PN-ACA-520

FINAL

FEASIBILITY STUDY FOR

RMPS

RISK MANAGEMENT AND PROFIT SHARING

TO IMPLEMENT A RISK MANAGEMENT AND PROFIT-SHARING PROJECT FOR MICRO, SMALL AND MEDIUM SIZE ENTERPRISES

Prepared for *THE BUSINESS CENTRE*

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT - TANZANIA

December 20, 1994

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FEASIBILITY STUDY

R M P S

RISK MANAGEMENT AND PROFIT SHARING

TO IMPLEMENT A RISK MANAGEMENT AND PROFIT-SHARING INTERMEDIATION PROJECT FOR MICRO, SMALL AND MEDIUM SIZE ENTERPRISES

I. EXECUTIVE SUMMARY

The purpose of this feasibility study is to recommend an appropriate structure for the establishment of a revolving financing facility for micro and small scale businesses in Tanzania. USAID defines microenterprises as having up to 10 employees and medium scale enterprises as 11 to 49 employees. Virtually the full range of TBC clients are in this range. Further, the need for such a financing facility has been identified by The Business Centre (TBC) as a critical constraint to business growth. A financing structure called Risk Management and Profit Sharing (RMPS) has been proposed as a first step toward stimulating commercial bank financing of indigenous enterprises, which are the target market for TBC. (See Attachment 1 for Definitions of Client Size.)

Local financial institutions are in the process of a government mandated restructuring, have little or no liquidity, are technically insolvent, and are not actively lending. The two new foreign banks do not lend to the target market. Another six banks have been licensed and are in the process of meeting operating requirements. When banks do lend, they require extensive collateral and security do, in large part, to the historical record of poor loan repayments and the lack of reliable credit information on borrowers.

The constraints to SME credit access are compounded by the lack of attractive savings options, especially for the micro and small enterprises. Thus, it is difficult for entrepreneurs to martial the capital and collateral they require for bank financing.

The current inflation rate of 30% p.a. and a Central Bank monetary policy of soaking up excess liquidity with a high bank discount rate, has driven Treasury Bill rates to 60% p.a. and borrowing rates to 40% and higher. The primary option for micro and small enterprises is the informal "curb" financial market with interest rates of 5% to 10% per month. It is true that trading firms with good volume and quick turn-over of inventory are able to make profits which can carry a high cost of financing, passing the cost on to the consumer. However, these conditions are difficult for the smaller entrepreneurs attempting to expand or purchase essential equipment. They need time to obtain and install the equipment, generate sales and collect revenue which, can take three to twelve months.

The proposed RMPS structure could address several of the identified constraints for a focused microenterprise and small business market segment. The financial modeling shows that some 42 companies could be financed over a three year period with an average loan of between TShs 10-20 million ($20,000-40,000). The recommended structure would follow the RMPS plan. As with any donor supported financing mechanism, some adjustments will be recommended over time to minimize the burden on USAID and to encourage private sector financial institutions to take the full market risk. In the long run, large scale intermediation by the banks between savers and borrowers can best be stimulated by appropriate government fiscal and monetary policies, especially in the area of taxation. Equity and transparency in government policies will encourage the same qualities in the public, reducing the barriers to financial access.

II. PRINCIPAL FINDINGS

The principal findings as to the proposed RMPS structure are set out in Attachment 2 and a summarized below.

FUND SIZE

A fund size of $1 million is appropriate. Such a size would fund at least 42 TBC clients over three years at a level TBC staff could manage without being diverted from their original and primary objective of providing consulting services to build entrepreneurial capacity. With experience, financing may be manageable for more clients, especially if suitable on-lenders to microenterprises are identified and participate in the RMPS program. Some of the funds will be placed on deposit, most likely in Treasury Bills. The interest earned would be added to the RMPS pool funded by a USAID grant. This is an important feature as a hedge against inflation, which is currently 30% per annum. The funds earned will also provide a loan loss cushion.

LOAN SIZE AND STRUCTURE

While demand with in the target market of micro and small scale customers of TBC could range from TShs 750,000 to TShs 50 million ($1,500 to $50,000), such a wide range is not practical for TBC to manage. Very small business loans take almost as much time to prepare larger loans. In order to have the desired impact on as many companies as possible while simplifying the management process, it is recommended a basic term loan structure with an income note or straight interest option be provided.

An 18 month term loan with a maximum grace period of 3 months before principal payments begin and an rate of return calculated on commercial terms and tied to the profitability of the borrower would be an appropriate vehicle which would enable many companies to purchase essential equipment or expand operations. The facility could provide term working capital for growth companies. It could also be use to finance other finance providers, such as SELFINA (part of the SERO Enterprises Initiatives (T) Ltd. group owned and operated by professional women) which provide leasing and other credit to microenterprises, especially women.

Some borrowers may not be comfortable with committing an unknown amount of future profits as a return on the funds borrowed. For these clients, there could be a straight interest structure. For firms which exceed their financial projections, earning more profits than expected, paying straight interest will cost less, but it will place a higher demand on cash flow in the early months.

PRICING

The pricing is to be negotiated by the lending Financial Institution (FI) and TBC. It is recommended that the rate of return on the investment (ROI) be commercial and not below market. Microenterprise lending experience demonstrates that subsidized lending rates inhibit the development of viable financial markets. Further, with "curb market" rates at 5% and higher per month and the effective cost of commercial credit about 25% over the interest rate due to fees and processing costs, the rate charged on the RMPS loan will in fact be below market. Various rate assumptions have been tested in the RMPS Credit Project Cash Flow projections in Attachment 4.

COLLATERAL

Limited to liens and security interest on commercial assets used in the business and generally financed by the loan.

Most banks require seemingly excessive amounts of collateral, including personal mortgages and pledges of personal property as well as liens on commercial assets. Historical loan repayment default experience is the reason.

Under RMPS, TBC will provide extensive client supervision and TA which is intended to strengthen client management practices, identify credit worthy borrowers and provide loan collection controls. The TBC presence and recommendation will reduce, but not eliminate, the appropriateness of collateral. When the RMPS program ends, the objective is to have prepared clients to obtain financing from private sector lenders. Pledging company assets to the lender is an important form of control and protection.

ASSIGNING CREDIT RISK

Ultimately the credit risk, failure of the borrower to repay, will be absorbed by the USAID provided RMPS pool of funds on deposit at the Financial Institution. In order to engender prudential lending and diligent collection, both the FI and TBC should be at risk. If the client is not successful and is not able to provide the profit sharing ROI anticipated, both the FI and TBC, and BA will receive less, or no, fee.

As to the RMPS pool of funds, income earned on the investment of unlent funds in Treasury Bills could keep the RMPS pool at a constant value, in inflation adjusted terms. This would permit continued lending and would serve as a cushion to absorb loan losses.

However, if the loan loss experience exceeds the pool earnings, the ability to lend will decrease impacting TBC's ability to achieve its development objectives and the fee earnings of the Financial Institution (FI), TBC and the Business Advisors (BAs). For the client, the failure to repay will cut them off from future credit and a loss of the collateral. Thus, all participants have a stake in seeing that the loans perform.

ROLE OF TBC

The Business Advisors would identify the eligible client, assist in preparing a business plan and loan request to meet the FI's standards and present the package to TBC for review.

TBC analyst would review the package and suggest improvements as necessary. All supporting documentation, accounts, projections, corporate documents, business plan, etc. will be assembled. The complete package meeting TBC standards will be presented to the FI.

ROLE OF FINANCIAL INSTITUTION

The FI will review the package within a short period, three working days is suggested, and either approve or indicate deficiencies. The loan will not be rejected solely on the grounds of insufficient collateral or prior credit experience. Rejected loans can be revised and represented. The FI will conduct an independent review, including a site visit generally, before the funds are disbursed.
A standard loan application form will be prepared to reduce time and legal expense. Since the standard loan is for up to 18 months with a maximum grace period of 3 months and an income note fee basis, costly variations should be avoided.

POTENTIAL FINANCIAL INSTITUTIONS

The financial institutions considered as appropriate include First Adili Bank, Akiba Commercial Bank, Meridien BIAO, Tanzania Development Finance Limited and Standard Chartered. The existing government owned banks and development finance institutions are being restructured and were not considered.

The First Adili Bank is recommended as the most appropriate partner for the RMPS project. The bank is indigenous, is licensed and will be operational in January 1995. The shareholders include SwedeFund providing TShs 400 million (about 28%), National Provident Fund Tshs 300 million paid in (about 21%) with 2/3 in non-redeemable non-voting preference shares, and Parastatal Pension Fund subscribed for TShs 300-350 million (about 21-25%) to be paid in January 1995 also with 2/3 in non-redeemable non-voting preference shares. An additional 18 small shareholders, all Tanzanians, have paid in their capital which is currently TShs 120 million and expected to reach TShs 200 million.

SwedeFund has recruited an expatriate Director of Banking Operations and will provide additional part time technical banking advisors. African non-Tanzanian expatriates have also been recruited as Assistant Director General Banking, Assistant Director Financial Investment Services and Director of Finance. All other staff are Tanzanian. Staff will be in place during January 1995.

A full evaluation of First Adili and future monitoring of the banks capacity and performance will be required before a grant can be completed.

Of the other banks considered, Akiba is raising capital and is not expected begin operations until mid-1995 at the earliest. Staffing and operating procedures have not been established. If the RMPS program permits more than one bank to participate, Akiba could be a future candidate. Meridien BIAO, a foreign owned and managed Africa based commercial bank, has expressed interest, has been operating in Tanzania for almost 18 months, and is a good alternative to First Adili. TDFL does not currently lend to the target market segment, although they have expressed interest in doing so. Given their traditional development finance institution structure, TDFL is a fourth choice. Standard Chartered does not currently lend to the target market and is considered to conservative to participate in a scheme as innovative as RMPS. CitiBank has just announced their plans to open a full service commercial bank in 1995 and their interest in the RMPS should be determined.

SUSTAINABILITY

This RMPS is intended to address an immediate need for financing as identified by TBC for its target clients. It meets the two primary constraints in the financial sector today; lack of funds for the banks to lend, and lack of adequate credit information on which to form a lending decision. It is an innovative pilot project of limited amount and duration. As such, the product offered is focused as to the target microenterprise and small scale market operating through a grant to a single FI. However, one of the RMPS's substantial benefits will be the establishment of a role model for other lenders as new financial institutions enter the scene.

It is essential that TBC clients start banking relationships on a basis that can lead to mutual trust and future access to credit. This incudes meeting reasonable banking standards and developing full bank relationships taking advantage of the services offered. Clients should open both operating and saving accounts. In fact, many customers of TBC may need a regular savings program more than loans.

RMPS is intended to be a revolving fund which could continue beyond the remaining four year life of the TBC project. At some point the FI will have to decide how to carry the RMPS funds on its books. The proposed structure assumes the BoT and MoF will approve an exemption to the normal reserve requirements on deposits, which would be reasonable to expect. However, additional non-grant funds raised by the FI would probably not be exempt. By that time, it is hoped reserve requirements will have been reduced.

OPERATIVE STRUCTURE

A standard loan application form will be prepared to reduce time and legal expense. Since the standard loan is for up to 18 months with a maximum grace period of 3 months and an income note fee basis, costly variations should be avoided.

IMPLEMENTATION

Memorandum of Understanding between TBC and the financial institution as to their respective roles, characteristics of the target markets, the credit requirements, acceptable collateral, standard forms and other operating details will be negotiated and agreed to.

Appropriate staffing for TBC will be determined to accomplish the increased credit analysis work, prepare financial projections and market studies, prepare and review business plans, and establish MIS to monitor loan performance. Given the amount of analytical work required, the MBA program interns will be very helpful.

Training will be required for both TBC staff and for the FI to assure a common understanding of credit and lending principles, agree on the processing of applications, establish pricing standards and incentive compensation for performance.

The Business Advisor network of TBC will need to be expanded and suitable training in loan candidate identification, preparation and monitoring provided. Borrowing candidates for the RMPS program will be identified so that lending can begin when the full RMPS program is in place. Market research has recommended the service mark ACCESS as the RMPS product name.

The grant from USAID to the FI will have to be approved and put in place. Agreements from the BoT and MoF, especially as regards an exemption from reserve requirements, the income note structure and procedures for provisioning non-performing loans and charging loan losses to the RMPS pool of funds, will be negotiated and approved in writing.

USAID oversight procedures and reporting requirements for TBC and the FI will be agreed and appropriate MIS set up.

Legal lending contractual agreements between the FI and the borrower will be drafted and approved as will standard collateral and security agreements. Legal agreements on the payment of fees between the FI and TBC and the Business Advisor will be agreed.

The legal status of TBC itself will need to be resolved. TBC is not currently incorporated and can not enter into legally binding contracts.

III. ENVIRONMENT FOR BUSINESS DEVELOPMENT

This section examines the constraints to micro and small business development in Tanzania: the evolution of government incentives to the private sector; new developments in the financial sector; the availability of capital; the experience of commercial financial institutions in providing finance to the small and medium size formal sector; and donor agency financial sector programs.

The Financial Sector

The financial system which existed in Tanzania before the new Banking Act of 1991 is essentially defunct and new institutions must be built from the ground up. There is attractive potential for intermediating between savers and borrowers. This provides an opportunity for a new generation of Tanzanians to learn banking and finance skills and create services which address real, practical local needs.

The normal market array of financial services does not now exist. Working capital loans, trade finance, import/export services, equipment financing, expansion financing for new venturers and growth all need to be developed, as do capital and share trading markets.

Bank Lending Experience

Since nationalization of the banking community in 1967, the only source of financing to the micro, small and medium size formal sector has been through the largest commercial bank, the National Bank of Commerce, and parastatal development finance institutions sectorially focused. The centrally managed socialistic economic policies led to managed credit and loss making operations.

Availability of Credit

There currently are no commercial financial institutions providing capital for business start-up and/or expansion in the microenterprise and small scale markets. There is a minimal amount of working capital and trade finance being provided by NBC and the two foreign banks, Meridien BIAO and Standard Chartered to well established customers with adequate traditional collateral and security. Standard Chartered serves only the large corporate market.

Of the fifteen legally constituted financial institutions in Tanzania, all the local government owned financial institutions are technically insolvent and are being restructured. They are not making loans. The two new private commercial banks, Meridien BIAO Bank Ltd. and Standard Chartered, Ltd., are not providing financing directly to micro and small enterprises. Meridien BIAO is setting up an investment bank which will target medium size enterprises in 1995. A private development finance institution, Tanzania Development Finance Limited, is funded through lines of credit from its shareholder DFIs and focuses on term project finance with medium to large size customers.

The lack of a reliable supply of credit and financial services also limits the ability to identify the full demand for financing or the availability of hidden savings in the economy that could be mobilized through and efficient and transparent financial market.

There have been a few experiences which indicate the potential for funds mobilization and lending activities could be sizeable and profitable.

Meridien BIAO was opened in August 1993 and took in more than $13 million in Tanzanian Shilling (TShs) deposits during the first three months. The volume has continued to grow rapidly to the point that Meridien BIAO is a major market maker in government Treasury Bills (T bills). The bank will make TShs 2 billion in 1994, equal to its original capital.

New Financial Sector Developments

Following the slow start in 1993 when only two new banks open for operations, there are now six banks which have received licenses and expect to commence operations in 1995. First Adili BAnk, Akiba Commercial Bank, Eurafrica Bank, Trust Bank, Habibu Trust (Kenya) and Savings and Finance Ltd. all have licenses. Citibank has just announced plans to open a commercial bank and presumably has received a licenses bringing the total to seven new banks.

A new indigenous bank in formation, Akiba Commercial Bank has raised over TShs 190 million ($360,000) in subscription capital of which almost half was raised in one week as a new rural subscription campaign began in early December 1994. The promoters expect to raise at least the minimum capital of Tshs 500 million and begin operations by June 1995.

A new cooperative savings and loan association was launched by a local company, Business Care Services, attracting over 100 employees and in excess of Tshs 3 million through payroll deductions in the first three months.

The Tanzania Venture Capital Fund has raised $7.2 million in subscribed capital over the last year and has approved 12 investments. However, of the two local investors, TDFL and National Provident Fund (NPF), only TDFL and paid in their capital call.

Donor Agency Financial Sector Programs

USAID has three programs under the FED Project which can play a vital role in supporting the development of these new financial instruments.

- At the most risky, long term end of the financial services spectrum, Tanzania Venture Capital Fund (TVCF) through its management company Equity Investment Management (EIM) is: creating a role model for mobilizing high risk investment funds and structuring equity investments; stimulating public understanding and acceptance of outside equity investment; promoting interest in share trading; and in the process of working with potential partner clients, has impacted 3 to 4 times the 400 or so entrepreneurs whose projects they have reviewed in the last 18 months. To date, 12 projects have been approved for financing and $2.7 million out of $7.6 million in subscribed capital as been committed. This activity is a tremendous demonstration of what can be accomplished in laying the foundation for a new financial markets environment in Tanzania. The first USAID grant has been successfully completed. A second grant is in process.

- At the shorter term, business operations end of the financial services spectrum, The Business Centre is: stimulating interest in developing and expanding business which will help create success stories essential for promoting a wider understanding of business concepts; providing essential business management services to microenterprise and small business; creating a consulting and business advisory network and is promoting the acceptance of services to assist entrepreneurs; providing a financing link for microenterprise and small businesses which will stimulate the development of new financial institutions and demonstrate the potential for profitable lending to carefully qualified borrowers; developing new and appropriate financial products which can be packaged and marketed to other companies (e.g. cooperative savings and loan programs and employee car hire purchase schemes). Hundreds of business people will be impacted, supported and encouraged by these activities helping to transform the emerging pro-business culture in Tanzania.

- Between these two ends of the financial spectrum are a range of financial instruments and services necessary for a healthy business environment. Development is required to stimulate and directly promote development of new financial products and services by making markets in treasury bills and commercial paper; take equity investment positions in companies and financial institutions; finance property development; and development of capital markets, including share trading and eventual establishment of a stock exchange.

Danida, the Danish aid program, has been a major supporter of the restructuring of one parastatal DFI, Cooperative and Rural Development Bank. Shares are being offered to the public in an effort to recapitalize CRDB, and up to 80% is reported to have been subscribed and paid in. Although reports are mixed, within the banking community it is believed that CRDB is close to achieving its restructuring goals.

IV. INPUTS REQUIRED FOR SUSTAINABLE SME GROWTH

There are many factors in the Tanzanian enabling environment which impact on access to credit by micro, small and medium scale formal sector businesses. The current picture is of very limited access to normal commercial credit. The desired objective is to move toward credit for the majority of credit worthy borrowers. The force field analysis portrays which factors are positive in terms of opening access and which factors are inhibiting progress in the desired direction.

Generally, more can be accomplished by focusing efforts to reduce the negative factors while giving room for the positive factors to exert their influence. A table outlining some of these factors and suggesting an action plan is presented in Attachment 5, Access to Credit - Force Field Analysis, Outline of an Action Plan.

V. DEMAND PARAMETERS FOR A SMALL BUSINESS EQUITY FUND

This section presents a non-analytical assessment of potential demand for credit in Tanzania based on interviews with five financing institutions. The picture which emerges is of a potential demand for credit in the $10 million to $50 million range currently unmet.

Data on the identified financing needs of microenterprises and small businesses, as collected by TBC to date, is limited. In part this is attributable to the lack of access to financing which would stimulate in depth evaluations of credit need, the chicken and the egg syndrome. TBC initial intake forms reveal that about 74% of the 72 client seeking Basic Advisory Services (BAS) during the first full quarter of operations through September 1994 indicated a primary interest in finance. However, actual client evaluations have often revealed that the business persons do not have an adequate grasp of their business operations, accounting, inventory control, production planning, pricing, marketing and distribution to be able to properly manage available cash flow, much less plan for bank financing needs. If nothing else, this finding supports the value of TBC in advising and assisting business people in fundamental business skills.

Experience with venture capital funds has demonstrated that once a supply of financing is available and advertised, demand for credit begins to develop. For the purpose of understanding potential demand, we can make some proforma assumptions.

- Request for BAS increases with TBC exposure to 100 per quarter, or 400 per year.
- Of this number, 10% need and qualify for financing, or 40 clients. This is about 1 1/2 times the qualification rate for applicants to EIM for venture capital financing.
- The range of financing required by the target SME firms would range from $15,000 to $50,000, with a average loan of $30,000. This would generate an annual demand of 40 clients at $30,000 each or $1.2 million per year.
- Over a three year time horizon, the capital demand would be $3.6 million. Adjusted for inflation, the demand could increase to $5.6 million.
- With a five year time horizon, over 200 clients would be provided financing totaling $6 million before adjusting for inflation. If inflation decreases over the five years, as the Bank of Tanzania expects, and averages 15%, the dollar value of demand thorough TBC alone could exceed $10 million.

This figures provide a conservative estimate of potential demand which far exceeds the initial capital of $1 million to $1.5 million proposed for this fund. However, if all loans are repaid on time and the average life of first time loans is less than 12 months, and a commercial rate of interest, greater that the rate of inflation, is charged, then the recycled pool of capital will address the anticipated minimum demand and stimulate intermediation from the community to meet the expected incremental growth in demand as the business sector grows.

See Attachment 3, for a summary of the findings.

VI. IMPLEMENTATION PLAN

This section outlines an implementation plan for the RMPS scheme. Several critical issues will need to be agreed on, including the following:

- Development of accountability standards for The Business Centre and other participating financial institution.

- Determination of the means by which persons involved with management of RMPS will be "at risk" both in the making of investment decisions and in administering the fund. The "at risk" concept is important as an incentive to sound decision making and long term sustainability of RMPS scheme, including the ability to attract new investors.

See Operating Structure and Implementation headings i Section II, Principal Findings for further details.

The following are basic concepts which should be incorporated into the design concept.

- The structure should be inherently able to generate deal flow (credit worthy transactions) on a proactive basis.

- Clients seeking financing through RMPS will be able to receive technical assistance to enhance their business skills and viability of their project, thus improving the projects credit risk.

- Lending to Micro and small enterprises is expensive. In order to encourage participation by a financial institution, the bank administration costs must be kept at a minimum.

- In order to achieve much higher TBC impact than presented in the demand section above, it will be necessary to build a network of business advisors to provide services and monitor loans. If 10 new qualified advisors are certified in 1995 and each can generate 5-10 credit worthy clients each year, at the end of three years 150 to 300 new loans totaling TShs 1.5 billion to TShs 6 billion ($11 million) could be financed. While this is the potential, such demand far outstrips the RMPS funds anticipated, but could be funded by a vigorous bank deposit taking program and the copying of the RMPS concept by other new banks.

- All the players in the financing process must be at risk from a business and financial perspective and decisions must be based on sound business, not development, terms.

The roles of TBC, the business advisor network and participating financial institutions are outlined below. These roles should be negotiated carefully and agreed to in writing by all parties before operations begin. Either Memorandum of Understanding or contractual agreements should be entered into depending on the legal and contractual nature of the provisions. For example, when compensation is to be paid for services rendered, a legal contract should be utilized. When a procedure for processing transactions has been agreed, a Memorandum of Understanding might be sufficient.

The Business Centre will be responsible for developing the initial deal flow, designing the criteria for approving ACCESS credit, designing and delivering training to Business Advisors and to client companies. TBC will also build the Business Advisor Network, selecting and supporting the advisors in consulting and financial advisory skills.

The Business Advisors will develop their own client base both directly and through referrals from TBC. Each Advisor will identify clients with financing requirements which qualify for RMPS credit. They will work with the client to develop a loan request application to the standards established by TBC and the participating financial institution (FI). Advisors will maintain a working relationship with each client who has received RMPS credit and will be responsible for collection of principal, interest and any dividends if an income participation note credit instrument is use. The advisor will be compensated for these "relationship management" services through an management fee payable from the income receive by the FI.

The Financial Institutions will manage the pool of loan funds provided by USAID through the FED Project. Funds not currently lend will be invested in short term low risk investments, such as T Bills. The FI will be responsible for the final lending decision based on criteria agreed to in the Memorandum of Understanding and any contractual agreements. The FI will maintain a book of all loans made and payment status. Periodic reports, at least monthly, will be provided to TBC which will keep individual Business Advisors informed as to their loans. The FI will, at its discretion, conduct a field appraisal before disbursing each new loan and will conduct follow-up site visits, announced or unannounced, at least semi-annually. For these services, the FI will be compensated by interest income on the loan, less any amount payable to the Business Advisor as their management fee. A management fee may also be appropriate to provide a minimum compensation to the FI to cover direct costs until loans generate fee income.

The process of generating a loan would be along the following lines.

The Business Advisor would identify a eligible client and prepare an RMPS credit request. The request would be reviewed on a 48 hour turn around by a business lending officer at TBC. Agreed credit requests will be directed to the FI which will make the final decision within 3 days. From submission by the Business Advisor to final approval should not exceed 5 working days.

The Business Advisor will continue to provide for fee advisory services to RMPS clients as negotiated directly. Incentives to collect non-performing loans should be provided. One possible formula could be as follows. If a loan goes into default, the Business Advisor does not receive the loan management fee unless 100% of the principal and more than 75% of the interest and charges are recovered, in which case the Business Advisor will receive a pro-rata share of the fee after collection expenses.

The Business Advisor will be responsible for structuring the financing required with technical assistance from TBC and the FI as required.

Pricing on the facility will be on a commercial basis with a positive spread over inflation and competitive with similar credit in the marketplace.

It is anticipated that this RMPS credit program could have the following impacts:

- broaden access for microenterprises and small scale businesses to business advisory services and financing;
- expand utilization of TBC services and leverage capacity;
- establish a role model for new financial institutions starting in Tanzania and promote lending activities to the target market;
- create a range of products for micro and small enterprises (working capital, import and export finance, equipment finance, leasing).

See Attachment 4, RMPS Project Cash Flows for Years 1995-1998 for financial assumptions regarding the expected impact.

VII. MEASUREMENTS

A challenge for USAID will be to establish agreed measurable indicators with which to evaluate the impact of the ACCESS and related FED programs. This following list is proposed as a starting point.

- people trained
- new financial products introduced
- amount of financing arranged and booked
- number of companies assisted
- sales volume increase of clients from baseline
- increase in number of financial sector service providers
- amount of funds mobilized in savings, investment funds and through credit lines
- newspaper articles, TV programs and radio coverage of financial and business issues
- focus groups for subjective feedback on government policies
- evolution of new financial institutions and restructuring of existing (traditional) government owned financial institutions

ATTACHMENT 1

DEFINITIONS CLIENT SIZE

TYPE	EMPLOYEES	FINANCING SIZE TShs '000	PRODUCT DEMAND/ INTEREST RATES	
MICRO	< 10	750 to 5,000	Savings Working Capital Leasing	18-25% 60% pa+ N/A
SMALL	11 - 49	2,500 to 25,000	Savings Working Capital Leasing Equipment Loans	18-25% 33-39% N/A 29-40%+
MEDIUM	50 - 99	10,000 to 100,000	Savings Working Capital Leasing Equipment Loans Expansion Loans Quasi-Equity Equity	18-30% 33-40% Supplier 35-40% Limited N/A 50-60%
LARGE	> 100	25,000 to 500,000	Savings Working Capital Leasing Equipment Loans Expansion Loans Quasi-Equity Equity M & A Investment Mgt. Public Offering	18-30% 33-40% Supplier 35-40% 40% N/A 50-60% Non-local TBills Non-local

ATTACHMENT 2

POTENTIAL MARKET DEMAND FOR FINANCING

SOURCE	TYPE	NUMBER LOANS P.A.	AVG. TSHS FINANCING PER LOAN	LOAN VOLUME 1995	LOAN VOLUME 1997
TDFL Start-up Entrepreneurs Don't currently serve this market.	Micro	500	5,000M $10,000	2,500M $5M	7,500M $15M
TBC Clients Would not serve most medium - large market.	Micro Small Medium Large	75 30 15 20	500,000 to 20M 20M - 50M 50M -150M >150M	1,500M 900M 1,125M 8,000M	1,600M 1,500M 2,250M 10,000M
SELFINA Leasing SERO Enterprise Initiatives (T) Ltd. Group	Micro Women	yr. 1 50 yr. 3 300	700,000 - 2,500M Small equipment leasing	125M	750M
1ST ADILI BANK Commercial Bank	Small	25 to 40	6M - 13M	250M	400M
EIM Venture Capital	Medium	20 to 30	15M - 25M	400M	750M
TOTAL		**+/- 1,000**		**TShs 14,800M** **$30M**	**TShs 24,750MM** **$50M**

ATTACHMENT 3
THE RMPS CONCEPT

FEATURE	RATIONALE
Target Market	Micro, small and medium registered Tanzania companies. Clients of TBC lack access to traditional bank financing due to lack of standard credit information and liquidity shortage in the banks. The priority would be those clients which meet standard bank criteria in terms of character and capacity to manage financing, but lack the credit record, capital or collateral. The Business Advisor (BA) network set up by TBC will be the primary source of clients.
Financial Instrument	Income participation note with a straight interest bearing note if preferred. The possibility of a conversion feature to take shares in the company should the client be unable to repay could be considered. The loan will be provided by a Financial Institution (FI) drawing on gant funds deposited by USAID under the FED Project and RMPS. The income note delays payment of interest and the associated cash drain impact on cash flow during project start-up. Since the income note is quasi-equity, if the company performs better that expected, the return to the lender will be also higher that the target ROI. If the projected profits are not achieved, the return to the RMPS pool will be lower. Some borrowers may want to fix the cost of funds in advance; therefore an interest rate option should be available.
Fee Schedule	The fees should be negotiated by TBC and the selected FI and may be adjusted with experience over time. As a start, with a ROI objective of 25% in real terms (which is the minimum venture capital return expected by TVCF), the FI would receive 12%; TBC and the BAs would split 12%. These fees would be paid at maturity of the income note based on client performance and profit sharing. See ROI below.
Rate of Return on the Income Note (ROI)	Commercial rate of return to be agreed by TBC and the FI based on current market cost of funds and a spread covering costs. Microenterprise lending studies show below market interest rate lending inhibits the broader development of commercial saving and lending programs. The current informal "curb market" rates are 5% per month and more, or 60% p.a. plus.

FEATURE	RATIONALE
Rate of Return on the Income Note (ROI)	The actual cost of commercial credit, interest, fees, collateral registration, legal expense and bribes approaches an additional 25% over the stated interest rate bringing the cost near the "curb market". RMPS would be much lower with no bribes, lower collateral costs and simplified legal requirements. Example: With a single payment 18 month loan of TShs 20 million at 50% nominal ROI (25% plus inflation), the cost to the client would be 20X50%X18/12=15. The client would have to earn TShs 30M profit from the TShs 20M investment, part of which would come from inflation. Example: If the 18 month loan is repaid in equal principal payments after 3 months grace, the profit to be shared drops because the money actually used over the 18 months is less. In this case, the cost would be 20X50%X10/12=8.3. The client would have to earn only TShs 17M on the investment, or $34,000 in profit.
Amount of Loan	In a range of TShs 10 million to TShs 25 million ($20,000 to 50,000). Smaller loans require as much management time and expense. With TBC's limited staff resources, this range will permit loans to some 42 clients over three years. Some of the loans could be to other lenders, such as SELFINA which is targeting equipment leases to microenterprise women. This would open a new indirect market for TBC while expanding the range of loans significantly.
Collateral	Limited to liens and security interest on commercial assets used in the business and generally financed by the loan. Most banks require seemingly excessive amounts of collateral, including personal mortgages and pledges of personal property as well as liens on commercial assets. Historical loan repayment default experience is the reason. Under RMPS, TBC will provide extensive client supervision and TA which is intended to strengthen client management practices, identify credit worthy borrowers and provide loan collection controls. The TBC presence and recommendation will reduce, but not eliminate, the appropriateness of collateral.

FEATURE	RATIONALE
Collateral	When the RMPS program ends, the objective is to have prepared clients to obtain financing from private sector lenders. Pledging company assets to the lender is an important form of control and protection.
Grace Period	A period of up to three months before repayment of principal begins is recommended. If the projected cash flows show the impact on cash flow would be to constraining to the client, payments can be lowered initially and increased over time, or a balloon payment at maturity can use used. Under current BoT regulations, banks must begin collecting on loans within 3 months and most make provisions after 6 months non-performing. While it is possible a special exemption could be obtained, it would be better discipline for the client and the bank to adhere to the norm. On income note, the payment would be limited to a principal installment.
Credit Risk	Ultimately the credit risk, failure of the borrower to repay, will be absorbed by the USAID provided RMPS pool of funds on deposit at the Financial Institution. In order to engender prudential lending and diligent collection, both the FI and TBC should be at risk. If the client is not successful and is not able to provide the profit sharing ROI anticipated, both the FI and TBC, and BA will receive less, or no, fee. As to the RMPS pool of funds, income earned on the investment of unlent funds in TBills could keep the RMPS pool at a constant value, in inflation adjusted terms. This would permit continued lending and would serve as a cushion to absorb loan losses. However, if the loan loss experience exceeds the pool earnings, the ability to lend will decrease impacting TBC's ability to achieve its development objectives and the fee earnings of the FI, TBC and the BAs. For the client, the failure to repay will cut them off from future credit. Thus, all participants have a stake in seeing that the loans perform.
Operative Structure	The BA would identify the eligible client, assist in preparing a business plan and loan request to meet the FI's standards and present the package to TBC for review.

FEATURE	RATIONALE
Operative Structure	TBC analyst would review the package and suggest improvements as necessary. All supporting documentation, accounts, projections, corporate documents, business plan, etc. will be assembled. The complete package meeting TBC standards will be presented to the FI. The FI will review the package within 3 working days and either approve or indicate deficiencies. The loan will not be rejected solely on the grounds of insufficient collateral or prior credit experience. Rejected loan can be revised and represented. The FI will conduct an independent review, including a site visit generally, before the funds are disbursed.
Operative Structure	A standard loan application form will be prepared to reduce time and legal expense. Since the standard loan is for up to 18 months with a maximum grace period of 3 months and an income note fee basis, costly variations should be avoided.
Sustainability	This RMPS is intended to address an immediate need for financing as identified by TBC for its target clients. It meets the two primary constraints in the financial sector today; lack of funds for the banks to lend, and lack of adequate credit experience on which to form a lending decision. It is an innovative pilot project of limited amount and duration. As such, the product offered is limited as is the target market and the number of FIs. It is essential that TBC clients start banking relationships on a basis that can lead to mutual trust and future access to credit. This incudes meeting reasonable banking standards. Clients should open both operating and saving accounts. In fact, many customers of TBC may need a regular savings program more that loans. RMPS is intended to be a revolving fund which could continue beyond the 3 years life of this project and the life of the TBC project. At some point the FI will have to decide how to carry the RMPS funds on their books. The proposed structure assumes the BoT and MoF will approve an exemption to the normal reserve requirements on deposits, which would be reasonable to expect. However, additional funds raised by the FI would probably not be exempt. By that time, it is hoped reserve requirements will have been reduced.

FEATURE	RATIONALE
Termination of RMPS	Should the FI not perform, or decide at a future date that it can no longer manage the RMPS, there should be an alternative for USAID. The probable exit strategy would be to return the funds to the SATF. By design, the SATF would be the logical legal entity to make future investments with FIs and to receive any profit or balance at the end of the contract.

ATTACHMENT 4

RMPS CREDIT PROJECTED CASH FLOWS FOR YEARS 1995–1998

	1995	1996	1997	1998	TOTAL	$ TOTAL
BUSINESSES ASSISTED BY TBC						
TOTAL ASSISTED PER YEAR	165	200	250	300	915	
ELIGIBLE FOR ACCESS	7	20	15	0	42	
USES OF FUNDS RMPS FINANCING	TShs thousands					
TERM FINANCE						
Average Loan TShs '000	10,000	17,500	20,000			
Total Loan Volume	70,000	350,000	300,000		720,000	$1,384,615
IRR Target	55%	51%	47%			
Avg. Term Months	18	18	12			
COST OF FUNDS						
Inflation	30.0%	25.5%	21.7%	18.4%		
PFI	12.5%	12.5%	12.5%	12.5%		
TBC	6.3%	6.3%	6.3%	6.3%		
Business Advisor	6.3%	6.3%	6.3%	6.3%		
TOTAL COST	55.0%	50.5%	46.7%	43.4%		
INCOME TO PROVIDERS						
RMPS Pool	144,571	96,750	76,986	122,535	440,842	$847,773
Financial Institution	4,762	24,688	32,922	13,944	76,316	$146,761
TBC	2,381	12,344	16,461	6,972	38,158	$73,381
Business Advisor	2,381	12,344	16,461	6,972	38,158	$73,381
Total fees to providers	9,524	49,375	65,845	27,888	152,632	293,522
TOTAL INCOME	154,095	146,125	142,831	150,422	593,474	$1,141,296
Total Income $	$296,337	$281,010	$274,675	$289,274	@ TShs520 = $1	

AVERAGE FEE PER LOAN	Avg. Loan	Fees TShs	Fees $
RMPS POOL FREE FUNDS		10,496,243	$20,185
Financial Institution	17,142,857	1,817,042	$3,494
TBC		908,521	$1,747
Business Advisor		908,521	$1,747
		3,634,084	$6,989

ATTACHMENT 4

RMPS CREDIT PROJECTED CASH FLOWS FOR YEARS 1995–1998

INFLATION ADJUSTED VALUE OF USAID GRANT FUNDS FOR RMPS

	1995	1996	1997	1998	TOTAL	$ TOTAL
USAID Grant	$1,000,000	$0	0	0		1,000,000
TShs Equivalent '000	520,000	520,000	520,000	520,000	520,000	
Avg. Loan Volume	38,095	197,500	263,380	111,551		
Avg. Free Funds	481,905	322,500	256,620	408,449		
TBill 91 days	30.00%	25.50%	21.68%	18.42%		
Income On Free Funds	144,571	96,750	76,986	122,535	440,842	$847,773
TShs Value of USAID Funds	664,571	761,321	838,308	960,842		
Inflation Adjusted Fund TShs	(364,000)	(271,180)	(212,388)	(173,266)	(173,266)	($333,204)
					787,576	$1,514,570

At a rate of inflation equal to the 3 month TBill rate, income earned on the free balances invested in TBills and reinvested in the USAID RMPS fund pool will provide a cushion for loan losses while provideing and overall positive return to the pool for further lending.

ATTACHMENT 5

THE RMPS CONCEPT

ACCESS TO CREDIT - FORCE FIELD ANALYSIS

Outline of an Action Plan

There are many factors in the Tanzanian enabling environment which impact on access to credit by micro, small and medium scale formal sector businesses. The current picture is of very limited access to normal commercial credit. The desired objective is to move toward credit for the majority of credit worthy borrowers. The force field analysis portrays which factors are positive in terms of opening access and which factors are inhibiting progress in the desired direction. Generally, more can be accomplished by focusing efforts to reduce the negative factors while giving room for the positive factors to exert their influence. The picture might look as follows.

POSITIVE	NEGATIVE
Limited competition - permits higher returns.	Management skills - often do not meet professional standards. Business planning skills and standards are required.
Reasonable monetary policy - open foreign exchange, positive rates of interest.	Fiscal policy - excessive tax rates encourage avoidance; arbitrary import exemptions increase competition. Over spending increases inflation and interest rates.
IPC potential investment stimulus - has attracted both foreign and domestic investment.	Government unpredictability in application of investment policy and irrevocability of incentives.
New banks opening - increased transparency, reliable savings and financial products.	Limited competition reduces inter-mediation between savers and local commercial borrowers. Likely to change over next 12-18 months.
Hidden savings - when a reliable bank does open, significant deposits move from the informal into the formal sector.	Traditional local banks serving urban and rural markets are being restructured and are not trusted. New financial institutions serving rural markets are needed. Women entrepreneurs are discriminated against.
Auditing and regulatory mechanisms and standards exist.	Accounting and reporting standards are not high or reliable preventing lending institutions from trusting the information.

POSITIVE	NEGATIVE
The legal system permits the taking of collateral and security in commercial assets, thus promoting a firm's credit standing.	Excessive collateral is required by lenders due to lack of trust and transparency in business dealings.
Business ethics has an historical base and is supported by the majority.	The unbalanced government fiscal policies and arbitrary application has fostered rampant high level corruption with a negative impact on public ethics.
Abundant natural resources provide attractive investment opportunities and food resources for local, regional and international markets.	Government mismanagement has resulted in poor infrastructure development, an electricity crisis and general lack of adequate resource allocation management.
Public awareness of the government mismanagement and pressure for change is increasing.	The existing political structure may be minimally responsive to public sector pressure due to lack of electorial accountability. Alternatives to the current stable of politicians may be limited.
Donor support has sustained the country and funded much of the positive development. Increased donor coordination and conditionality encouraged a change in the Cabinet.	The continued availability of donor support has fostered dependency and permitted a few to profit excessively.

These factors could be rated and ranked in terms of impact, represented by the length of the arrows. TBC could then set its action plan to reduce the most negative factors.