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CO-OPERATIVE DEVELOPMENT IN AFRICA: PROSPECTS AND CHALLENGES

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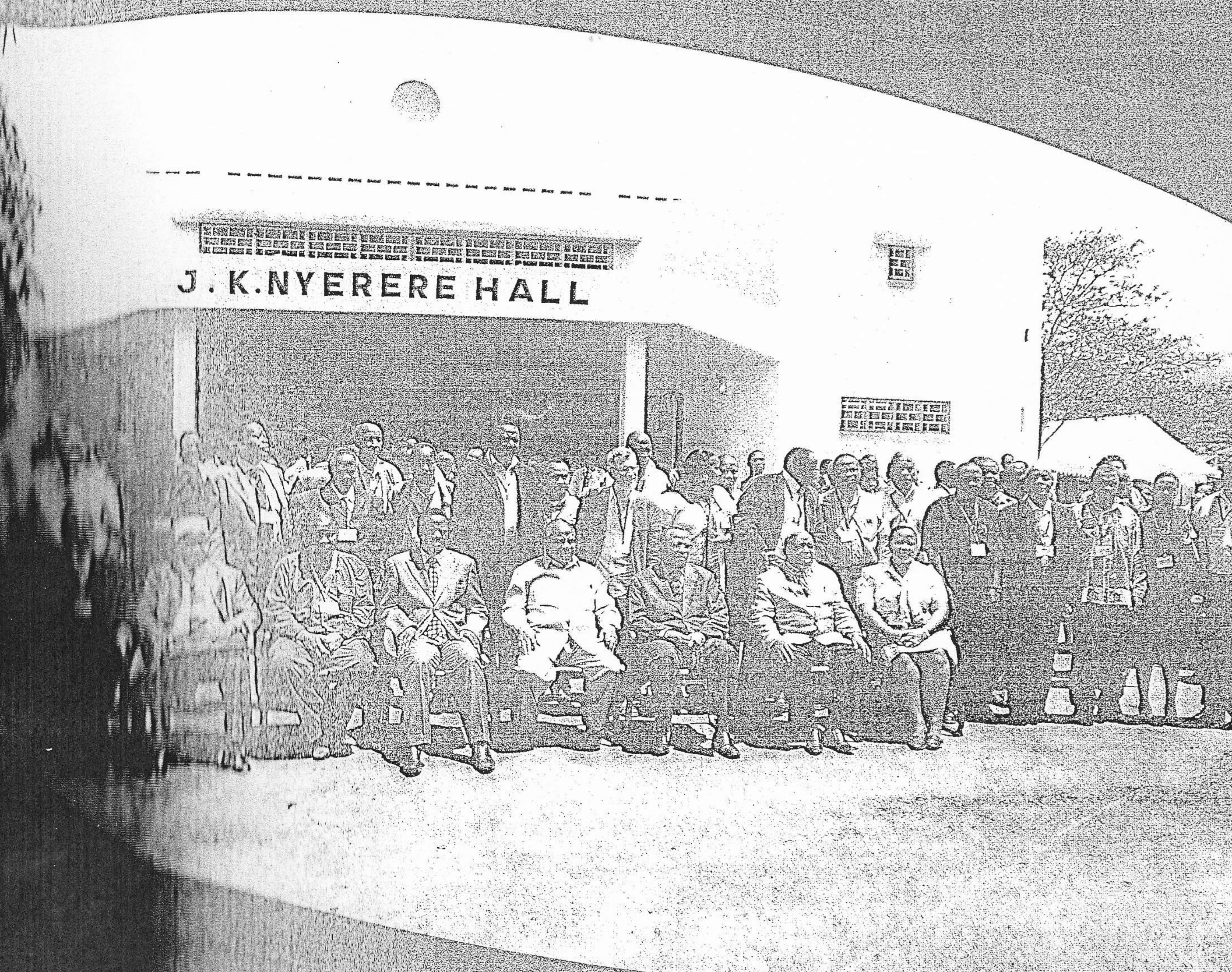

2.2 SUB-THEME II: COOPERATIVES AND FINANCIAL SERVICES

2.2.1 An Investigation and Analysis of Factors Affecting Internal Capital Formation in SACCOS: A Case Study of 49 SACCOS in Selected Regions In Tanzania

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CHAPTER ONE: INTRDUCTION

1.1 Background and Problem Context

Savings and Credit Cooperatives (SACCOS) and other Cooperative Financial Institutions (CFIs) throughout the world share a core value system, although the historical and cultural contexts of particular countries have an influence on how they have developed. Economic contexts also play a significant role; hence the SACCOS movement is a sophisticated sector which forms an important part of the financial system in several developed countries. However it is still an infant sector in the developing world such as Eastern Europe and Africa, where SACCOS face development challenges, including poor governance and lack of internal capital (Ferguson & McKillop, 1997)

Poor governance and increasing shortage of internal capital in Savings and Credit Cooperatives (SACCOS) in developing countries have overtime continued to affect negatively the financial stability and performance of these institutions. Despite these gaps, existing literature support the notion that SACCOS and other Cooperative Financial Institutions (CFIs) serve many poor people, even though middle-income clients are also among their membership (Carlos E. Cuevas & Klaus P. Fischer, 2006).

The "mixed outreach" as some practitioners have labeled, and the diversity of SACCOS' clientele translate into the fact that, in many cases SACCOS serve larger numbers of poor people than specialized ("targeted-to-the-poor") microfinance institutions, without relying on donor support as the latter do (Cuevas 2000). Yet, the perception that SACCOS are associated with "middle-class" customers has kept them outside the radar screen of governments and donor development resources, particulary, technical and financial support.

The imbalance in technical and financial assistance to non-cooperative microfinance institutions versus SACCOS in Latin America has been criticized recently (Westley, 2001). The critique is based on the facts that: (i) SACCOS are the dominant suppliers of micro-enterprise credit in the region; (ii) they provide savings services, which other microfinance institutions usually do not; (iii) they provide a broader range of credit products including housing and consumer loans; and (iv) SACCOS have a relatively larger presence in rural areas in Latin America. Westley attributes this imbalance in donor support to the (mistaken) perception that SACCOS and other CFIs do not serve the poor in spite of evidence to the contrary. . One may add to this explanation that the apparent success of specialized microfinance institutions (mostly donor-funded non-governmental organizations) in capturing donor support is because they use the banner of poverty alleviation, and lack of knowledge among donor staff about SACCOS and other CFI sector.

Despite of lack of sufficient support and attention from development agencies and Governments, some SACCOS and CFIs have successfully continued to provide efficient financial services to their members and the community at large. They mobilize savings from members and savings received are "repackaged" and used to issue loans to members and other borrowers at prices (interest rates) that have to cover the cost of funds and other operational costs and generate a surplus for recapitalization.

In order to effectively serve a large population and have an impact in the wider financial system, SACCOS need, among other things, to operate with sufficient capitalization. The level of financial capital formation is an indicator of the SACCOS' ability to provide financial services to its members and the community at large. As an indicator of the SACCOS' ability to absorb risk, capitalization enables SACCOS to achieve a safe expansion of their balance sheet assets (loan portfolio and other investments) using deposits and savings entrusted to them while benefiting from good protection (PFCMP, 2007). It is the creation or expansion, through members' savings, deposits and reserves that enables the SACCOS to create productive assets, the result being increased internal capital. By mobilizing members' savings to fund members' loans, SACCOS are proving to be sustainable financial institutions serving a diverse, economically active membership. Nearly US$10.6 billion in member savings of SACCOS in developing countries are invested in loan portfolio exceeding US9.7 billion. Much of the SACCOS' lending portfolios, as high as 70% in some developing nations, go towards micro enterprise sector (Ahimbisibwe, 2007).

In the East and Central African region, there has been a significant increase in number, membership and improvement in the internal capitalization in SACCOS overtime. Data compiled by WOCCU in 2009 indicate that, there were 3996 SACCOS in Kenya with about 3.8 million members, savings amounting to USD 2.75 billion, loan outstanding USD 2.52 billion and assets amounting to USD 3.29 billion. Ethiopia had about 5,975 SACCOS with membership amounting to 477,817, savings USD 88.3 million, outstanding loans USD 12.84 million and assets amounting to USD 99.2 (WOCCU, 2009). Likewise there has been significant growth in membership, assets and capitalization in SACCOS in Uganda. As indicated in Table one, Tanzania has also witnessed a considerable increase in membership and internal capital in SACCOS.

According to Bailey (2001) SACCOS offer and can offer a number of products to their members apart from productive loans;

- **Savings:** This is done through various savings products offered in the SACCO, particulary the liquid savings which permits unlimited number of withdrawals, the semi–liquid with a restricted number of withdrawals per month, and the fixed deposits.
- **Emergency loans:** These are normally extended to meet emergencies. They are normally short-term with relatively higher interest rates.
- **Life and loan insurance:** These are normally offered when one dies of accident or from unexpected incident.
- **Fixed deposits:** This is normally offered for target savers who keep money for sometime until openings arise.
- **Christmas or special occasion savings:** These are offered to merry makers especially during festive seasons.
- **Educational savings:** These are offered to members with school going children to enable them pay school bills with out much bother.
- **Housing loans:** These are intended to help members improve their shelter and sanitation.
- **Funeral insurance:** under this scheme members contribute so as to be offered assistance to enable them make a decent burial and other related services to their-loved ones.

Given the facts availed in the preceding section, it is evident that SACCOS' contribution in the economy and in the financial system, in particular, has been immense. The kind of financial and other services they provide to their members both the poor and the middle class, and the community in general cannot be undervalued. Yet these institutions are faced with multitude of gaps in terms of weak governance structures and low internal capitalization. This calls for significant attention from various stakeholders including governments, academicians, the donor community, development agencies, and researchers to look into ways and options that can help to improve performance of these institutions.

1.2 Statement of the Problem

According to available statistics, Savings and Credit Cooperative Societies (SACCOS) are among the fastest growing financial entities in Tanzania today (PFCMP Module A, 2010). The growth is manifested in terms of membership, savings accumulation, and loan portfolio. For example, by June 2005 there were 1875 registered SACCOS in Tanzania with membership of 254,651; share capital and reserves was Tshs 13.2 billion; savings and deposits amounted to Tshs 31.4 billion; and loan portfolio balance of Tshs 27.2 billion and having issued loans to members amounting to Tshs 54.1 billion (MCM,2005). By 2007 statistics indicates that there were 4338 registered SACCOS with 623,537 members owning shares and reserves reaching Tshs 21.2 billion; combined savings and deposits amounting to Tshs 84.1 billion; outstanding loan portfolio of Tshs 103.1 billion and loan issued amounting to Tshs 179 billion. Table one summarizes the SACCOS data for the period 2005 through 2010

Table 1: SACCO Data 2005-2010

Year	No. of SACCOS	No. of Members	Shares and Reserves (Equity E)(Tshs bil)	Savings (Tshs bil)	Internal funds (IF) Tshs bil	Total Loans Issued(LI) Tshs bil	Outst. Loans (LO)Tshs bil.	Capitalization Ratio (E/LO)
2005	1875	254651	13.2	31.4	44.6	54.1	27.2	48.5%
2006	2028	291344	18.5	49.1	67.6	N/A	74.0	25
2007	4338	623537	21.2	84.1	105.3	179	103.1	20
2008	4780	713699	26.6	107.4	134.0	N/A	137.1	19.4
2009	5330	819492	32.7	145.0	177.7	380.1	188.3	17.4
2010	5257	933090	33.3	212.3	245.6	553.3	229.8	14.5

***Source:** MAFC Statistics 2005-2010 and analysis of collected data*

Given that the major asset in SACCOS is the outstanding loans; the capitalization ratio has been computed as a ratio of Equity (E) to Outstanding Loans (OL). This ratio has consistently been falling from 48.5 percent in 2005 to 14.5 percent in 2010. The falling trend indicates a serious danger on the ability of SACCOS to absorb potential losses that may arise from loan defaults.

Moreover, given the fact that the average increase in membership in SACCOS has been over 266 percent during the period, there is a mismatch between the growth of SACCO membership on one hand and the rate of capital formation per member on the other.. A number of studies have been done on the effects of decreasing internal capital in Agricultural Marketing Cooperatives (see FAO study, 1999). However, what is not clear are the factors and internal processes that lead to low capitalization and the factors that contribute to capital formation in SACCOS. This study intends to explore the major factors affecting internal capital formation in SACCOS in Tanzania using data from 49 SACCOS.

1.3 General and Specific Objectives

1.3.1 General Objectives of the Study

- The general objective of this study was to investigate major factors affecting SACCOS internal capital formation processes in Tanzania

1.3.2 Specific Objectives

Specific objectives of the study were:

- To examine factors that contribute to capital formation in SACCOS
- To explore methodologies and strategies applied by SACCOS in improving internal capital formation.

- To examine the effect of financial linkages and networking relationships on SACCOS' internal capital formation

1.4 Research Questions

This study was guided by the following research questions

- What are the factors underlying the internal capital formation in SACCOS?
- What are the strategies and methodologies applied by SACCOS to improve internal capitalization?
- To what extent are the financial linkages and networking contributing to internal capitalization in SACCOS?

1.5 Justification of the study

As an indicator for growth, stability and increased ability to serve its members, the rationale for effective capital formation in SACCOS is now very critical. Most SACCOS have failed or have remained stagnant partly due to negative or sluggish capital formation processes. Even those which survive have not been able to grow to keep up with the pace of members' expectations. This study is justified as it intends to examine the major determinants of capital formation in SACCOS.

1.6 Working definition of Key Terms

Capital formation: For the purpose of this study capital formation refers to the increase of SACCO's share capital, savings and reserves, or simply internal capitalization.

Linkage Banking: Is a business partnership between a regulated financial institution (bank, credit institution, or microfinance deposit-taking institution) and one or many independent, non-regulated institution(s), such as Savings and Credit Cooperatives (SACCOS) or credit-only MFIs.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This part makes a review of concepts and theories related to the research problem. It also makes a survey of literature related to previous research findings with the aim of establishing the theoretical and empirical base of the study. First, we briefly provide the theoretical base of the study before embarking on empirical studies

2.2 Theoretical Overview

2.2.1 The Concept of Capitalization in SACCOS

Savings and Credit Cooperatives (SACCOS) like any other financial service providers need adequate capitalization in order to effectively serve their members and remain financially stable in the market. Capitalization in SACCOS signifies its financial stability and capacity to serve its members more effectively. It is one of the best measures used to evaluate the ability of a SACCO to absorb financial risk, and also forms a component of the financial institutions capital structure (PFCMP, 2007). SACCOS capitalization takes into account the following components: equity share issued and subsribed, surplus and reserves. It represents for the SACCO a safe financial reserve that does not generate any loan cost. PFCMP (2007) argue that in order for a financial institution to achieve a safe expansion of its balance sheet, it must possess adequate capitalization in order to provide adequate protection to deposits entrusted to it. The elements that make up capitalization are all items that distinguish themselves as non-cost-incurring liabilities. Also, it is all of the permanent or long-term resources that confer good stability upon the SACCO. Thus, in the event loan losses lead to an operating deficit, the institution will draw on its equity or its capitalization. If the latter is already low, inadequate protection for the members' deposits will ensue. Capitalization is, therefore, the institution's financial foundation. Capitalization is measured in terms of the capitalization ratio, thus:

$$\text{Capitalization ratio} = \frac{\text{Equity} \times 100}{\text{Total assets at balance sheet date}}$$

This ratio should be greater than 10% and be on the rise or stable after the threshold of 10% has been attained. Capitalization may be increased by a rise in the number of equity shares issued, surpluses generated by the institution's operations, as well as by increasing reserves.

While there is plenty of literature on corporate capitalization and capital formation, little is available on cooperative capitalization. In most literature, capitalization connotes the sum total of corporation long term debts, stock and retained earnings. It also refers to the market price of the entire company calculated by multiplying the number of shares outstanding by the price per share, also called market cap or market capitalization (www.investorword.com/714/capitalization.html 18/08/2011). Thus, for most businesses the goal of financial management is to use funds efficiently in order to increase the value of the invested capital. These definitions fall short of the cooperative concept as cooperative shares cannot be valued on the basis of market prices just like corporate shares. Moreover, the fact that shares in cooperatives are subject to member withdrawal, some writers have called it share savings instead of share capital. Only the statutory reserves, other capital reserves and undivided earnings are considered the cooperative capitalization components (see Jim Jerving, 1989).

The goal of financial management in SACCOS differs from that in a corporate firm. While the goal in the corporate firm is to maximize the value of shareholders' wealth, the goal in SACCOS is to use members' savings wisely and efficiently so that the surplus generated is used to offer better services such as low cost loans as well as fair rates of return on savings (Jerving, 1989). Jerving (1989) further asserts that, as a financial institution, a SACCO operates with implicit trust that the money deposited will be safe and wisely managed. Once there is mismanagement blemishing that trust, depositors and savers will likely take their money elsewhere. Under such circumstances, pleas for member loyalty or cooperative philosophy will never save a soiled reputation. Thus, SACCOS' management and the board have to maintain a good and unquestionable reputation of the SACCOS if they want to attract and maintain a solid SACCOS capitalization.

As indicated before, it is important to note here that the issue of capitalization in SACCOS and in other cooperatives has been controversial in literature and in practice due to its fragile nature arising from lack of permanency. One school of thought have it that, despite its vulnerability to member withdrawals, share capital should remain part of equity because it is not practicable for all members in cooperatives to demand withdrawal of their shares at the same time unless the SACCO is winding up. Apart from that, SACCOS like other cooperatives maintain share transfer reserve fund which takes care of share capital withdrawals by the leaving members. The other school of thought oppose the idea on the ground that share capital in SACCOS is vulnerable to withdrawal by members in a similar fashion like members' savings, hence it is more of a liability rather than part of equity. According to this school, it is incorrect to call it part of the SACCO equity. Some writers including Jerving (1989) call it share savings, hence constituting the liability rather than equity capitalization. While the controversies surrounding the nature and structure of capitalization are pertinent and cannot be underrated, this study is not going to be bogged down by these differences. What is important to note here is that SACCOS like other cooperatives are inherently seeking to be independent and autonomous, thus they have to strive to build up internal capital through internal accumulation mechanisms regardless it is through issue of shares, accumulation of surpluses, or savings mobilization. Therefore, when looking at SACCO capitalization in a broader perspective, apart from equity capitalization, SACCOS need to mobilize "compulsory" and "voluntary" savings from members in order to build up an internal capital that would serve as a sustainable source of loanable fund and an engine for financial stability

2.2.2 Agency Theory and SACCO Capitalization

In a situation where there is separation of ownership from management, there is a potential conflict of interest between the two stakeholders. While ownership in public companies and cooperatives is widely spread, management of the business rests in the hands of a few managers who may not have a significant proportion of shares in the business. This can give rise to what is called 'managerialism' or self serving behavior by managers at the expense of the owners. Accordingly, managers may be more concerned with their own welfare than that of the owners, but doing just enough for the owners to prevent awkward questions at board meetings (Kaijage & Tarimo, 1998). In cooperatives, the separation between the board and management is somewhat blurred. Jerving (1989) points out that in many cases in SACCOS the board may be doing the management functions. However, there is a clear separation between board/management on one hand and members on the other hand. While it is true that members of the board are also SACCOS members, this does not guarantee that there is no managerialism behavior in cooperatives. In fact the lack of clear separation of functions between the board and management increases the risk of managerialism behavior because it becomes easier for the two governing organs to collude at the expenses of members. There are numerous examples of managerialism in cooperatives whereby board members/managers have been involved in rampant corruption and mismanagement of SACCOS funds leading to collapse of many SACCOS. Furthermore, expense preference behaviors such as perquisites related to splendid offices, posh cars, and much other private lavish expenditure are common. Such board members/managers have tended to pursue low-risk survival strategies and are not ready to make hard or high-risk decisions that can be beneficial to members for fear to be exposed. The Board/Management has had almost a free hand in using the money in the way they have considered best. Members have remained a mass of largely passive capital suppliers, whose ownership and autonomy has not been respected adequately. With such kind of expense preference behavior, it becomes difficult to mobilize members' savings for internal capitalization. Moreover, expense preference behavior leads to high cost of operation that generates long term losses which eats into capitalization.

2.2.3 Linkage Banking and SACCO Capitalization

Unlike the case of mergers and acquisitions, linked institutions remain distinct, independent firms. Common components of linkage banking include:

- **Financial Services:**
  Often the first step in establishing a linkage banking partnership involves use of the financial services of the bank by the SACCO or its clients. Frequently, the two parties negotiate more favorable terms for the SACCO, in exchange for the amount of business that the bank will gain. Both partners can use this arrangement to establish mutual trust and confidence. For example, a bank may offer loan capital to a partner SACCO, and at the same time manage any excess funds that the SACCO may have. On the other hand, looked positively, external financing offers a new means of outside control over the SACCO and puts pressure on co-operative management towards improved capital investments and effective management.

- **Capacity building:**
  The regulated institution can offer capacity building to its partners in the form of training, apprenticeships, and employee exchanges. These can be in such areas as accounting, internal controls and audit, treasury management, customer service, and human resource management. The SACCO benefits from low- or no-cost training, while the bank is building the institutional capacity of its partner, hence lowering its risk. Services that the bank offers will be low cost to the bank, but of high value to the partners.

- **Back Office Coordination:**
  As the relationship becomes more advanced, the bank may take on some of the SACCOS' back-office tasks, such as IT or accounting, on a fee basis. This saves the SACCO from making expensive investments in these areas, while allowing it to benefit from the bank's expertise and scale. The bank can leverage its existing capabilities to gain an additional source of fee income.

- **Co-branding of savings and electronic banking products:**
  Once sufficient trust has been built, the bank may allow the SACCOS to offer some of its products on a co-branded basis. The SACCOS benefits from a wider product offering (critical in times of increasing competition), while the bank gets a wider distribution network without adding "bricks and mortar". Also, the bank's brand can penetrate into areas where future customers live.

- **Agency relationship:**
  Depending on regulatory constraints, the SACCOS may act as an agent of the bank, offering its services on an agency basis. This is one step beyond co-branding, as customers may not even realize the difference between SACCOS-managed product and a bank-managed product.

- **Equity stake:**
  To ensure continuity and a degree of control, the bank may wish to take an equity stake in the SACCOS. This can give the bank a seat at the table for all major decisions, and ensure that the goals of the partners continue to be in harmony. Alternatively, but less likely, the SACCOS might take part ownership in the bank, to ensure that it remains the bank's preferred partner.

While there are many benefits to a successful linkage banking partnership, the partners need to have confidence in each other. The bank is taking on reputation risk, particularly if the SACCOS is offering products on its behalf. Likewise, the SACCOS is taking on the risk that the bank will find a different partner, leaving it without valuable services on which it has come to depend. Also, the bank could eventually enter into direct competition with the SACCOS after using the partnership to learn its business.

2.3 Empirical Studies

In this section we try to review a brief empirical studies related to internal capitalization in SACCOS. Much of the reviewed literature and studies done have concentrated on savings mobilization and very few to SACCOS internal capital formation. Although the two concepts are related to a great extent, only a few studies have tried to link the two. For example, a study done by FAO (1999) in Kenya on capital formation in Coffee and Dairy Cooperatives indicated a strong relationship between members' savings and the ability of the Cooperatives to increase their capital. The study also revealed an increasingly serious liquidity and capital shortage in most of the cooperatives in developing countries. While these findings were reflecting weaknesses in Agricultural Marketing Cooperatives, they were also relevant to SACCOS.

Ahimbisibwe (2007) asserts that cooperatives, regardless of their type, need to generate their own internal funds in order to remain autonomous, maintain their identity and serve their members more effectively. By mobilizing members' savings to fund members' loans, SACCOS are proving to be sustainable financial institutions serving a diverse, economically active membership. Internally generated savings provide an independent and sustainable supply of funds, which can be invested in rural production, housing, micro enterprise and small business loans. As observed by Magill (1994) SACCOS are intermediaries between surplus and deficit spending membership (units). Hence, they link those with surplus inevitable funds with those in need of funds (the borrowers). However, SACCOS' capacity to increase outreach in quest for greater impact creation in the communities has been derailed, simply because, there are insufficient loanable funds due to low levels of savings as borrowers require well over and above of what they save.

Ahimbisibwe (2007) further points out that it is common practice that some clients' applications are rejected on the basis of failure to meet minimum savings requirements as as provided for in the SACCOS' lending policies and procedures even though some will have presented reasonable business plans. In connection to that, Garson (1996) asserts that, SACCOS members are expected to develop a saving culture to sustain their SACCOS financially and to fight against dependency on external borrowing which is rather expensive and thus deprive them of the would- have been dividends. Equally important, the World Bank World-wide Inventory of MFIs found that, many of the largest and most sustainable institutions in micro finance industry rely heavily on saving mobilization (World Bank survey, 1995). The survey further revealed that, the ability to effectively mobilize savings depends greatly on the macro economic, legal and cultural environments.

2.3.1 Effect of Co-operative Principles on Internal Capital Formation

The issue of low internal capitalization has been one of the major concerns to cooperators and many development organizations. In particular, researchers have also wanted to investigate the effects of cooperative principles and practices on the cooperative capital formation. 1999 FAO entered into partnership with Turku School of Economics and Business Administration (TSEBA) to look more closely at the behavioral factors affecting co-operative capital formation for coffee and dairy sectors in Kenya. FAO regarded the issue as problematic, not only because of the "not-for-profit" nature of co-operatives which tended to discourage the accumulation of co-operative surpluses for investment purposes, but also because of their adherence to the principles of democratic control based on the "one member one vote" rule and to "limited return on capital" which created other problems for internal member capital formation. Research studies on this topic were conducted in Guatemala, India and Kenya during the period of 1994-95, where various hypotheses regarding co-operative capital formation, member participation and growth were tested mainly by using quantitative research methods. The limitations of this approach became apparent especially in the interpretation of behavioral aspects of capital formation.

The Principle of User-ownership

According to the findings, this principle restricts ownership of a co-operative society to users, persons as those who do not use the services are not allowed to be members, and therefore, shares of cooperatives cannot be traded in a stock exchange for sale to any capital investor. Shares of a co-operative society do not have a market at which members can dispose or sell their shares. The co-operative redeems the shares at their nominal or purchase value when the member withdraws from active use of the co-operative services. The non-marketability of member shares denies the member the right to use his/her share as a means to accumulate capital gain (value) and thus serves as a disincentive in attracting capital (FAO, 1999). The co-operative investor-owner does not obtain similar benefits from his capital investment in the co-operative as he would in an investor-owned firm.

The consequences arising from this practice, according to the researchers, have resulted into the following:

- Increasing agency problem and managerialism: the Board in collaboration with management has almost a free hand in making selfish decisions in using the money in the way they deem best. Members have remained a mass of largely passive suppliers, whose ownership and autonomy has not been adequately respected.
- Members have not invested in the share capital of the co-operatives: partly because the investment does not accumulate exchange value and partly because with only a minimum number of shares the member can gain access to the bulk of services offered by the co-operative.
- A person can become a member with full powers to use all the facilities by buying one share of nominal value irrespective of the net worth of the cooperative per member. Because the cost of new member entry does not change over time in spite of increases in co-operative net worth, new members can join the co-operative at a highly subsidized price, and in a sense become "free riders".
- User-ownership principle assumes that only the active service users are the decision-makers in the co-operative. The membership registers of co-operatives include frequently a high number of passive members (20-50%) which is contrary to the user-ownership principle and does not promote mutuality between active members. For the purpose of redeeming the capital invested by the owners, co-operatives should rather view share capital as a long-term loan. Capital redemption plans are not yet prepared by many co-operatives and require internal profitability. Most in Kenyan cooperatives (and of course in many African countries including Tanzania) have not educated their members on the benefits, which may accrue to them after the active membership period and the need to generate funds consistently from operations in order to pay these benefits.

- **The Principle of Democratic or User Control**
  According to user-control, members participate democratically in decision making in their co-operative according to a one-member, one-vote principle. User-control is important from the democratic control point-of-view. However the principle tends to discourage members with more investments in the cooperative as all members are treated equally regardless of the investment one hold. The long term consequences of this principle have been that some members of the board and management often manipulate some "illiterate or weak" members for their person gain. They will corrupt them in return for a vote. In the surveyed co-operatives in Kenya, two deficiencies in the implementation of the principle of user-control were noted:
  - Cooperative members' funds have in certain cases been mismanaged leading to huge financial losses and loss of confidence. Yet no evidence was found of a single court case of fraud of co-operative funds. The principle of user-control does not extend to the control of the co-operative's funds because of corruption and lack of transparency.
  - A vital group of users does not have ownership or control in the matters relating to the governance of the co-operative society. Women have been recognized by most of the interviewed (members and staff) to be the main users of cooperative services or suppliers of produce to the co-operatives. It is also recognized in this survey that women have priorities, interests and aspirations that are often different from the male-users of co-operatives. Yet women are left out of the decision-making process in the organizations, which rely for their growth and success on the active participation of its suppliers.

- **The Principle of User Benefit**
  The user-benefit principle of co-operation requires that benefits of membership be distributed to user-members equally on the basis of the volume of use. This is often interpreted also as business-at-cost. Business-at-cost is misunderstood to legitimize the common practice of draining a society of its operational funds as has been witnessed in most of the surveyed co-operatives.

Members of consumer co-operatives consider that the co-operative's surplus has been generated only due to overcharging the consumers. Similarly, members of SACCO believe that they have to be charged low interest rates despite the fact that the SACCO has to meet its operational costs and generate surplus for expansion and long term sustainability. The concept of business-at-cost is understood to require that any surplus be paid back to the members in the name of fairness. Members then take the whole surplus out and leave nothing in the organization for future capital investments. When there is loss members do not consider themselves liable to pay an additional fee or pay higher interest on loans to cover for a loss. They go with the attitude "Let the organization suffer, while we take out what we deserve."

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

The research design used in this study was descriptive survey. The study aimed at collecting information from respondents on factors contributing to capital formation in SACCOS taking into account the fact that there has been a growing tendency for members to borrow large sums of money without corresponding commitment to save. The researchers used both questionnaires and in-depth interviews. Both primary and secondary data were used. Primary data was obtained using questionnaire and interviews while secondary data was searched from SACCOS records and statistical reports of Cooperative Department. The study covered a period five years from 2006 to 2010. Previously the study intended to cover from 2005 to 2010 but most SACCO in the sample could not provide the 2005 data.

3.2 SACCOS Sampling

A combination of both purposeful and random sampling was used to select 49 SACCOS from 10 regions of Tanzania. A number of factors contributed to the selection of the sample, namely, easy accessibility, readiness of respondents to provide information and avoidance of bias. To ensure that most areas of Tanzania were represented in the sample, the researchers selected sample SACCOS based on zonal blocks. For the purpose of this study, zonal blocks was established as hereunder and the SACCOS selected were as follows:

Table 2: SACCOS Sampling

Zone	Regions Covered	No. of SACCOS
Eastern Zone	Dar, Coast Region	4 SACCOS
Southern Highlands	Iringa, Mbeya	12 SACCOS
Southern Zone	Ruvuma	4 SACCOS
Central Zone	Dodoma	8 SACCOS
Lake Zone	Mwanza	5 SACCOS
Northern Zone	Kilimanjaro, Arusha and Manyara	16 SACCOS

The 49 SACCOS forming the sample were drawn from 10 regions as follows: Dar 3, Coast 1, Iringa 8, Mbeya 4, Ruvuma 4, Dodoma 8, Mwanza 5, Kilimanjaro 9, Arusha 6, and Manyara 1. The Western Zone which comprises of Kigoma and Kagera regions was not included in the sample. However, since most SACCOS in Tanzania have more or less similar features, the researchers believe that the forty nine SACCOS in the sample drawn from ten regions of the country are a true representative of SACCOS in Tanzania. For details of SACCO distribution per district see appendix 1

3.3 Methods of Data Collection

Both interviews and questionnaires were used in data collection. To save time and money, most target/respondent SACCOS were contacted first to know their readiness to provide information. In some instances the researchers used research assistants such as Cooperative Officers, MUCCoBS Program Officers and PFCMP Tutors to collect information.

Questionnaire

Because it would be very expensive to reach all SACCOS in the sample through face-to-face contact, the researchers used questionnaires especially in those areas which could not easily be reached. The questionnaire contained both open-ended and closed ended questions. They also demanded numerical data to fill in. The questionnaires prepared were then sent to the pre-identified respondents.

Interviews

Both structured and semi structured interviews were used to collect data from respondents. Structured interviews were used to obtain specific information especially those related to numerical data. Using interview guide, semi-structured interviews sought to obtain in-depth information on various factors affecting capitalization. They also enabled the researchers to get feelings and attitudes of the board, management and members on financing arrangements between their SACCOS and other financing organizations.

Focus Group Discussions

In a number of cases the researchers conducted focus group discussions with members and non-members in the selected SACCOS. The purpose of these discussions were to verify the validity of data given by management and board and also get members and non-members feelings about the performance of the SACCOS leadership and management

3.4 Data Analysis

Data analysis involved both qualitative and quantitative techniques. Quantitative analysis involved the use of SPSS software version 12.0 and Excel. Following collection of quantitative data from 49 SACCOS the researches entered the data into the SPSS template. The researchers used key analytical features in the SPSS software such as descriptive statistics, frequencies, graphical analysis, cross-tabulation and correlation coefficient to draw out conclusion for summarization of the finding. Data collected qualitatively through interviews was summarized in tables for easy comparison and conclusion.

CHAPTER FOUR

DATA PRESENTATION AND DISCUSSION OF FINDINGS

4.1 Introduction

This part sets out the major findings of the study making reference to the general and specific objectives of the research. It starts by providing general information on the SACCOS studied. The general information includes the initial data such as age of SACCOS, initial capital and assets. The second part gives the major findings of the study.

4.1.1 Age and other initial Data of SACCOS

4.1.1.1 Ages of SACCOS

Most SACCO in the sample aged between 5-10 years, but others had up to more than 40 years of age. The distribution of age was as follows:

Table 3: Age of SACCOS

Age group	Frequency
< 5 years	11
5 – 10 years	20
11 – 20 years	14
Over 20 years	4
Total	49

***Source:** Survey data*

The youngest SACCO was two years old and the most aged had 43 years having been initiated in 1967. The relationship between age of SACCO and the amount of internally generated capital, and the extent to which the age of SACCO determines the amount of internal capital are discuss in the coming sections.

4.1.1.2 Initial Membership and Capitalization

As regard to initial members, 13 SACCOS or 26.5% of all SACCOS in the sample started with membership of 51-100 members. Only two SACCOS or 4.1% started with over 600 members. Figure 1 below depicts membership groups, frequencies and percentages in the sample. Also for more details see appendix 2.

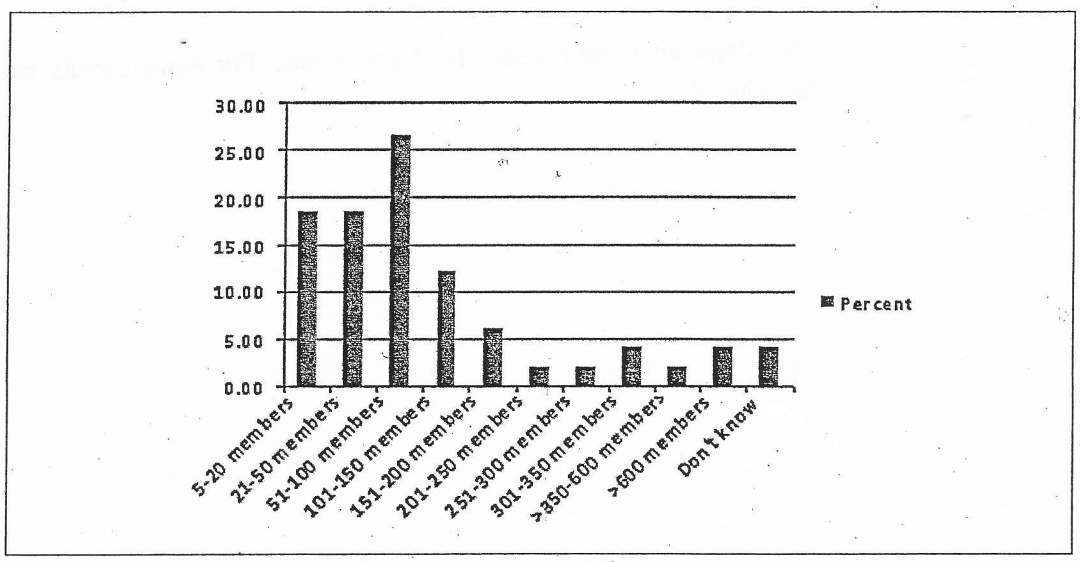

Figure 1: Initial Membership

Of the 49 SACCOS studied, 6 SACCOS started with initial capital of less than Tshs. 100,000 while 6 SACCOS started with initial capital of more than Tshs. 50 million. However 16.3 % of SACCOS, which is highest percentage, started with initial capital ranging between Tshs. 100,000/= to 1 million. Figure 2 below summarize the initial membership and initial capitalization. For more details capital see appendix 3

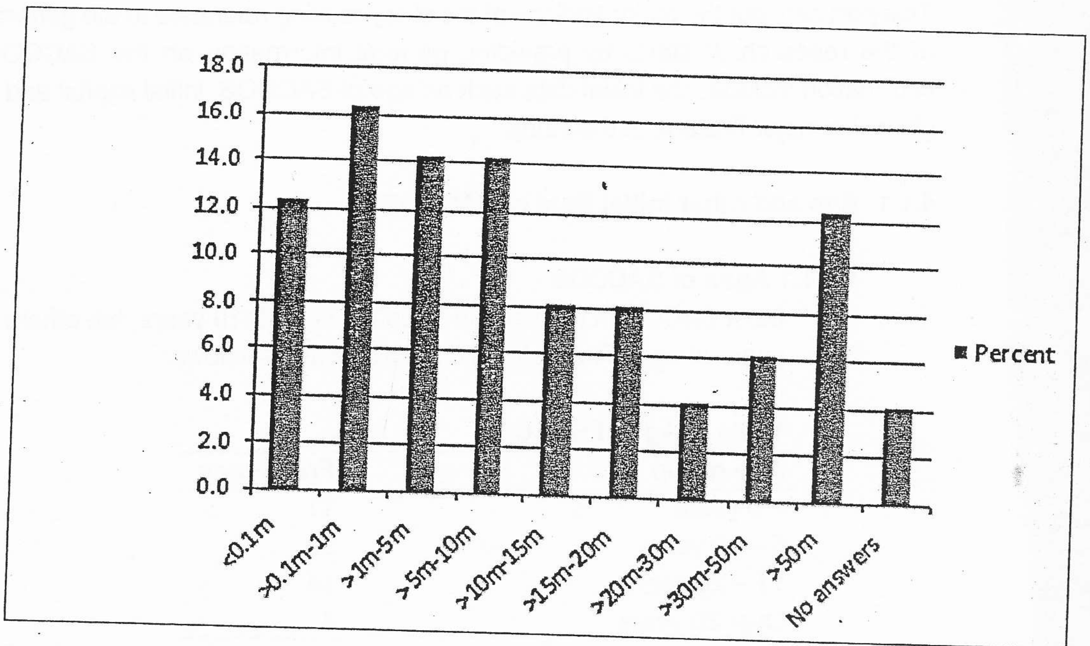

Figure 2: Initial share capital

While the data above may not be sufficient to enable us draw up meaningful implications on initial membership and capitalization, it is still evident that most SACCOS started with too low initial members and capitalization to enable those SACCOS establish a strong financial base for sustainability.

4.1.1.3 Initial Assets

Twelve SACCOS or 24.5% started with short-term assets ranging between Tshs 1m to 10 million while 10 SACCOS (20.4%) started with short –term assets ranging between Tshs 10 million to 50 million. Six SACCOS (12.2%) claim to have started with no short-term assets while six SACCOS (12.2%) started with initial short-term assets to the tune of more than Tshs. 100 million.

The major short-term asset held was cash. For more details see figure 3 below and appendix 4

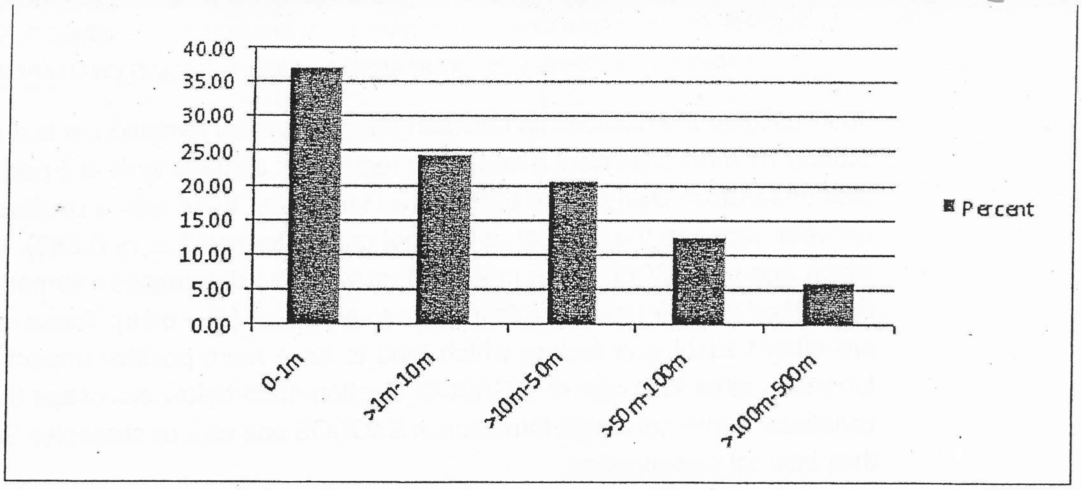

Figure 3: Initial Short-Term Assets

The surveyed SACCOS' initial long-term capital also varied with twelve (12) (24.5%) starting with long-term assets ranging between Tshs. 1 million to 10 millionn, twenty one (21) started with no long –term assets while one (1) had more than Tshs. 100 million of long-term assets. Most of the long-term assets held were non financial such as furniture and office buildings. Very few SACCOS held assets in form of financial investments such as treasury, bills, bonds or shares from other organizations. For more details see figure 2 and appendix 5

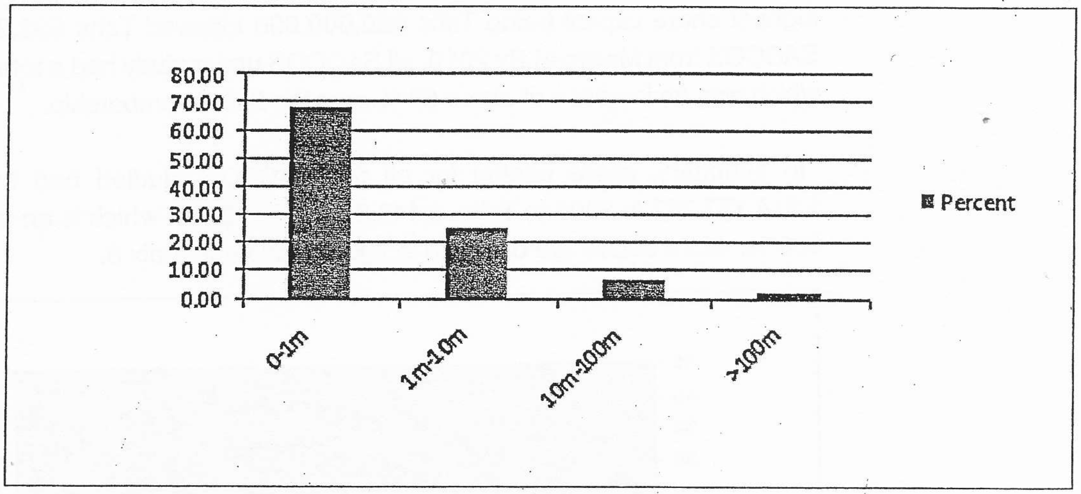

Figure 4: Initial Long Term Assets

4.2 Findings on SACCOS Capital Formation

4.2.1 Introduction

This part provides an exposition of the findings on the status of SACCOS' capital formation for the period between 2006 and 2010 The analysis of capital formation in SACCOS was through the examination of changes and trends of share capital, savings and accumulated reserves (internally generated funds).

4.2.2 Relationship between Age of SACCOS and Capital Formation

As mentioned earlier, SACCOS in the sample had different ages. This study investigated whether there was any linear relationship between the age of SACCOS and the amount of internal capital and to establish the extent to which age of a SACCOS determines the amount of capital formation.

To investigate the relationship between age and capital formation, a test of correlation (Pearson product moment coefficient r) and linear regression analysis tools at 5 percent level of significance was undertaken Using these tools it was found that there was a positive but weak relationship between age and the amount of internal capital formed (i.e. r= 0.283). Moreover, the extent to which age of SACCO (as an independent variable) determines internal capital formation (as a dependent variable) was also found to be very weak (r2 = 0.08). These results tell us that, there are other variables or factors which tend to have more positive impact on the internal capital formation other than age of a SACCO. Section 4.2.5 below discusses the potential factors that contribute to internal capital formation in SACCOS and various strategies SACCOS use to improve their internal capitalization.

4.2.3 Status of Capital Formation during 2006-2010

4.2.3.1 Share capital and membership

Of the 49 SACCOS studied, only 40 SACCOS had started operation by 2006 with a total of 22,441 members. By 2006, there were 11 SACCOS with share capital of less than Tshs. 5 million (out of which five (5) share capital of less than Tshs. 1 million) In 2006 there was no SACCOS with a share capital exceeding Tshs 500 million. By 2010 there were only 6(out of 11) SACCOS with share capital of less than Tshs. 5 million. and none of them with capital of less than Tshs. 1 million. Two SACCOS had share capital above Tshs 500 million (the highest share capital being Tshs 620,000,000 followed Tshs 532,806,000 both held by SACCOS from Mwanza) By 2010, all SACCOS under study had a total of 35,941 members, which was an increase of about 60 % over the 2006 membership.

In summary, share capital for all the SACCOS studied had increased from Tshs. 1,318,777,267 in 2006 to Tshs. 3,440,823,494 in 2010- which is an increase of more than 160 %. More details are depicted in figure 5 and appendix 6.

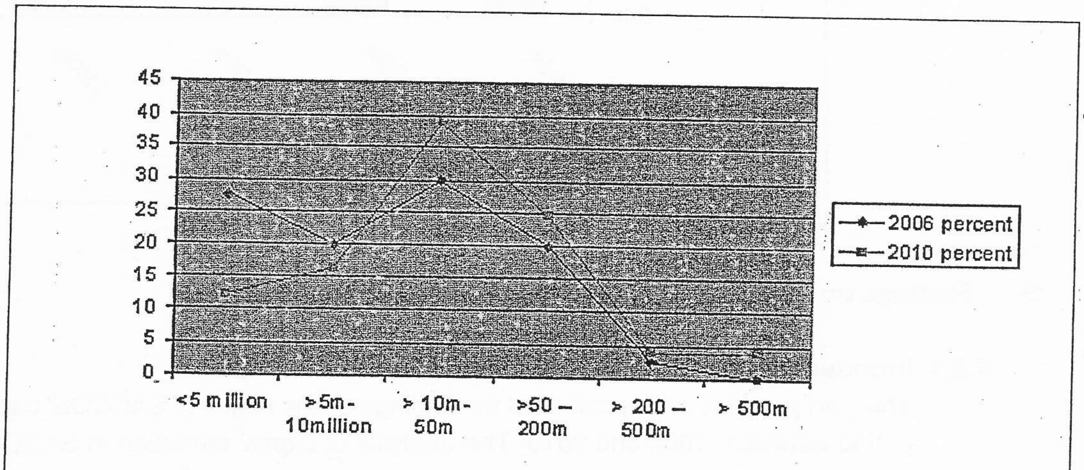

Figure 5: SACCOS' Share Capital 2006 and 2010

As figure 5 indicates, there has been significant increase in capital in term of share capital over the period from 2006 to 2010. The increase in share capital is attributed to a number of factors including the increase of membership and increased effort by SACCOS' leadership to persuade existing members to complete payment of outstanding shares.

4.2.3.2 Internal Capital Structure Pattern for 2006 and 2006

During this study it was revealed that total internal capital for 2006 and 2010 in respect of the SACCOS studied amounted to Tshs 7,768,056,399 and Tshs 24,282,832,290 respectively. This is more than 212.5 percent growth rate over the two periods. Table 4 below provides more details:

Table 4: Internal Capital Structure Pattern for SACCOS

Capital component	2006		2010	
Amount	(Tshs)	Percent (%)	Amount (Tshs)	Percent (%)
Shares	1,318,777,267	17	3,440,823,494	14.2
Reserves	610,066,902	7.9	2,744,217,252	11.3
Compulsory savings	5,839,212,230	75.1	18,097,791,544	74.5
Total	7,768,399	100	24,282,832,290	100

Source: *Survey data*

The table above indicates that in 2006 share capital and reserves (equity capital) comprised only 24.9 percent of the total internal capital structure of the SACCOS while the remaining internal capital structure i.e. about 75.1 percent was compulsory savings. In 2010, equity capital improved just marginally from 24.9 percent in 2006 to 25.5 percent. More details of SACCOS' internal capitalization for 2006 and 2010 are shown in appendix 7.

While the Cooperative Act does not spell out the optimal capitalization structure for SACCOS, common sense tells us that share capital and reserves (equity capital) should occupy a larger percentage of the SACCO capital structure in order to restore permanency and financial stability, given the nature of these institutions. Experience in many SACCO shows that members tend to withdraw their compulsory saving more readily than equity capital (share capital and reserves). In general terms, the pattern of the internal capital structure in the SACCOS studied reflects high level of potential financial risk that may arise from bankruptcy and agency costs (Van Horne &Wachowicz, 1997). It also indicates the extent to which most SACCOS are vulnerable to external shocks due to lack of permanent risk cushioning mechanisms.

In 2006, the lowest amount of internal capital amounted to Tshs. 3,025,000 (KKKT Women SACCO- Dodoma) and the highest being Tshs. 1,333,227,041 (NSSF SACCOS- Dar-es-Salaam). In the same year, 17.5 percent of SACCOS in the sample had internal capital of less than Tshs. 10 million, while 2.5 percent of SACCOS had internal capital greater than one billion. The mean internal capital for all SACCOS in the sample was Tshs. 213,098,660.

For 2010, the lowest internal capital was Tshs. 14,563,300 (KKKT Women SACCOS-Dodoma) , the highest was Tshs. 3,182,614,761 (ELCT-ND SACCOS) and none with less than 10million.. 14.3 percent of surveyed SACCOS had internal capital ranging between 10 million and 50 million and 16.3 percent than Tshs. 1 billion. The mean internal capital in 2010 amounted to Tshs. 537,989,783, which is an increase of 152 percent over the 2006 internal capital.

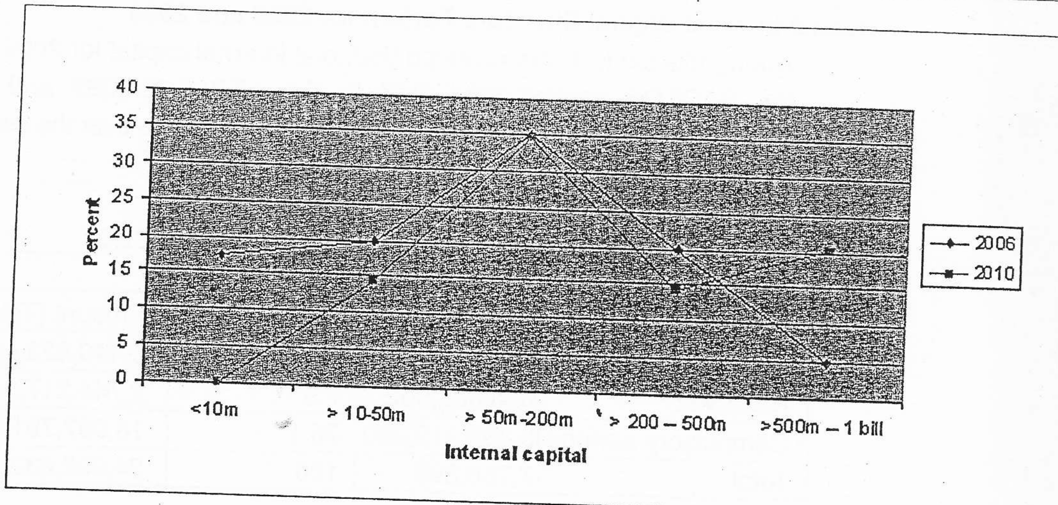

Figure 6: Internal capital during 2006 and 2010

As it can be observed in figure 6, there has been a significant shift of the graph to the right indicating that more SACCOS have increased their internal capital in 2010 as compared to 2006.

A number of factors have contributed to the increase in internal capital in 2010.

The increase in membership 22,221 in 2006 to 35,941 in 2010 prompted an investigation of the relationship between membership in SACCOS and the amount of internal capital formed. In this regard, a test of the correlation was undertaken (Pearson product moment coefficient r) and linear regression analysis tools at 5 percent level of significance. Using the tools it was found that there was a positive but weak relationship between number of members in SACCOS and the amount of internal capital formed (i.e. r= 0.4). Furthermore, the extent to which the number of members in SACCO (as an independent variable) determines internal capital formation (as a dependent variable) was also found to be weak (r2 = 0.16). These results tell us that, apart from the number of members, there are other variables or factors which tend to influence internal capital formation in SACCOS.

Because of increasing demands for loans by members, SACCOS have also been demanding an equivalent proportion of compulsory savings in order to increase their loanable funds and security for the loans. Thus, in order to qualify for larger loans, there has been individual effort and pressure on the part of members to increase compulsory savings, a factor that has contributed positively to increased internal capital formation during the period. Other potential factors that might have contributed to internal capital formation are discussed in section 4.5

4.2.4 Internal Capital vs. Outstanding Loans

For the year 2006, total outstanding loans (for all surveyed SACCOS) amounted to Tshs. 9,170,892,060 while the corresponding internal capital amounted to Tshs. 7,768,056,400 (see table 4). Given that major assets in SACCOS are outstanding loans, it implies that 84.7 percent of the outstanding loans were financed from within the SACCOS themselves. By 2010, total outstanding loan had jumped to Tshs. 31,712,314,744 (an increase of 245.8 percent when compared to 2006). The corresponding internal capital in 2010 amounted to Tshs. 24,282,290 indicating that only 76.6 percent of the outstanding loans were financed from within SACCOS compared to 84.7 percent in 2006. Although the capitalization ratios are still high as compared to the industrial standard of 10 percent (PEARL Ratios), the declining capitalization ratio between the two periods indicates a decreasing capacity of SACCOS to absorb potential losses that may arise from default or from unpredictable business failures. Furthermore, it impliedly indicates an increasing dependence on external funding between the two periods. Details of outstanding long term loan between 2006 and 2010 are indicated in the Table 5 below:

Table 5: Internal Capital as a percentage of Outstanding Loans

Year	Shares Tshs	Reserves Tshs	Savings Tshs Capital (IC)	Total Internal (LO)	Outstanding Loans	Ratio (%) 1C/LO
2006	1,318,777,267	610,066,903	5,839,212,230	7,768,056,400	9,170,892,060	84.70%
2007	1,442,341,492	937,431,688	10,110,092,271	12,489,865,451	17,171,102,936	72.74%
2008	2,347,111,070	1,218,051,380	10,601,620,956	14,166,783,406	20,211,091,663	70.09%
2009	2,444,992,273	1,773,536,450	12,145,540,124	16,364,068,847	23,882,985,813	68.52%
2010	3,440,823,494	2,744,217,252	18,097,791,544	24,282,832,290	31,712,314,744	76.57%

Source: *Survey data.*

Despite the huge volume of outstanding loans that are in the hands of member-borrowers, members in many SACCOS continued to complain that their demands for loans were not adequately met. During interviews with some members, it was revealed that several of them had up to 20 million loans in arrears, and yet they wanted to borrow more new loans. While it is difficulty to verify whether members' loan demands were actually economically justified, it was obvious from the data; save for a few SACCOS, that many SACCOS could not meet those demands using internally generated loanable funds. Unfortunately some SACCO leadership, probably because of hunting for cheap popularity or lack of nerve to tell the truth to their demanding members, have found themselves resorting to taking unnecessarily huge loans from banks . For example, one SACCO in Kilimanjaro with only about 800 million in internal capital had outstanding bank loans of more than 4 billion as of December 2010. Some of the borrowers have left the place and others have died, leaving the SACCO with very minimal hope to recover those loans.

An interesting observation was the fact that some borrowers, despite their low commitment to save in SACCO, they owned seemingly profitable business and others were employees with good net pay balances. Their net balances were either reinvested in their businesses or retained in banks, yet they were reluctant to transfer those savings into their SACCOS in order to increase their entitlement for borrowing. When asked why they were not ready to transfer their savings into the SACCO, their response was clear: they did not trust the leadership and management of their SACCOS. Impliedly, they wanted to use their SACCO as mere conduits for getting loans. Further empirical verification through interviews and focus group discussions with some SACCOS management and members indicated the following reasons for apparent relative low commitment to save in SACCOS (which boils down to low capacity of SACCOS to meet loan demands):

- Some members had very low confidence to the incumbent leadership and management. They doubted the ability of those leaders to safeguard members' savings. Those members felt safer to rather borrow first and repay later rather than save first and borrow later in such a risky SACCOS
- Other lenders such as financial NGOs and commercial banks with a microfinance window did not require one to save first before getting a loan. Some members, because of their lack of understanding or refusal to accept the philosophy of "save before you borrow" would like to turn the SACCOS into a "credit only" microfinance institution or a bank.
- Some SACCOS, through linkage banking with some commercial banks such as CRDB Bank and National Microfinance Bank (NMB) have been receiving huge loans from those banks. By doing so they have created a "savings-killing" culture in SACCOS as members have relaxed in terms of contributing to internal capital.

- Some respondents were putting their blames to the conservative cooperative practices such limited return on share capital and equal voting rights regardless of the varying interests and risks members have in a SACCOS. They also blamed the existing weak regulatory framework and the weakened Cooperative Department for not being able to safeguard their savings in case the leadership misappropriates their money.
- In some cases it was obvious that members of SACCOS could not raise enough money to save. While members were seemingly committed to their SACCOS, they did not have enough surpluses to save as they were living at subsistence level.

4.2.5 Factors and Strategies for Internal Capital Formation in SACCOS

4.2.5.1 Introduction

This study also explored major factors that contribute to capital formation in the sampled SACCOS. Respondents, based on their experience and practices, were asked to identify various critical aspects that could SACCOS build a strong internal capital without necessarily committing itself to easy but expensive external borrowing. Furthermore, respondents were also asked to indicate the strategies used by their SACCOS in mobilizing internal capital such as shares and savings.

4.2.5.2 Factors for Internal Capital Formation

Through in-depth interviews and discussion, members were required to identify factors and rank them according to how they see their importance. The identified factors were then sorted, tallied and then ranked based on the frequency with which were they were identified. The following aspects in the table below summarizes the major factors identified as critical for internal capital formation in SACCOS

Table 6: Factors for internal capital formation as identified by respondents

S/No.	Factor	Frequency	Percentage
1	Leadership with integrity and commitment to serve members in a transparent manner	25	30.9
2	Well informed membership with cooperative education and business management	19	23.5
3	High quality services and simplified methodology that avoids unnecessary delays	16	19.8
4	Engagement of Professional Staff and effective working facilities to improve efficiency and image	6	7.4
5	Pay positive return on shares, savings and deposits	6	7.4
6	Reduce dependence on external borrowing	5	6.1
7	Build networks with SACCOS and other credible financial institutions	2	2.5
8	Initiate new financial products to meet members financial needs	2	2.5
	Total	81 [1]	100

***Source:** Survey data*

From the table it is observed that good leadership and well informed membership were identified as highly ranked factors that contribute to capital formation in SACCOS, while building networks and introduction of new products are ranked least.

Although the identified factors are yet to be empirically tested, to allow for generalization of the findings, they reflect the perception of members on .capital formation aspects. It is true that SACCOS must have good leadership in order to build confidence of members as a condition to

1 The number exceeds 49 because of multiple responses

attract members' savings. However building networks among SACCOS and introduction of new products are equally critical in influencing capital formation in SACCOS. Moreover, as it has been established in the preceding sections, age of a SACCO and number of members in a SACCO have significant influence on capital formation. Thus, the identification and ranking of the factors may cast some doubt on the accuracy of the factors. Nevertheless, they provide grounds for further empirical studies.

4.2.5.3 Strategies used by SACCOS to mobilize Internal Capital

In their effort to create internal capitalization, SACCOS have been utilizing various methods and strategies. Respondents were asked to identify and rank those strategies. Table 7 provides a summary of the strategies employed by SACCOS to mobilize internal capital.

Table 7: Strategies used by SACCOS to mobilize Internal Capital

S/N	Capitalization Strategy	Frequency	Percentage
1	Mobilization meeting to attract new members and persuading existing members to increase their shares and savings	45	52.3
2	Giving incentives such as repeated higher loans for those who show high discipline in loan repayments, pay dividends etc	12	14.0
3	Assuring demands for loans are met as much as possible without delay	9	10.5
4	Developing new products that meet emerging members demands (fixed deposits, emergency loans)	8	9.3
5	Making close follow up on loan repayments	8	9.3
6	Investing excess funds into profitable investment	2	2.3
7	Promotional activities including advertising the SACCO activities and provision of community services	2	2.3
	Total	**86** [2]	**100**

Source: *Survey data*

It was established that meetings and providing incentives to members were highly ranked as major strategies SACCOS use in mobilizing internal capital while investments and promotional activities attained the lowest ranks. As discussed before, the identification and ranking of the strategies provide a springboard for further empirical studies to test their validity.7

4.2.7 Linkage Banking and its impact on SACCOS' Internal Capital Formation

It has been argued that SACCOS need to form networks among themselves and even with other non-SACCO financial institutions as a measure to secure cheap funds that may help generate surplus for long-term internal capital formation. Apart from funding, these relationships can support capacity building in term of training and working facilities.

Based on these arguments some SACCOS have entered into financial relationship with various financial institutions, financial NGOs, government sponsored lenders etc in order to secure external funding to supplement their internal capital. The major question, however, has been: Have these relationships helped SACCOS to improve their internal capital, and particularly generating long-term benefits that will enhance the capital base of the SACCOS?

SACCOS were asked to tell whether they have any financial or business relationship with other financial partners. Table 7 below indicates the financial partners with SACCOS

2 The number exceeds 49 because some SACCOS had multiple responses

Table 8: SACCOS Linkages with other Financial Partners

Financial partner	Frequency	Percentage
CRDB Bank	15	21.7
NMB	9	13.0
SELF	12	17.4
SCCULT	8	11.6
DUNDULIZA	7	10.1
PRIDE	5	7.2
Other Financial NGOs	2	3.0
SACCOS	2	3.0
No Relationship with any	9	13.0
Total	**69** [3]	**100**

Source: Survey Data

As indicated in Table 7, CRDB Bank was the most popular partner followed by SELF and then NMB. Only 3 percent of the SACCOS said they had financial relationship with other SACCOS. For those SACCOS which had relationship non-SACCO partners alleged that the major benefit out of those relationships was the loans from those institutions. The major lenders in this case were CRDB Bank and NMB Bank, which are commercial banks. PRIDE and SELF have also been lending to SACCOS. Others benefits mentioned, especially derived from relationship with CRDB Bank was capacity building in term of training and provision of working facilities such as office equipment (safes, calculators) and office furniture etc. Moreover, these relationships had helped to boost the image of SACCOS when they partner with banks with big bank names such as CRDB Bank. However, most SACCOS in those relationships complained of high interest rates changed on loans. They further complained that, while they were doing the donkey job of loan follow ups and sometimes using SACCOS' funds to repay the bank loans on defaulting borrowers, the lenders have always been harsh to get all their money back without taking into account the additional follow up cost the SACCOS incur. Moreover, SACCOS were using most of the management time to follow up loans in order to ensure the money is paid back, but the lenders were just sitting in their offices waiting for monthly repayment cheques. Furthermore, the interest spread the SACCOS receive from loans obtained for on-lending, could not adequately meet all the cost involved in those loan transactions. It was further revealed that the existence of external loans for on-lending has undermined SACCOS effort to mobilize internal funding since members see no logic in savings if funds can be obtained elsewhere..

There has also been doubt as to the relevance of the type of training carried out by the lenders. The doubt has been based on whether such training takes on board the cooperative philosophy. Moreover, the lenders have been taking advantages of the weak position of the SACCOS. They have also been more profit-focused rather than concentrating first at building capacity of these SACCOS. Generally most SACCOS feel that the disadvantages arising from these relationships highly outweigh the benefits and have had a negative effect on internal capital formation efforts.

Derived from the preceding discussion it can be inferred that these relationships have failed to produce desired results due to SACCOS' weak bargaining power and capacity. Some of the identified reasons for weak bargaining position are:

- Poor education and lack of financial skills on the part of SACCO leadership that fail to interpret the consequences of the loan contracts
- Non-participatory approach in loan application procedures that fail to involve members including telling them the consequences of such loans contracts
- Personal Interests of leaders and management who looking for cheap popularity and at the same time involving themselves in misappropriation of loaned funds

3 Some SACCOS had multiple relationships

- Conspiracy between SACCO leadership and the lending partners to benefit themselves at the expense of the SACCOS and members.

Another interesting finding was that only a few SACCOS had relationships among each other. In fact 13 percent did not have relationship with any partners, including other SACCOS. It was not clear why there was such minimal relationship among SACCOS. As it has been emphasized before, It Is beneficial for SACCOS to establish relationships among themselves as such relationships facilitate networking. SACCOS networking are important to help SACCOS obtain new services that are too costly to be borne by a single SACCO (PFCMP Module B, 2007). Networking can also help SACCOS create a common fund such as the Central Finance Facility (CFF) where SACCOS could deposit their excess liquidity and borrow when they need. Networking could also be used for joint lending especially when one SACCOS as a lender cannot afford to finance a big loan demand, a concept known as loan syndication (Kaleshu, 2007)

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary and Conclusion

The study sought to explore and analyze the processes behind internal capital formation in SACCOS. Specifically the study examined the factors that contribute to capital formation and the strategies and methodologies used by SACCOS in raising internal capitalization. Furthermore the study examined the ability of the SACCOS to meet demands for loans and their financial capacity to absorb risks that may arise from loan defaults. Forty nine SACCOS from ten regions in Tanzania were involved in the study. The study used survey approach and covered the 2006 to 2010 period.

The study found that despite the fact that internal capital has grown significantly at an average of more than 152 percent between 2006 and 2010, it has not been adequate enough to meet demand for loans from members. Moreover, the extent to which the internal capital could absorb potential losses arising from default has been decreasing overtime, exposing SACCOS to both operational and financial risks. The major factors contributing to low internal capital are: leadership in SACCOS that lack trust from members and potential members; existence of competitors who provide loans without the need for borrowers to save first; availability of huge amount of funds from commercial banks leading to systematically weakening the internal drive to save; practices and attitudes inherent in cooperatives which de-motivates members from additional investment and savings ; and subsistence livelihood which fails to generate enough disposable surplus for savings.

It was also revealed that major factors that contribute to internal capital formation include leadership with high level of integrity and commitment to serve members; well informed membership who actively participates in the affairs of the SACCO and who manage their business efficiently. It was further also found that, SACCO use meetings and various incentives as major strategies to mobilize internal funding.

It was further revealed that the financial linkage among SACCOS was almost non-existent. However most SACCOS studied had established financial relationship with commercial banks and non- banking financial NGOs'. Many SACCOS complained that their partnership with commercial banks ~~have~~ had left them highly indebted to those partners as a larger part of loans which were extended to members have not been repaid. In some cases, SACCOS had to use their internal funds to repay the defaulted loans, hence depleting their internal capital. Generally the linkage between SACCOS and external funding has not assisted many SACCOS to improve their internal capital formation.

5.2 Recommendations

Based on the findings it is recommended as follows:

- SACCOS should strengthen their governance structures. To start with, members must elect leaders who have integrity and who can win the confidence of savers, a condition which is critical for internal capital mobilization.
- SACCOS need to engage professionally qualified staff , acqure and utilize better working facilities so as to increase efficiency in service delivery and create confidence of the members.
- In order to restore a culture of internal, SACCOS need to balance between loans from outside and internally generated capital. SACCOS also need to discourage loan applications which are driven by the existence of loan funds from banks and other fund suppliers, who in most case aim for profiteering and take advantages of the weakness of SACCOS.
- SACCOS also need to forge financial relationship amongst them through networking. This can be done by establishing a central finance fund whereby all SACCOS in the network can contribute towards this fund and use this fund to access credit. SACCOS can as well use their relationship to create sustainable networks and undertake joint loan financing or loan syndication.

- The Government needs to improve its legal and regulatory framework by establishing laws that will protect depositors' money in SACCOS and by recruiting competent inspectors to improve SACCO oversight.
- The SACCO regulations should set the minimum internal capital requirement for SACCO before being registered and allowed to operate. Sources of capital should also be clearly spelt out.

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