TANZANIA EXPORTERS ASSOCIATION

(T A N E X A)

RECOMMENDATIONS

FOR IMPROVING THE CREDIT GUARANTEE SCHEMES

Dar es salaam, September 2010

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Foreword

Statistically, Tanzania is one of the poorest countries in the world, and one of the most dependent on international financial support. Agriculture is the dominant economic sector, catering for 80–85% of the population, but incomes to most small farmers and farm workers are low and unstable. Coffee, tea, cotton, tobacco and other commodities that are vulnerable to fluctuations in international markets dominate agricultural exports.

Like in most Sub-Saharan countries the formal economy is declining, partly due to inefficiency and lack of profitability in production. Most informal sector operators are solely targeting their local market, joint distribution and marketing efforts are absent and individual ambitions are limited to the generation of enough income to feed the family and cover other family expenses. Massive economic and technical support from the international community over several decades has not given the intended results in terms of reduced dependency of foreign support, economic growth and reduced poverty. This, however, does not mean that Tanzania lacks a basis for prosperity: the country is one of the most politically stable in Africa; it is rich in natural resources, has an advantageous geographical location and access to important export markets. Thus, the explanation for the unfortunate situation must be sought elsewhere. Lack of finance to support production and export undertakings particularly, collateral to obtain loans from Commercial Banks under the existing procedures and conditions stand forward as one of the major influencing factors.

RECOMMENDATIONS FOR IMPROVING THE CREDIT GUARANTEE SCHEMES

1.0 INTRODUCTION

Tanzania Exporters Association (TANEXA) is a private, non governmental Apex Association, which serves as a focal point for uniting and giving voice to Tanzanian exporters. However, over the years one of the major challenges that association members have been facing is lack of a clear and steady source of finance to support their production and export undertakings. In particular, most exporters do not have the required collateral to obtain loans from Commercial Banks under the existing procedures and conditions. In order to address this issue, in the mid 2000's the Government introduced the Export Credit Guarantee Scheme (ECGS) and the Small and Medium Enterprises Credit Guarantee Scheme (SME-CGS), both aimed at enabling borrowers with weak collateral to access loans through financial institutions which would in turn be guaranteed by the Government through the Bank of Tanzania. However, even after the establishment of these Schemes, the problem of accessing loans by exporters continued. The Guarantee Schemes are underperforming. Consequently, TANEXA started an advocacy campaign with the Government, which included a series of workshops aimed at coming up with proposals and recommendations to the Government, to improve the situation.

2.0 HISTORICAL BACK GROUND

2.1 Introduction of the Credit Guarantee Schemes

The Export Credit Guarantee Scheme (ECGS) and the SME Credit Guarantee Scheme (SME-CGS) were established by the Government of Tanzania in 2003 and 2005 respectively. The objectives of the two schemes are;

- To promote economic development in general by encouraging high value exports, such as horticulture and floriculture, and other value added exports that will generate high level of employment and foreign exchange earnings
- To promote and support Small and Medium Enterprises (SMEs), which have a significant role in the economy, by creating an enabling environment for its expansion and facilitating access to financing resources.

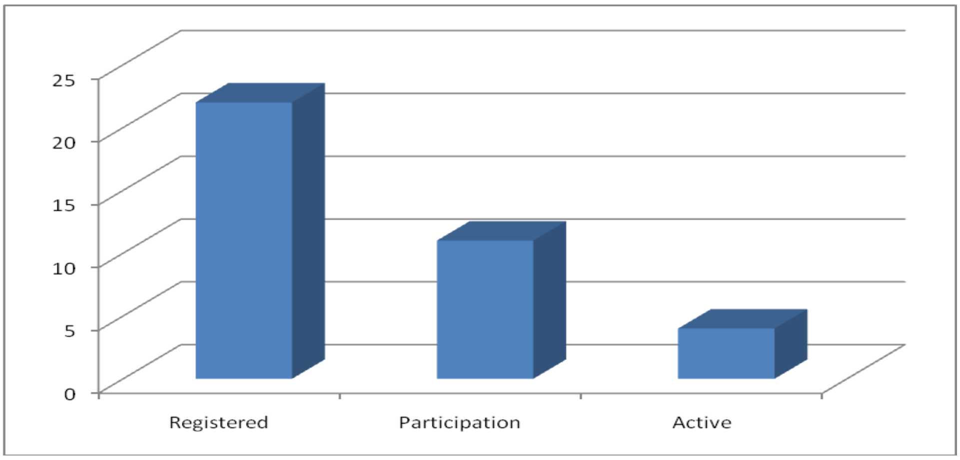
Both objectives are in line with government efforts of promoting economic growth and poverty reduction as outlined in other policies, national and international initiatives such as the SMEs policy, MKUKUTA, Vision 2025, and the MDGs.

2.2 Institutions Involved

These Schemes are under the Ministry of Finance and Economic Affairs (MFEA), and managed by the Bank of Tanzania (BOT). A logical presentation of the two schemes shown in annex 1 indicates that there are also other vital institutions involved. These are the Ministry of Industries, Trade and Marketing (MITM-SME department and relevant public institutions like Small Industries Development Organization (SIDO) and Board of External Trade (BET) which fall under this Ministry), 6 Facilitating Institutions and 22 Participating Financial Institutions (PFIs).

2.3 Use of the Schemes up to 2008/09

Since the inception of the two schemes in the mid 2000, 22 PFIs have registered to participate in the two schemes. As illustrated below, out of the 22 registered PFIs only 11 have used the scheme up to the fiscal year 2008/09. Also out of the 11 PFIs that have been involved in the CGS, only four PFIs have been substantially active.



The four active PFIs have contributed approximately 63% of total participation. The summary of the use of the two schemes is well reflected in the table below;

Table showing use of the schemes up to 2008/09

	Item	ECGS	SME-CGS
1	Period covered	2002/03 -2008/09	2005/06-2008/09
2	Guaranteed Projects	89 (approx. 15 p.a)	48 (approx. 16 p.a)
3	Value of Projects	TSh 295.626 billion	TSh 3.054 billion
4	Guarantee Cover Conditions	Maximum cover 75% for short term and 50% for long term	Maximum cover 50%

Source: The Bank of Tanzania

2.4 TANEXA workshop of September 2008

Due to the problems faced in the course of operating the two schemes, TANEXA commissioned a research regarding their implementation. Findings of the research were deliberated upon at a one day workshop organized by TANEXA on 17th September 2008. The general objective of the workshop was to provide opportunity to stakeholders at all levels to learn from different perspectives, to identify key challenges facing the schemes and to suggest relevant policy options. The workshop was attended by representatives from the following institutions: Government departments, Non-Governmental Organizations (NGOs), Financial Institutions, Research Institutions, Development Partners, Small and Medium Enterprises and Exporters.

The main outcomes of the workshop were;

- ***Information Sharing:*** TANEXA was asked to extend its study to cover more details about lessons learned from other schemes in places like Namibia and Swaziland and how those lessons might be applied in practice to the Tanzanian context.
- ***Establishing Demand:*** A need to get more information from the Banks in order to establish why others shy away. The TBA was to coordinate with TANEXA and coordinate the Bank views.
- ***Efficient Operations:*** A need to have a common approach towards establishing efficient CGSs. TANEXA was asked to work closely with the specialist the BOT would be hiring to advice on the revamping of the SME CGS. This would be essential and the extended TANEXA study could save that consultant time and effort. It would also help communications between the BOT and the CGS users, whose views would be reflected in the study. Ideally, the BOT consultant's views, if not specific findings were to be reflected in the study to ensure consistency.

- ***Efficient Governance:*** A need to introduce a central place within Government to take decisions relating to the CGSs. This would be important not just for reducing bureaucratic delays, but also for disseminating information more efficiently and ensuring that public money injected into the CGSs is utilized as planned and without undue delays. Feedback system would also be more efficient and effective.
- ***Transparency:*** A need to market the CGS widely through a public awareness campaign after the extended study is completed and the BOT consultant has finished his/her work. Over time, it would be important to disseminate success stories and lessons from experiences that did not work. Transparency would be essential for future success.

3.0 THE CURRENT STUDY

3.1 Study Objectives

The current study on the utilization of the two schemes which was commissioned by TANEXA aimed at coming up with a united proposal on how to shape the RE-ENGINEERING of the two schemes into an effective source of GUARANTEES for accessing funding from PFIs and other financial considerations.

The study was followed by a series of events: One was a workshop held on 10th September, 2009 to streamline exporters and PFI's recommendations on the restructuring of the two schemes. The workshop was followed by a conference held on 18th November, 2009. The essence of this conference was to give recommendations and proposals to the Government to make the schemes accessible by the intended clients. A third event was a workshop held on the 14th of January 2010 to review recommendations which emerged from the November conference. The workshop was attended by all key stakeholders of the Export Credit Guarantee Scheme (ECGS) and the Small and Medium Enterprises Credit Guarantee Scheme (SME-CGS).

3.2 Key Study Findings

The following are key findings of the study commissioned by Tanzania Exporters Association (TANEXA) to review the utilisation of the Export Credit Guarantee Scheme (ECGS) and the Small and Medium Enterprises (SMEs) Credit Guarantee Scheme (CGS);

- High fees on ECGS facility e.g. a facility of TSh 100m attracting as much as TSh 19.78m[1], 50% collateral requirement for eligible SMEs and cover of at least 50% for a new project and 80% for an existing project make the PFIs' costs prohibitive.
- Handling speed of guarantee applications is not satisfactory because the entire ECGS process seems to be quite bureaucratic and thus information availability and flow about the two schemes remains a problem which makes BOT seem unprepared to manage the two schemes. The current manager of the two schemes (Bank of Tanzania) admits that public awareness on the existence of the two schemes is very low despite some efforts to sensitize the public, through the PFI's.
- Given current demand by exporters and SMEs, the size of capital for both schemes (i.e. ECGS and SMEs CGS) is very low, as revealed by the Bank of Tanzania numbers. According to the manager of the two schemes between 2002/03 and 2008/09 the ECGS guaranteed 89 projects only with the guarantee value amounting to TSh

[1] See annex 3.

295.626bn. Between 2005/06 and 2008/09 the SMEs CGS guaranteed only 48 projects with a guarantee value amounting to TSh 3.054bn. It is unfortunate, that the size of capital for both schemes (i.e. ECGS and SME CGS) was not directly revealed by both the Bank of Tanzania and the Ministry of Finance.

- Not all PFIs participated actively and there has been relatively inactive participation to the schemes by foreign banks. In general the process however between PFIs and the BOT is still unclear.
- Coverage on existing financing and export promotion facilities among exporters and SMEs producers is limited. This shortcoming is enlarged by the absence of measures to enhance marketing and promotion of SMEs and their products by relevant organs. These two limitations and the fact that all SMEs are treated the same as if they are homogenous portray the ECGS as not supportive of value added products particularly in the agricultural sector.
- Most of the successful state-owned Credit Guarantee Schemes the world-over are independently run as separate legal entities. Placement of the guarantee schemes under a government agency, with an involvement of a particular Ministry, creates conflict in purpose for lack of interest and experience by public officials in working with SMEs and guarantee schemes.

3.3 Lessons Learned from other countries

Four countries in the SADC region have established successful Credit Guarantee Schemes targeting SMEs. These successful national models are in Namibia, Swaziland, Botswana and South Africa. The schemes in Namibia, Botswana and Swaziland are supported both by the Government and donors. However, the credit scheme in South Africa is almost wholly government funded.

Of the schemes in the above four countries, Botswana has been the most successful in its credit guarantee programme. Salient features of the Botswana scheme include the following:

- The Botswana Credit Guarantee scheme for SMEs is supported by both the Government and donors
- The scheme known as CEDA Credit Guarantee Scheme (CCGS) is managed by an independent institution established by the Government, the Citizen Entrepreneurial Development Agency (CEDA)
- There are only three players in the scheme namely; CEDA, Participating Financial Institutions (PFIs) and the Borrower.

The CEDA Credit Guarantee Scheme has been successful because of the following reasons;

- It has been accepted by all PFIs
- The fees charged by the PFIs are affordable
- Two days processing time to make decisions is a attractive to Clients and PFIs
- They also offer several schemes dedicated to specific target groups such as; the CEDA Soft Loan Scheme, Young Farmers Fund, Credit Guarantee Scheme and CEDA Venture Capital Fund.

Other successful schemes outside Africa include among others the following;

- Credit Guarantee Corporation of JAPAN which guaranteed 1.094 million projects worth 13 trillion yen in 2006 and 1.09 million projects worth 13.3 trillion yen in 2007
- Credit Guarantee Corporation of MALAYSIA Berhad which over the last 37 years of its existence has facilitated the creation of

365,000 SMEs (an approximate average of 10,000 SMEs created annually) and

- The Thai Credit Guarantee Scheme (THAILAND) which guaranteed 5,526 projects in 2004; 8,025 projects in 2005; 8,688 projects in 2006; and 8,999 projects in 2007.

Given the above findings and the current set up of the two schemes in Tanzania, their performance is unlikely to improve significantly. In order to improve the performance of the two schemes, their current operation in terms of management, structure, capital, modus operandi, and degree of autonomy they have to be transformed through extensive BUSINESS PROCESS RE-ENGINEERING.

4. RECOMMENDATIONS

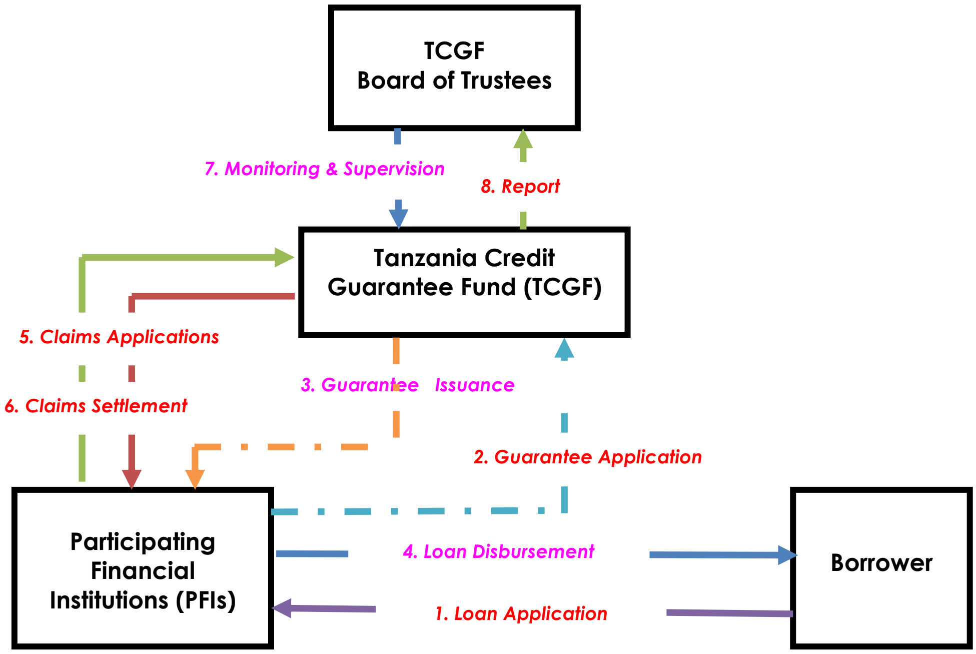
4.1 Formation of the Tanzania Credit Guarantee Fund (TCGF)

Based on the current shortcomings of the two schemes and on international best practices, the schemes need to be transformed into a state-owned single separate legal entity. The performance of the two schemes will improve tremendously, if a legally separate entity with a clear MISSION and STRATEGY designed to be self-financing is established. The proposed state-owned separate legal entity could be named as TANZANIA CREDIT GUARANTEE FUND (TCGF).

4. 2 Governance of the Fund

The proposed FUND should be under governance of a Board of Trustees. Members of the Board of this FUND should come from the related institutions. These are; Ministry of Finance, Ministry of Industry, Trade and Marketing (MITM), Small Industries Development Organization (SIDO), Board of External Trade (BET), Tanzania Exporters Association (TANEXA), Tanzania Bankers Association (TBA), TCCIA, CTI and TWCC. Day to day activities of the FUND should be under the Chief Executive Officer of the Fund. Below is an illustration of the proposed TCGF.

Proposed Logical Scheme of TCGF



With the operations of the two schemes being under the Guarantee FUND, issues of transparency and accountability to the public will also improve.

4.3 Establishment of National Branch Networks

In order to extend the two schemes to SMEs and exporters all over the country, the proposed FUND should DECENTRALISE the services of the two schemes through a branch network. A branch network is recommended because of the size and population of the country. The

Ministry of Industries, Trade and Marketing (MITM) through its public institutions (SIDO and BET) should be proactive in playing their noble role of promoting SMEs and Exports. Since establishing a branch network at the outset is costly, the FUND could arrange initially to utilise SIDO regional offices or PFIs offices to provide services to entrepreneurs and exporters in respective regions.

4.4 Additional Capital Required at the Initial Stages

The CAPITAL for the proposed FUND should be reviewed with a view to strengthen it in order to meet the ever increasing demand. Specifically, sufficient start up capital and other forms of government support are necessary at the initial stage to ensure effective operations of the FUND. An initial capital required for this purpose is estimated to be TSh 29 billion which is five times the current available funds for both CGS which will cater for a minimum of 300 clients a year.

4.5 Capacity Building and Recruitment of Staff

Efficient functioning of the FUND is largely dependent on the presence of SUFFICIENT NUMBER OF STAFF that is able rapidly to perform tasks such as assessment and approval of eligibility, monitoring guaranteed loans, processing and reviewing claims, storing information on borrowers, preparing reports on schemes' operations and possibly providing additional services as part of the FUND's portfolio of services. RECRUITMENT and CAPACITY BUILDING of competent staff should therefore be undertaken by the FUND.

4.6 Shortening of Applications Processing Time

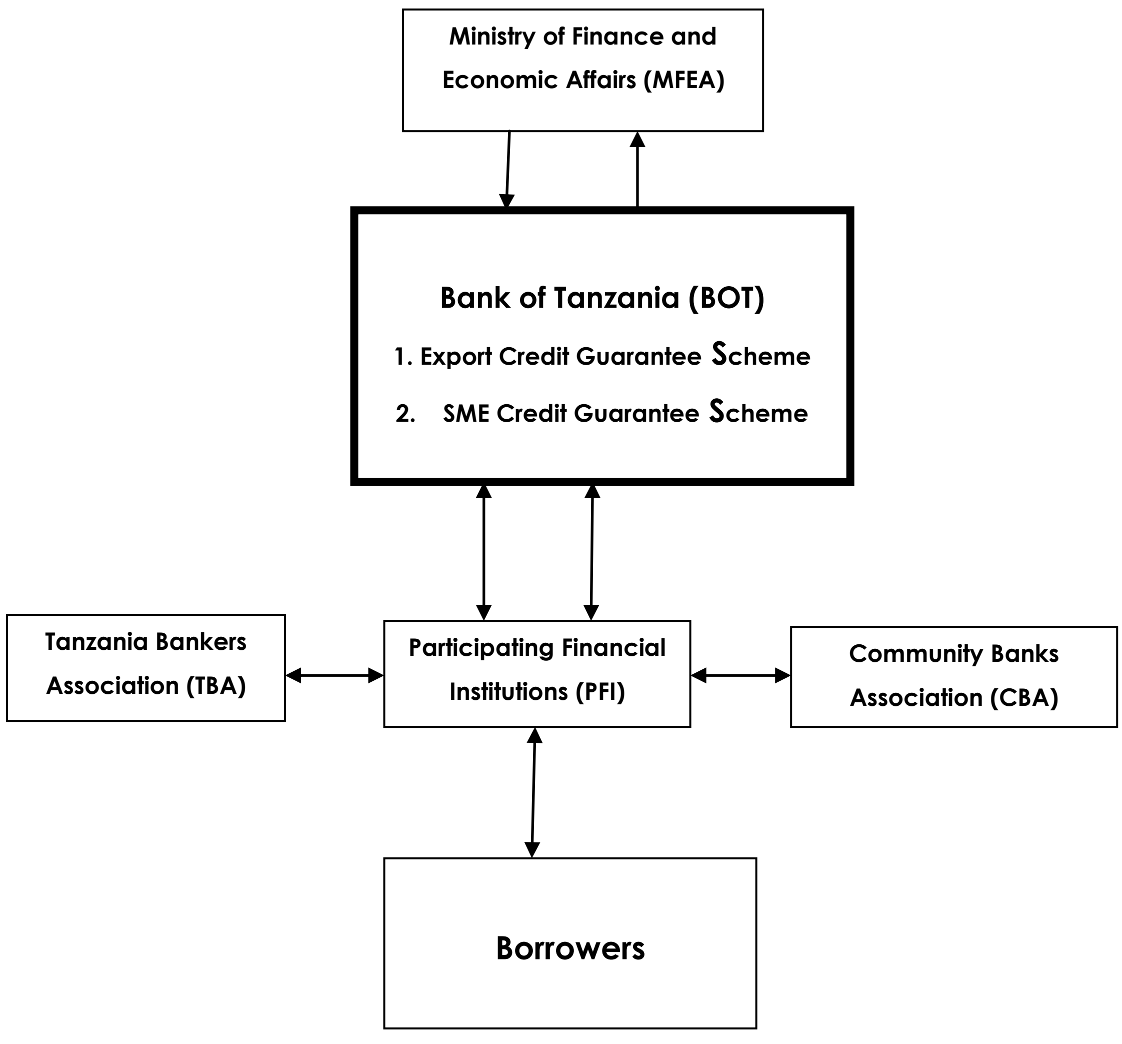
The business re-engineering process will include the recruitment of competent and able fund staff who will improve the operations of the fund. This means administrative work will be reduced for all involved thus shortening the period from guarantee request to grant from several months of waiting to less than five working days.

4.7 Other General Recommendations

- The establishment of the Guarantee Fund could also allow the accommodation of more Empowerment schemes as the need may arise. With a separate legal status, government intervention to the FUND should be restricted to policy decisions, funding and extending counter-guarantees. Technical support could be sourced initially while capacity for local staff is being built.
- In order to achieve its objectives of improving SMEs' access to finance and to assist economic decentralization, the FUND has to be proactive in gaining recognition and acceptance by lenders and borrowers. Therefore Marketing of the two schemes is important, since most SMEs in Tanzania seem to be unaware of the existence of the two schemes. A strong relationship is recommended between the proposed FUND and PFIs. This is important because such relations are a prerequisite for effective operations of any empowerment scheme.
- The proposed FUND should also consider introducing additional services in its portfolio of activities such as consulting, training of bankers on how to deal with SMEs lending, project appraisals, business plans preparations and accounting services. Overall the entire process of accessing the two schemes should be streamlined. The FUND should also consider introducing counter guarantees (insuring the issued guarantees) in order to boost the confidence of the financial sector and perhaps entice active participation of more PFIs. The government should also be aware of the fact that the

Credit Guarantee Fund when managed properly should be profitable. By charging *commercial rates of pre*mium and fees the CGS will make profit which will support further growth and expansion.

ANNEX 1: Current Structure of Institutions Involved



ANNEX 2:

Tanzania (current and proposed situation) compared to other countries

Item	Tanzania (proposed) TCGF	Tanzania (current) ECGS + SME CGS	Botswana	Namibia
Entity responsible for the Credit Guarantee Schemes				
Legal status	State owned separate legal entity	State owned	Parastatals state owned	TRUSTEE
Capital available (per year)	TSh 29 billion	TSh 250 million	Starting capital about U$D 8 million	U$D 2.3 million
Governance	Board of Trustees	Bank of Tanzania	Board	Board of Trustees
Operations				
Number of staff	_	_	5	7
Average reaction time (turn around time)(1)	5 days	Months	3 days	2 days
Marketing				
Products (schemes)	ECGS SME CGS, Venture Capital	ECGS SME CGS	Soft Loan Scheme, Young Farmers Fund, CG S and CEDA Venture Capital	Soft loan scheme, young farmers and CGS venture capital and CEMAEF
Distribution	PFIs	PFIs	PFIs	PFIs

(1) The total time between applying for a loan with guarantee from a (commercial) bank to agency that has to approve the loan on behalf of the Government (or National Bank).

ANNEX 3: Estimation of the costs of fund

Cost of fund (c) for facility secured by ECG can be estimated as follows:

Bank of Tanzania facility fees (a), commercial banks fees (b), application fees (c) and other fees such as legal fees (d).

C= a + b + c + d

For instance if a new client is in need of pre-shipment export credit facility of TSh 100 million and chooses to lodge application through bank that has the following fee structure, then estimated cost of fund will be as shown in the Table below;

Table: Applicable charges for transaction secured by export guarantee schemes

Fees category	Applicable charges	Amount
	Rates	TSh
BOT Fees	1%	1,000,000
Application fees	0.5%	500,000
Facility fees	1%	1,000,000
Legal fees	0.28%	280,000
Interest	17%	17,000,000
Total	19.78%	19,780,000

The above costs imply that the client will have to operate at a cost less than 80 percent of the total revenue in order to break even based on fees structure of bank A. However this could even go beyond 20 percent especially for banks which are charging an interest rate of 21% and above.

Also noted in the review is a cumbersome procedure associating with the schemes. The duration of the facility seems to be too short for an exporter operating in Tanzania where the infrastructure and other business support services are poor. The duration of 60 days for post export and 270 days for pre-export financing is said to be inadequate considering the operating environment in Tanzania. In addition to that, the exporter must be able to raise a minimum of 20% (which in this case in TSh 20 million) either through borrowings or from other sources before applying for the guaranteed facility. This raises some doubts as to the practicability of the imposed requirements especially for exporters operating in small scale. This is evident from the schemes report that it is almost stagnant for the last two years.