occur over the extended life of the scheme's application in which the intentions stated at its onset may be inaccurately or imprecisely disseminated during new personnel orientations. In this situation, the BOT may end up monitoring TIB's lending since TIB bears only cost without proper payment.

Based on these considerations, Case 1 is recommended as the implementation arrangement for the proposed TSL program. In order to make this scheme feasible, the FMU needs to be capable of managing funds. In this respect, TIB's FMU is expected to perform roles necessary for the proposed TSL program since it has sufficient experiences and a track record of managing 10 funds, including those deposited by the government (the MOF, BOT, Rural Energy Agency, and so forth) and the World Bank.

Potentially, there may be a conflict of interest between TIB and the FMU under this scheme. The issues which have to be examined in this case are mainly the following: (i) lending to obviously unfeasible projects from the beginning, (ii) funding of TIB through creating fictitious projects, and (iii) fund embezzlement by TIB employees.

The roles expected to be performed by the FMU are cash management, administrative management and formal checking of loan requirements. The credit committee reviews and decides TIB's lending. An external expert can join the credit committee to avoid the first potential issue (i). The second issue (ii) is a crime which can be committed by an institution as a whole. This issue is likely to appear at the end of the lifetime of a failing organization. The likelihood of this case is very low, considering the situations of TIB and Tanzania. If it should happen, the donor can stop flow of funds at any phase within the scheme. The first and second potential issues ((i) and (ii)) can also arise when lending to commercial banks, which formally have no conflict of interest with FMU, . if they lack a sound internal checking function An external expert can mitigate these risks to some extent by getting involved in the FMU's formal checking of each lending case. The accounts under the FMU are currently separated from the lending accounts of TIB. In the proposed TSL program, this practice of managing separate accounts will be in place. Even under all these prevention management steps, the fraud case of the third potential issue above (iii) may happen. An external audit of the FMU can be added to check the FMU's operation while strengthening the internal management of TIB.

The recommended arrangements consist of the following main points:

- The BOT will bear foreign exchange fluctuation risk;
- The lending rate will be lowered enough for SMEs to justify their capital investment after taking into account the availability of sufficient margins for TIB and commercial banks;
- The FMU will manage accounts of and administration of the TSL program;
- Know-how relating to financing of capital investment by SMEs will be accumulated at TIB.

Long-term financing particularly to capital investment by SMEs is the area to be strengthened in

Tanzania. It is very important to properly carry out due diligence before credit approval and to conduct constant monitoring of all individual lending cases after disbursement. For that purpose, it would be effective to provide technical assistance at the beginning stage of the program. Particularly, TIB needs to increase the number of professional staff and equip them with necessary skills. Upon the determination of implementation of the TSL program, TIB plans to adjust its staff size according to its need for coping with increased cases of lending.

The recommended scheme assumes that TIB will return to a financially sound position with a sufficient number of professional staff before the TSL program commences. If these assumptions are not proved and the conditions are not met before signing the loan agreement under the TSL funding scheme, the commercial bank portion will proceed while the TIB portion will become available after TIB satisfies the required conditions. Therefore, it is important to include a provision in the loan agreement stating that all TSL loans can be distributed to commercial banks if TIB can not satisfy the requisite conditions by the time of loan negotiation.

The portion allocated to commercial banks is assumed to be the equivalent of US $10.5 million (35% of the total loan), while the remaining US $19.5 million is assumed to be allocated to TIB under the recommended scheme. If sufficient concessionality cannot be obtained as a result of commercial banks requiring excessive margins, a scheme of retaining only TIB may result in a preferable alternative scheme.

3.1.2 Roles of Agencies Other Than the Implementation Agencies

MITI and SIDO will play important roles in the proposed TSL program although neither of them are the implementation agencies. MITI will contribute to the TSL by implementing the policies which will enhance competitiveness of the target sectors and will promote growth of SMEs. SIDO is expected to provide technical assistance to SME businesses and develop industrial estates. Please see Chapter 4 more about SIDO.

3.2 Proposed Fund Flows of the Proposed TSLs

3.2.1 Outline of the Fund Flows

The channel of fund flows is summarized in Figure 3-1. The funds coming to the BOT are noted as yen-based flows while the funds after the BOT are noted as TZS-based ones. All of the funds from the BOT will go through TIB's Fund Management Unit (the FMU). Funds will be transferred to TIB and commercial banks in concordance with each loan agreement. The management of TSL accounts by the FMU should be reviewed further.

The appropriateness of the proposed loan amount and the ability to disburse entire loan amounts within two years under the TSL program will also be further reviewed. These considerations can be concluded after confirming the participating banks. However, the current assessment indicates that there will be sufficient demand for long-term loans on a concessionary basis among SMEs.

3.2.2 Principles of Deciding Lending Terms

The principle for deciding lending terms is to provide long-term financing on a basis which is sufficient in concessionality for SMEs to justify their capital investment while maintaining reasonable margins for participating banks. For this purpose, it is the key for the BOT to bear foreign currency fluctuation risks. Considering the cost of currency conversion, it is important to negotiate the amount to which the BOT's interest rate can be lowered. If negotiations with the GOT and the BOT go well, it is also important to consider the minimum level of the concessionary rate. Excessive concessionality will create the risk of materializing less priority projects for Tanzania. The description of the lending terms below is presented to help understand the outline of the basic lending terms. Detailed terms will be decided after further review and negotiations. The tenor of TSLs will be 40 years. During this long period, the interest rate might fall in the market to well below 20%. To cope with this situation, it is important to incorporate a mechanism of retaining concessionality through a provision in the loan agreement. If the financial market matured enough to function well in Tanzania, the role of providing long-term concessional loans under the TSL program would cease to exist.

The lending terms described below are those proposed by JICA Survey Team, and are based on the findings during the survey mission. They will be officially defined after further review and negotiations with the government agencies in Tanzania.

3.2.3 Term Loans from TIB and Commercial Banks to SMEs

The conditions of term loans with tenors of 7 to 10 years are summarized in the points below.

- Maximum lending amount per borrower: TZS 2 billion（whether this will be applied to all the participating banks needs to be further reviewed）
- Interest rate: 12.51%-13.51% (a gross margin of 5 to 6% is added to the borrowing rate from the BOT[6]）
- Security: 125% of loan amount (the BOT guideline)
- Use: capital investment

3.2.4 Credit Facilities from the BOT to TIB and Commercial Banks through the FMU

The terms of a 10-year credit facility with bullet repayment are summarized in the points below. This facility may be renewed three times over a tenor of 40 years of the yen-based loans.

- Amount：US$ 30 million equivalent will be issued as the first credit facility. The amount of the facility will reduce after the second credit issuance and correspond to the amount repaid by the

[6] The SME lending rate = Yen interest rate + BOT currency fluctuation cost + fund fee + bank margin

BOT to the MOFP.

- Interest rate: 7.51%* (to be revised at every renewal of the loan agreement)

  * The interest rate consists of the following components: 0.01% for interest payment to the MOFP, 6.5%[7] for the foreign exchange rate fluctuation cost, and 1% for the fund management fee. The net interest revenue for the BOT excluding the fund management fee is 6.51%.
- Security: Treasury bonds

3.3 Proposed Target Borrowers for the Proposed Two-Step Loans

The target borrowers for the proposed Two Step Loans (TSL) are SMEs which are classified in accordance with the definition of the Tanzania government— that is, in terms of the number of employees[8] on staff at the time of each lending. Neither micro enterprises nor large enterprises are target borrowers. A revised definition, if introduced, will be applied to decide the category of small and medium-sized enterprises.

- Use of Funds: capital investment

- Targets: TIB cited agro processing, manufacturing, and small-scale mining as its target sectors in its SME Financing Program. MITI requested the TSL program be concentrated on the agricultural products processing sector. Given the structure of the Tanzanian economy, agricultural product processing will be the main target sector in the proposed the TSL program. But, other sectors should also be considered with an eye on growth opportunities.

3.4 Necessity of Technical Assistance and Proposed Programs

Considering the multitude of NPLs reported this fiscal year, TIB has to substantially improve and expand the capacity of its system of credit appraisal and loan monitoring of long-term finance for SMEs. Financing capital investment by SMEs is also an area to be strengthened by commercial banks in Tanzania. Technical assistance in this area is also necessary to made available for commercial banks.

After having reviewed the causes of NPLs, TIB has recognized its lack of technical capabilities to evaluate factory and plant design. According to TIB, instruction on these technical skills is not available in Tanzania. If such instruction can be given in concurrence with the introduction of the proposed TSL program, the transferred skills can help prevent the recurrence of NPLs and provide a

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[7] The currency fluctuation cost paid to the BOT under the World Bank's Housing Finance Project is adopted here.

[8] The definition of SMEs set by the Government of Tanzania at the time of credit approval is observed. The current definition provides the two indicators: 1) the number of employees and 2) the value of machinery and equipment. Since the latter indicator is not practical for the use of credit approval, the number of employees on staff is adopted to find whether a borrower is categorized as an SME. It should be noted that banks in Tanzania classify their lending into the category of SME finance according to the size of lending to the SME being classified.

valuable base for helping enhance industrialization in Tanzania.

Based on the findings above, the following two technical assistances are proposed in connection with the TSL program: 1) the enhancement of lending capacity of SME finance (TA1) and 2) the enhancement of technical evaluation capacities concerning technology and manufacturing processes (TA2). An outline of the proposal is summarized in Table 3-3. With respect to TA2, it would be useful to share the information collected under the activities of Kaizen (Strengthening manufacturing sector through quality and productivity improvement Phase 2) as areas of support in both TAs correlated.

Table 3-3. The proposed technical assistance (TA)

	TA1	TA2
Title	Enhancement of lending capacity of SME finance	Enhancement of technical evaluation capacities concerning technology and manufacturing processes
Beneficiaries	Those responsible for credit appraisal, loan processing and loan monitoring at TIB and commercial banks	Those responsible for technical evaluation at TIB and commercial banks
Objective	Transfer of know-how relating to credit appraisal and monitoring of SME finance	Improvement of preliminary evaluation (related to production technology and process) in capital investment projects
Mode	Mode I : Study tour for a limited number of staff of TIB and commercial banks (governance of development bank, case studies, and site visits) Mode II : On-the-job training in Dar es Salaam (DES) for those responsible for credit evaluation, loan processing, and loan monitoring	Mode I: Evaluation by and feedback of executed cases from an expert; and on-the-job training using the first application under the proposed TSL program Mode II: A review and evaluation of the cases under the TSL program by using the internet (whether all the cases

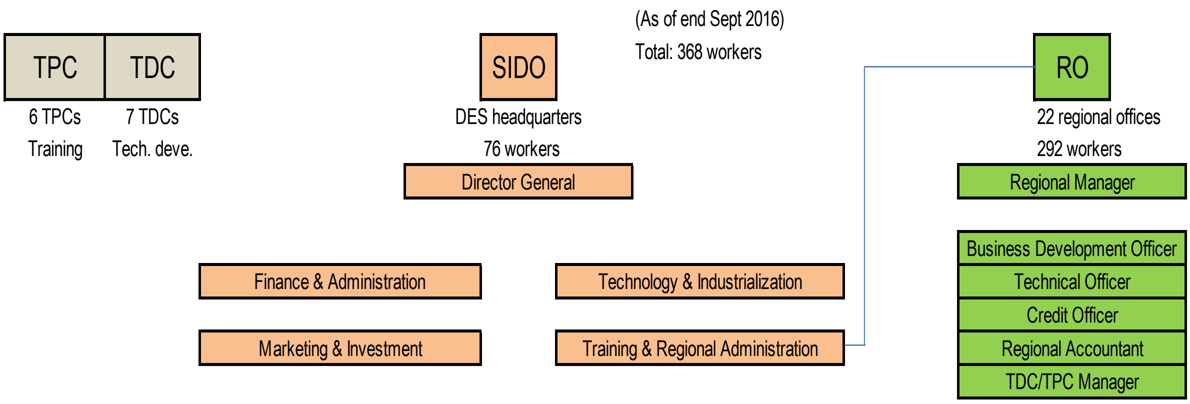
		will be covered is an issue for further discussions)
Implementation period & Focus of Assistance	Mode I: It is to be soon after executing the loan agreement (the frequency of this assistance will be decided after reviewing the number of participating banks). The focus of this assistance is (i) the background for the failed case, e.g., why the Japan Reconstruction Finance Bank (JRFB)operation was terminated after a short period following the scandal of Showa Denkou; (ii) the factors contributing to successful implementation of government development banks, e.g., the Development Bank of Japan of the same function as the JRFB (highlighting a different approach in credit appraisal and loan monitoring); (iii) implications of the above two cases in governance, management, and credit appraisal in the context of TIB; and (iv) experiences of development banks in Asia. Mode II: It starts before the first lending under the TSL program and again a few times at DES for the first year, with review and comments from Japan for the second and third years and on-the-job training at DES at the appropriate timing. (Whether all the cases will be covered from Japan, and the period and the frequency of on the job training at DES are issues for further discussions). Under this mode of assistance, the actual cases of TIB's NPLs will be used to find what went wrong.	Mode I: a month before credit appraisal of the first case under the TSL program Mode II: 11 months after Mode I finishes

(Sources) Compiled by JICA Survey Team (November 2016)

Chapter 4 Current Status of Industrial Cluster Development by the Small Industries Development Organization (SIDO) and the Possibility of Financing Industrial Park Development

The Small Industries Development Organization (SIDO) is an organization established in 1973 under the umbrella of the Ministry of Industry, Trade and Investment (MITI) by an Act of Parliament.

SIDO is committed to fostering small businesses and enhancing competitiveness through supporting entrepreneurship, strengthening business and skills, providing advisory services, and developing industrial parks. As of the end of June 2015, 368 staff members of SIDO worked at headquarters (HQ: 76 headquarters) and 22 regional offices located in 22 mainland areas of Tanzania (RO: Regional Office 292); and, three additional offices (Geita, Katavi, Simiyu) are now under preparations to open. Besides this, SIDO has 7 technical development centers (TDCs) that develop and manufacture machine tools and 6 training-cum-production centers (TPC) for specific clusters.



(Source) Compiled by the JICA Survey Team

Figure 4-1. SIDO's organizational structure

The Government's FYDP2 (FY 2016 - 2020) advocates that, in order for the Tanzanian economic transformation (industrialization) to contribute—largely and sustainably—to poverty reduction and the realization of an equitable society, large enterprises in priority sectors, such as manufacturing, construction, tourism, and so forth, are required to connect with local small-scale farmers and small and medium-sized enterprises (MSME) via the value chain. At the same time, the local government agencies (LGAs) are recommended to take the local economic development (LED) approach which promotes the industrialization of the local economy. Accordingly, the roles specifically entrusted to SIDO, which is an MSME supporting organization in rural areas, are the following two:

· Employment creation (especially for young people) through development of industrial parks for SMEs

· SME industrial cluster development utilizing lands to be provided by LGAs

In concrete terms, for the undeveloped industrial parks in 15 regions (namely, Mtwara, Lindi, Songea, Rukwa, Dodoma, Singida, Shinyanga, Kagera, Mara, Manyara, Njombe, Katavi, Geita, Simiyu and Morogoro), SIDO is expected to construct infrastructure (such as offices, water and sewage systems, roads, communication and electricity lines, and so forth) and rental buildings, and to establish five more regional offices (ROs) by 2020.

According to SIDO's new president, Sylvester Mupantouge (SIDO-DG), SIDO plans to progress industrial park development in regions in cooperation with LGAs in addition to the industrial parks and undeveloped land (41 at the regional level) already owned by SIDO. Their implementation is to be carried out through Public Private Partnership (PPP) in order to supplement the shortages of SIDO manpower and government budget. However, in order to enable the use of PPP—irrespective of the implementing capacity of SIDO—legal development, improvement of the expertise of executing ministries, supply of long-term funds by domestic financial markets, and so forth are necessary Additionally, it is considered that promotion of PPP in Tanzania is not easy.

4.1 Current Situation of SIDO’s Industrial Cluster Development for SMEs

Since its establishment in 1973, SIDO has been implementing industrial park development for SMEs, and its regional offices (ROs) have provided an installment sales program for industrial equipment (the predecessor of the current loan program), support for entrepreneurs, technical guidance, and so forth. In addition, the concept of industrial clusters development began in the 2000s. However, as shown in figure 4-2, there is only one case of industrial estate development within the past 12 years compared to 16 cases in the 30 years between 1973 and 2004.

	1973	1975	1977	1979	1980	1982	1985	1987	2003	2004	2010
Annual	4	1	1	4	1	1	1	1	1	1	1
Accum.	4	5	6	10	11	12	13	14	15	16	17

(Source) Compiled by the JICA Survey Team based on the list of industrial parks obtained from SIDO (2016.11)

Figure 4-2. Industrial cluster development by SIDO (number of industrial park development)

SIDO's biggest issue is a lack of development funds. In order to overcome this situation, Integrated Industrial Development Strategy (IIDS) 2025, published in 2011, calls for SIDO to lease industrial estate lands to SME proprietors and allow them to develop industrial estates with their own funds. Under this method, SIDO prepared a master plan (drawings) and letting policy for industrial estate land use, in order to attract companies to form specific clusters, and to induce development of water supply and electric power infrastructure by local government agencies accordingly. Construction of infrastructure and buildings on industrial estates by SMEs using this method was actually carried out until the beginning of 2014, but it was difficult for SMEs to borrow funds for capital investment from banks due to the harsh financial environment. Thus, this method was considered unsuccessful as it was only workable for SMEs with financial strength. Currently, there is a consensus among the stakeholders that considers it necessary for SIDO to build both the infrastructure and the buildings of the industrial parks and provide them to SMEs.

Meanwhile, there exists a situation in which it is difficult for the government budget to finance the development of industrial parks, which has not changed. Therefore, the government advocated under the FYDP2 that, rather than distributing the direct budget for the industrial park developments, more money for SMEs could be made by leveraging capital through capital increase to government development financial institutions (TIB and TADB).

As part of this effort, an attempt is now being made to develop industrial parks through a project finance (PF) method created by concluding the Industrial Park Development Cooperation Agreement (MOU) between SIDO and TIB.

However, in order to fulfill the requirements of PF, SIDO needs to (i) provide its lands for equity participation, (ii) select industrial park candidates that satisfy various conditions, and (iii) hire consultants to conduct feasibility studies (FS). Since SIDO lacks the capacity and know-how corresponding to the above, technical cooperation from TIB and other supporting agencies are required. At the same time, rather than being passive on this issue, it is important for SIDO to proactively mobilize its knowledge and resources to grasp and organize the investment environment conditions of industrial estates in each region and to approach potential investors.

4.2 Current Status and Development Needs and Issues of Undeveloped Industrial Park Estates Operated by SIDO

As of November 2016, SIDO has 41 industrial park estates (213.7 ha in total) at the regional level. 131.9 ha (about 1.3 million m2) corresponding to 61.7% of the total are still undeveloped. In addition, MITI has decided to expand the scope of the industrial park development from regions to districts, and provision of lands from districts has already started accordingly.

In order to grasp the current state, development needs, and issues of SIDO's industrial park development, the Survey Team members visited one developed industrial estate (namely, Dar es Salam Industrial Estates/DAR) and two undeveloped industrial estates (namely, Kizota Industrial Estates in Dodoma and Kihonda Industrial Estates in Morogoro).

Table 4-1 summarizes the current status, development needs, and issues of the individual industrial estates visited during this Survey period, and some common factors are summarized in sections (1) and (2) below.

(1) Current state and development needs:

Due to the fact that the government budget was not made available to SIDO's industrial parks, extra expenses have been incurred on SIDO's side including the below:

・ Each RO prepared a master plan for industrial estate use and submitted it to the government via the SIDO headquarters (HQ), but the budget requests some of the plans were not approved.
・ Even in the cases where budgets were approved, they only covered a fraction of the total required in each budget, and—what is worse—their disbursements have been delayed considerably.
・ All government agencies are obliged to request the Tanzania Buildings Agency (TBA) to prepare a Bill of Quantity (BOQ), the cost of which amounts to 10% of the total construction expense. Fees for the TBA to prepare a BOQ and to supervise at the time of construction are included. If the budget application is not approved, the financial burden of the RO increases since it is obliged to prepare a new BOQ for the same industrial estate again every fiscal year.
・ Three-phase power distribution lines and water supply pipes are drawn to the sites of the planned industrial parks. Therefore, basic charge payments to the electric power company, TANESCO, and the local government (LGA), and labor costs for 24-hour security are occurring even for undeveloped industrial estates.

(2) Issues

・ Executives of SIDO have traditionally argued that "SIDO's industrial estate site cannot be provided as collaterals [sic]." However, according to the SIDO Act (1973) Article 17, Section 1, SIDO may borrow money by way of loans or overdrafts, with the prior approval of the Minister of MITI. And the SIDO Board shall follow the Minister’s direction on securities (collateral, credit guarantees) and terms and conditions (maturity / interest rates) for their repayment. (Under the new DG, as of December 2016, SIDO is inquiring to the Ministry of Finance and Planning for provision of its land property as collateral.)
・ The method of determining the rent of the industrial estate, which is considered as subsidy to the SME residents, is not uniform and has been set considerably lower than the market price. In the

future, when developing an industrial park through project finance, it is necessary to set the rent relative to the market price.

- ROs—utilizing their knowledge and geographical competitiveness—should: investigate and compile data on the investment environments of places where industrial parks are to be developed; select promising industrial parks themselves; and, proactively sell their ideas to investors.
- HQ needs to revise the SIDO Act, if necessary, so that it can transfer the land owned by SIDO to investors and industrial park operating companies, involved in industrial park development.
- Regarding lands to be provided by LGAs to SIDO for industrial park development purposes, in order to strengthen SMEs' collateral, it is desirable that land ownership not be transferred to SIDO but rather directly from LGAs to moving-in SMEs.

Table 4-1. Current situation and issues of the undeveloped industrial estates

Industrial Estate	Current status	Issues
Dar es Salam	Providing a competitive advantage location to small businesses by inexpensive rent.	If TIB / SIDO were to use a PF method for the remaining 25% of undeveloped estates, negotiations on rent with the existing industrial estate associations may be difficult. It is recommended to separate the undeveloped areas from the already developed areas.
DODOMA / KIZOTA	The issue of KIZOTA industrial estate's development is becoming complicated in conjunction with the issue of relocation of SIDO headquarters to Dodoma.	The SIDO headquarters is planned to be relocated to the capital by September 2018 and the relocation destination is to be the land where the current DODOMA RO is located. If KIZOTA industrial park's development was to be carried out by PF, it would be important not to confuse the transfer of companies inhabiting the DODOMA RO site and the selection of the future tenant companies of KIZOTA industrial estate. (KIZOTA tenant companies need to be carefully selected.)
MOROGORO / KIHONDA	In this fiscal year's budget, the budgets only for the regional office	Due to the government budget constraints, the advancement of this industrial park's development is divided into pieces, which ultimately accumulates into a very high cost in total.

	and four buildings for rent have been approved, but budget disbursement is yet to come.	It is necessary for SIDO therefore to investigate and compile the necessary information on the investment environment and utilize it to attract SMEs and investors who have high growth potential by utilizing KIHONDA's favorable location instead of pursuing development little by little.

(Source) Compiled by the JICA Survey Team based on the information acquired through respective site visits

4.3 Business Model and Prerequisites for Loans to Industrial Park Development

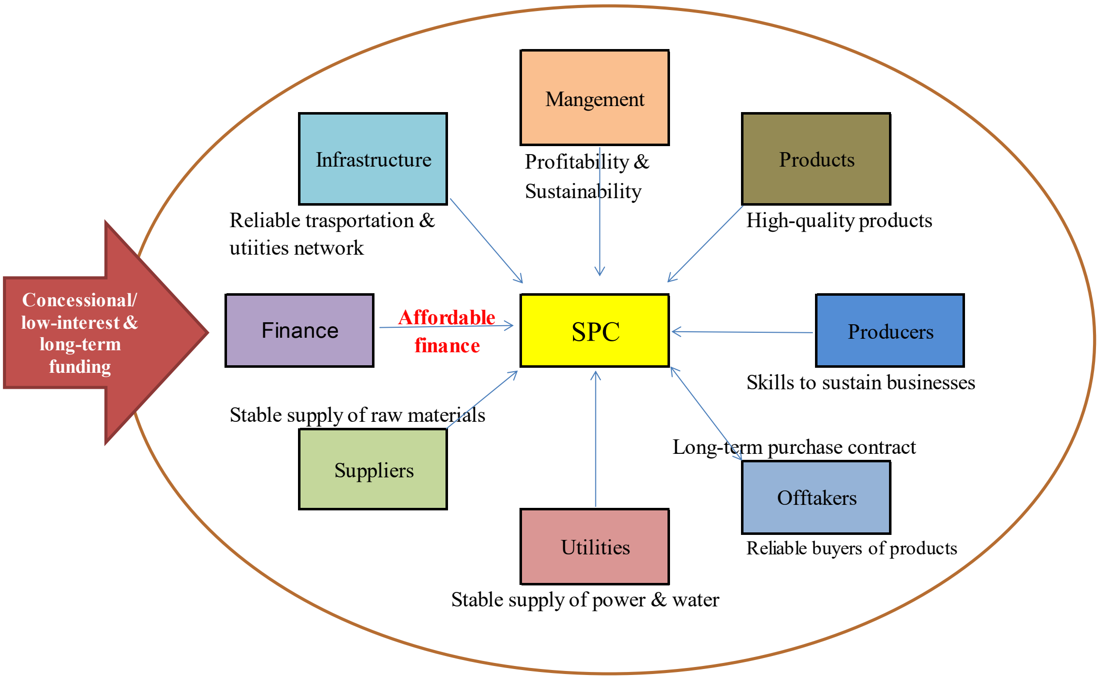
Currently, based on the MOU between TIB and SIDO, it is supposed that SIDO act as an asset owner (originator) to establish an industrial park development company (SPC: Special Purpose Company), to which TIB provides project finance (PF). By establishing an SPC for the development of each industrial park through PF and by offering non-recourse financing from the bank to each SPC, other assets owned by SPC-sponsor SIDO can be shielded from liabilities that may arise in case a project fails. However, in order to realize this, it is necessary to clarify who will take the credit risk ultimately (i.e., is it MITI, SIDO, or any of the other sponsors?). As well, it is necessary to satisfy various conditions to ensure that project investments will be paid entirely using cash flow generated by the project.

(1) Prerequisites

It is necessary to satisfy the following conditions to ensure business profitability and, thus, bankability of the target SPC. The following conditions have been summarized through consultation with the respective TIB department in charge of industrial development with SIDO[9]. (See Figure 4-3)

- High-quality infrastructure: Reliable transportation network (road, and so forth), water supply, and power supply network
- High-quality management: Professional management of SPC
- High-quality products: Equipment to allow production of high-quality products
- High-quality producers: SMEs with management skills
- High-quality supplier: (Quality Suppliers: Stable supply of raw materials)
- High-quality off-takers: Long-term purchase contract (good market demand, value chain)
- High-quality utilities: Stable supply of water & power
- High-quality finance: Reliable & affordable funding sources for working and capital investments

[9] Consulted several times with Business Development officers and Advisory Services officers of the Strategic Planning & Corporate Affairs Department of TIB



(Source) Compiled by the JICA Survey Team

Figure 4-3. Prerequisites for SIDO to become a sponsor and develop industrial parks by project finance

In SIDO's industrial park development, it is assumed that SIDO serves as the originator and sponsor of SPCs and provides land as equity. However, SIDO's land may not be able to be sold in cases of SPC defaults. As well, there seem to be no risk-takers considering the current situations in which SIDO is unable to afford cash contribution, the MOFP is not likely to provide credit guarantees, and the government is approving few and/or incomplete budgets. Under such situations, the project itself would not become fit for loans (i.e., bankable) from financial institutions. Therefore, SIDO needs to start negotiations with MITI in order to get credit guarantees from MITI, or needs to obtain the minister's prior approvals to enable SIDO's land assets transfers. The risk must be taken by MITI or SIDO. In addition, it is necessary to recruit investment from sponsors, such as large corporations, institutional investors, donor agencies, and so forth.

(2) Implementation of the project feasibility study (FS)

First, with regard to the industrial park estates identified through SIDO's internal investigations, SIDO will hold discussions and consult with TIB. For those industrial parks that both sides judge feasible for implementation and execution under project finance, a fully detailed project feasibility study (FS) will be conducted. Through a FS, it is necessary to confirm the stability and profitability of the project. Typical survey items of FSs are as shown in Table 4-2, among which the following must be made clear:

(i) strengths and competitiveness of industrial parks (industrial clusters) operated by industrial estate operating companies;
(ii) details (quality) of products manufactured in industrial estates, stability of sales channels, and consumption markets;
(iii) long-term stable purchasers (contracts with large company chains or public sector entities);
(iv) a stable supply of raw materials and stability of purchase prices and quantities.

Table 4-2. Survey items for feasibility study (only as a reference)

1	Project purpose and background
2	Infrastructure of project site and the interior and exterior of industrial park
3	Industrial facility layout
4	Details of the industrial cluster (in terms of products, technology, systems involved)
5	Procurement of raw materials
6	Utility supply (24-hours water and electricity supply, three-phase power distribution lines)
7	Storage and shipping of products
8	Business schedule
9	Test operation and delivery of facilities and equipment
10	Environmental assessment and other permits
11	Business management system, personnel assignment plan (SPC officer's career, etc.)
12	Method of procuring business funds
13	Market evaluation (market size, growth potential and profitability, investment recovery possibility, competitiveness of the industrial park, competitors, competitive environment)
14	Business profitability analysis (IRR, NPV, breakeven analysis, cost effectiveness analysis)
15	Business risk analyses (Market/ Credit/ Operational/ Contract implementation/Regulation/ Climate/Environmental/Country risks) and their countermeasures
16	Comprehensive evaluation

(Source) the JICA Survey Team

(3) Proactive roles of SIDO

SIDO may take advantage of the knowledge accumulated by the 22 ROs in mainland Tanzania (ROs will be expanding to 25 places), and cooperate closely with each regional district for identifying industrial parks that are likely to meet PF requirements. Regarding industrial parks that are deemed to be competitive, SIDO can collect and compile investment environment information and work with investors, including TIB, to enable project finance implementation. As a result, FSs will be carried out for industrial parks judged to be promising by investors. Based on the results, SIDO will move on to the establishment of an SPC and detailed planning of the project. Promising industrial park candidates should be extracted focusing on the following questions:

- Are there any industrial parks where domestic or internationally competitive industrial clusters can be formed?
- Is there any industrial parks that can be connected with domestic and overseas mass consumption markets?
- Are there downstream suppliers in the value chain? Are there supermarket chains, trading companies, or public institutions that distribute products stably?
- Are there upstream suppliers in the value chain? Are there suppliers that can consistently and reliably supply raw materials in terms of quantity and price?
- Do SMEs, which are likely to move into industrial parks, have management skills and high-growth potential? Is there a possibility that they can pay the rent at the market price level?
- Is it possible to supply energy and water 24 hours a day (policy coordination with administrative agencies)?
- Are there any large enterprises having linkages to SMEs that are located downstream of the value chain and have the possibility of joining the industrial estate? (Large companies have ability to pay loans, and their technical spillover to SMEs can also be expected)

At the same time, it is vital that SIDO negotiate with MITI, clarify the interpretation of SIDO Act Article 17, and make it possible to provide its property as collateral to third parties. In addition, it is desirable to revise the SIDO Act, as necessary, in order to make it possible to transfer SIDO property to third parties.

(4) Business model under two-step loan (TSL) program

With the assumption that the project mentioned above is to be financed by the TSL program, expected business models and their prerequisites and tasks are as below. For simplicity of comparison, it is assumed here that the PF conditions (detailed in Figure 4-3) other than those shown in Table 4-3 are already satisfied. Under that premise, here, recommended business models (i.e., the type of development funding sources) were pointed out depending on the market value of SIDO's industrial park estates (i.e. the size of the SPC capital) and the profitability of tenant SMEs (i.e., the ability to pay rents, the source of repayment).

Table 4-3. Selection of business models under TSL program (development resource) according to conditions

	Option 1	Option 2	Option 3	Option 4
SIDO land values	High	Low	High	Low
Tenant SMEs	High profitability	High profitability	Low profitability	Low profitability
Business mode (development funding source)	Market interest rates	Two-Step loans	Two-Step loans	Government budget
Prerequisites: Other conditions (elaborated in Figure 4-3) shall be met				

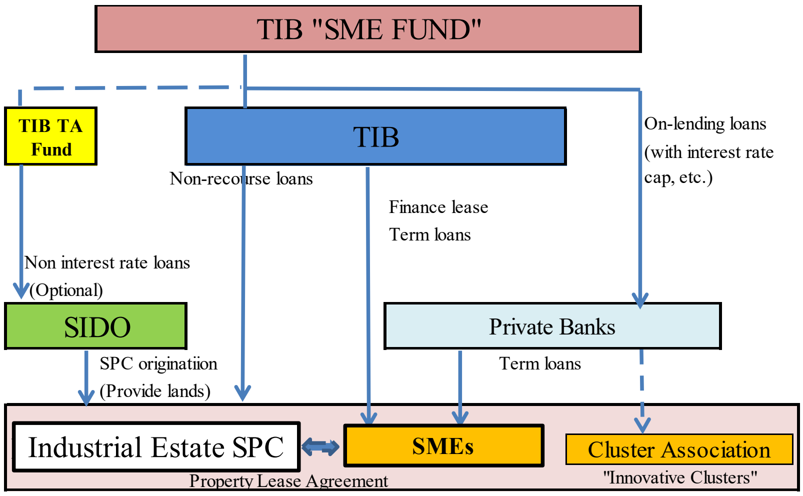
(Source) Compiled by JICA Survey Team

In practice, in order to judge the feasibility of the above model, it is necessary to further investigate other conditions including those listed below:

- Status of industrial clusters (supply and demand, growth potential, profitability), competitiveness of SPC (presence of strong sponsors other than SIDO, experienced management, industrial park location conditions, infrastructure level);
- Product details and supply mechanism of the tenant company; · Steady marketing strategy; · Competitive advantage;
- Presence of long-term stable suppliers of individual tenant and industrial clusters;
- Securing reliable raw material suppliers in terms of both reasonableness of price and quantity for individual tenants and industrial clusters as a whole

(5) Finance scheme and components of industrial estate financing project

If the two-step loan program for SME finance (SME TSL) materialized, there would be a possibility that some of the funds be used to finance SIDO's industrial park development via TIB (see Figure 4-4).



(Source) Compiled by the JICA Survey Team

Figure 4-4. SME TSL fund flow to SIDO industrial parks (one possibility)

In concrete fund flows, TIB can provide PF to individual industrial park operating companies (SPCs). At the same time, TIB can provide loans and finance leases (refer to BOX in PP25-26) to individual SME tenants for capital investments.

There is also the possibility that long-term loans will be provided to SMEs or Cluster Associations by private financial institutions that have procured funds for on-lending to SMEs from the SME Fund. As well, when implementing projects of local governments and other government agencies, TIB generally provides technical assistance (TA) with interest-free loans from its own TA Fund to support the formulation of FSs and business plans.

Such a TA service is indispensable in supplementing public sector know-how and expertise. In the SME TSL program, if possible, it is therefore recommended to replenish TA Funds with grants from part of the revenue from SME Fund's. Assuming that the SME TSL program will be utilized to finance SIDO's industrial park development, the components of the SME TSL program will consist of four items, as shown in Table 4-4.

Table 4-4. SME TSL project components

	TSL project component	Reasons it is necessary
1	FS grant funding (via TIB)	TIB's TA Fund (interest-free loans) is depleted. And, SIDO currently has no budget for conducting FSs.
2	SIDO capacity building (for investment environment researches, FS implementation)	SIDO lacks the ability to discover promising industrial parks, provide information to investors, and implement FSs, etc.
3	Provision of PF to SPCs	Budget support from the government is unlikely.
4	Provide capital investment loans to tenant SMEs	It can also be a target for loans from TIB when relatively large SMEs are included.

(Source) Compiled by the JICA Survey Team

4.4 SME Finance as Practiced by SIDO

As one of its important roles, SIDO financially supports the growth of entrepreneurs and small businesses through three financial programs. Specifically, is they are the National Entrepreneur Development Fund (NEDF), the Regional Revolving Fund (RRF), and the Credit Guarantee System (CGS). (See Table 4-5)

Regarding the NEDF and the RRF programs, SIDO's 22 regional offices (ROs) are in charge. In the future, provision of credit will become possible in three additional regions (namely, Geita, Katavi and Simiyu). The headquarters is not carrying out financing operations.

The average loan amounts per NEDF and RRF in the past three years were extremely small at TZS 978,000 (approximately JPY 50,000) and TZS 2.6 million (around JPY 130,000 to 140,000), respectively. In addition, the number of loans issued by the NEDF and the RRF was 330 per year, per office (RO), inclusively. With respect to credit appraisals, several personnel selected from the five members assigned to each RO (namely, loan officers, technical staff, business development staff, accounting staff, TDC/TPC managers) will conduct site visits. The result will be discussed at RO's credit appraisal committee, where all five members gather to make loan decisions. Credit appraisals generally take anywhere from 2 days to 1 month depending on the size of the loan amount. If it exceeds the loan ceiling of each program, the borrower will be introduced to other financial institutions, which is the other of SIDO's important roles.

The loan collection rates of the NEDF and the RRF are 92% and 90%, respectively, which is worse than the Tanzanian banking sector's NPL ratio (6.4% at the end of 2015). However, it can be judged that it is not at a particular level of concern in terms of financial management, considering the following factors: (i) the majority of SIDO loans are small personal loans; (ii) SIDO's collateral requirement is more relaxed than those of banks; (iii) SIDO's loans are conducted within its equity; and, (iv) SIDO has put aside enough loan loss reserves (corresponding to 9% of loans outstanding).

On the other hand, market interest rates of 22% (fixed) are applied as loan interest rates. For productive businesses (e.g., manufacturing industries, agricultural products processing industries, and so forth), relatively a lower interest rate (18% fixed) is applied. Considering the fact that SIDO's loans are equity funded (i.e., no cost for fund procurement), SIDO is able to offer interest rates much lower than the market rates. However, it is undeniable that interest income for SIDO currently is an important source of revenue to cover all of the expenses currently shouldered by ROs in the absence of government budget allocation.

As for the credit guarantee system (CGS), it was officially introduced from July 2015. Because the loan execution by the CRDB, which is in business alliance with SIDO, did not proceed much, the utilization of credit guarantees has not progressed as well.

The biggest reason for this delay is allegedly that the bank's loan collateral requirement is too strict (i.e., despite the availability of credit guarantees, the CRDB requires collateral which covers 125% of the total loan amount, which doesn’t relax the collateral requirement) . In addition, the high cost burden of credit application and credit appraisals is also a major problem.

The CRDB — SIDO joint survey was conducted in late November 2016 to identify all problems and in order to implement future system reforms. Based on the results, the CRDB and SIDO were to start revising the MOU between the two from December.

Table 4-5. Overview of SIDO's financial services

	National Entrepreneurship Development Fund National (NEDF)	**Regional Revolving Fund (RRF)**	**Credit Guarantee Scheme (CGS)**
Inception year	1994	1996	July 2015 (official)
Loans outstanding	58,318,132,000 TZS (as of end-September 2016)	TZS 11,819,050,000 (as of end-September 2016)	Credit guarantee fund: TZS 2 billion (With TZS 1 billion that JICA / SIDO deposited with the CRDB, the CRDB granted up to 2 billion credit guarantees)
Number of loans (Cumulative)	83,109 cases (from July 1994 to end-September 2016) (167,440 jobs created) Loan recovery rate: 92%	6,425 cases (from 1996 to end-September 2016) Loan recovery rate: 90%	9 cases (from July 2015 to 2016/11/8): TZS 215 million in total * Remaining guarantee reserve: TZS 1.8 billion
Annual amount and number of loans (of the past three consecutive years)	FY 2013/14: 6564 cases TZS 6,357,957,000; FY 2014/15: 5,757 cases TZS 6,120,320,000; FY 2015/16: 7,030 cases TZS 6,448,619,000; 3-year average @TZS 978,000/year.	FY 2013/14: 389 cases TZS 918,900,000; FY 2014/15: 349 cases TZS 913,550,000; FY 2015/16: 330 cases TZS 943,800,000; 3-year average @TZS 2.6 million/year.	Same as the above
Target entities	Entrepreneurs	SMEs	Agro Processing Business
Target areas	Nationwide	Nationwide	7 regions (Arusha, Dodoma, Kilimanjaro, Manyara, Mbeya, Morogoro and Singida Regions) (9 regions will be added)
Application reception institutions	22 ROs nationwide	22 ROs nationwide	One CRDB branch at each region is in charge. (Report from 7 branches to SIDO via CRDB headquarters)
Lending ceiling	@TZS 500,000-5 million	@TZS 500,000-6.5 million	@TZS 5-50 million
Use of loans	Capital investment funds, working capital	Capital investment funds, working capital	Guarantees of borrowings
Interest rates	18% fixed (productive sector) 22% fixed (non-productive sector)	22% fixed	20% fixed (CRDB 19% + SIDO 1%)
Fees	RO fees (Collected after loan appraisals, immediately after loan approval, before	RO fees (Collected after loan appraisals, immediately after loan approval, before	SIDO advance fee (TA commission) @ 1%

	loan execution)	loan execution)	
Maturity	3 years (36 months)	3 years (36 months)	3 years (36 months)
Collateral requirements	Equivalent to 125% of the borrowing amount, including personal guarantees (2 persons including the president) and collateral*. (*Not necessarily only real estate, but mobile goods such as home appliances and televisions can be included)		Real estate collateral equivalent to 125% of total loan amount
Steering Committee members	Chairman is the permanent secretary (PS) of Industry, MITI. Participation from SIDO, the TCCIA, the MOFP, the Office of Attorney General (the Ministry of Constitutional Affairs), the NMB and MITI.	There is no replenishment to the fund. The RRF is managed by SIDO Headquarters	Established according to MOU regulations. Chairman is PS of Industry, MITI. One person each from the MOFP, the Ministry of Agriculture and the CRDB; and three members from SIDO (the DG, Financial Service Manager, and Program Manager) participate.
Additional remarks	When receiving revenues (interest income, etc.) 15% will be sent to headquarters and 35% to the RO's current account, while 50% will remain in the NEDF account. Once entrepreneurs borrowed from the NEDF and have successfully repaid, they become eligible to utilize the credit guarantee system (CGS) on the next loan.	When receiving revenues (interest income, etc.) 30% will be sent to headquarters and 50% to the RO's current account, while 20% will remain in the RRF account.	For the revision of the MOU, SIDO/CRDB staff conducted a survey to identify issues, which was done over three weeks from November 14 to December 2 by visiting nine companies which received credit guarantees among the seven target regions as well as those applicants who failed to get approval. The survey results will be submitted to the Steering Committee for the implementation of MOU revisions.

(Source) Interviews results of the SIDO Credit Section based on the material provided by the JICA Industrial Cluster Development Advisor.

(Note) In addition to the above financial services, DAR Industrial Estate—out of its own funds, i.e., approximately TZS 10 million—granted entrepreneurs small loans at an annual interest rate of 2.5% under the incubation program. There is no budgetary allocation to sustain the service.