



FINANCIAL SUSTAINABILITY OF ISLAMIC SAVING,
CREDIT COOPERATIVE SOCIETY (SACCOS) IN
TANZANIA

BY

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ABSTRACT

In developing countries large population rely on Microfinance Institutions (MFIs) to have various financial services. Due to this, having MFIs that are financially sustainable enables them to improve society better such that to reduce poverty by serving the poor who in most cases do not qualify in standard banks. This is more important for Islamic Microfinance Institutions (IMFIs) that are non-exploitative to its members. As reported by various scholars such as Gebremichael and Gessesse (2016) that, most of the MFIs in developing countries lack financial sustainability. Generally, there are several studies on financial sustainability in IMFIs, however there has not been much discussion of same topic in Tanzania. Therefore, this study aims to examine the financial sustainability of Islamic Saving, Credit Cooperative Society (SACCOS) in the Tanzanian context. The study used institutional theory to explore, view and explain the financial sustainability of Islamic SACCOS. The study adopted a mixed mode research method. Data used in this study comes from annual financial reports of five years (2010-2014) of four SACCOS in Tanzania, whereby financial ratios were used to measure the financial sustainability. In addition to that, the interview was conducted with the management of these SACCOS to examine their perception of financial sustainability of SACCOS and factors affecting such sustainability. Quantitative data were analyzed using descriptive analysis, and a thematic study was conducted for data from the interview. The findings show a fluctuating trend for the financial ratios. In most of the years, Islamic SACCOSs did not meet the benchmark of 3% for Return on Asset (ROA) set by Accion, hence the Islamic SACCOS are not financially sustainable. Additionally, having responsible staff members, regular review of financial guidelines, education to members, cooperation between employees and management and staff training are found to be highly contributing factors towards SACCOS's financial sustainability. Moreover, the findings show that depending on only charges on members as the source of income is the main factor that contributed much to the Islamic SACCOS not being financially sustainable. Apart from adding to the literature on the financial sustainability of MFIs, this study is expected to serve as an alert for Islamic SACCOS to work on the issue of them being financially unsustainable by addressing the factors that hinder their financial sustainability. Moreover, as for regulators such as Cooperative Audit and Supervision Corporation (COASCO) can use the result in this study while providing the consultancy and audit services to these SACCOSs. Such efforts will enable them to achieve the goal for their existence by reaching most of the poor people who depend on MFIs for financial services.

مُلخَصُ البَحْث

في الدول النامية يعتمد كثير من السكان على مؤسسات تمويل المشاريع الصغيرة (MFIs)؛ للحصول على خدمات مالية مختلفة؛ لذا من المهم توفير مثل هذه المؤسسات المستدامة ماليًا وتمكينها من تحسين واقع المجتمع بالتخفيف من حالات الفقر الشائع من خلال تقديم خدمات للفقراء غير المؤهلين لخدمات المصارف التقليدية، وهذا أكثر أهمية بالنسبة إلى المؤسسات الإسلامية لتمويل المشاريع الصغيرة؛ التي لا تستغل أعضائها، وقد ذكر عدد من العلماء من مثل Gebremichael و Gessesse أن معظم مؤسسات تمويل المشاريع الصغيرة في البلدان النامية تفتقر إلى الاستدامة المالية، وبعمامة؛ هناك عدد من الدراسات حول الاستدامة المالية في هذه المؤسسات، ولكن لا نقاش كثيرًا في هذا الموضوع في تنزانيا؛ لذا تهدف هذه الدراسة إلى تحري الاستدامة المالية للمؤسسات الإسلامية في تنزانيا، ولا سيما جمعية التعاون الائتماني الإسلامية (SACCOS)، وقد استخدمت الدراسة النظرية المؤسسية لاستكشاف الاستدامة المالية للجمعية وعرضها وشرحها، واعتمدت أسلوب بحث مختلط، فقد جُمعت البيانات من التقارير المالية السنوية لمدة خمس سنوات (2010-2014) من أربعة مراكز لجمعية التعاون الائتماني الإسلامية في تنزانيا، ثم استُخدمت النسب المالية لقياس الاستدامة المالية، كما أُجريت مقابلة مع إدارة الجمعية؛ لتبيّن تصورات الاستدامة المالية لديهم، والعوامل التي تؤثر في هذه الاستدامة، ومن ثم؛ جرى تحليل البيانات الكمية باستخدام التحليل الوصفي، مع دراسة موضوعية للبيانات من المقابلة، وقد أظهرت النتائج تذبذبًا في المعدلات

المالية، وفي معظم السنوات لم تستوف الجمعية نسبة 3 ٪ من عائدات الأصول؛ لأن الجمعية غير مستدامة ماليًا، فضلاً عن أن الموظفين المسؤولين، وتدريبهم، والمراجعة المنتظمة للمبادئ التوجيهية المالية، وتعليم الأعضاء، والتعاون بين الموظفين والإدارة؛ كلها من العوامل التي تسهم إسهامًا مؤثرًا في تحقيق الاستدامة المالية للجمعية، وأيضًا؛ أشارت النتائج إلى أنه اعتمادًا على الرسوم المفروضة على الأعضاء فقط؛ كان مصدر الدخل هو العامل الرئيس الذي أسهم إلى حدٍّ معين في أن تكون الجمعية غير مستدامة ماليًا، وإضافة إلى الدراسات المتعلقة بالاستدامة المالية لمؤسسات تمويل المشاريع الصغيرة؛ يُتوقع من هذه الدراسة أن تعين جمعية التعاون الائتماني الإسلامية (SACCOS) في معالجة العوامل التي تعيقها عن تحقيق الاستدامة المالية، كما يُمكن للهيئات التنظيمية من مثل شركة التدقيق والإشراف التعاوني (COASCO) أن توظف نتائج هذه الدراسة في أثناء توفير خدمات التدقيق والاستشارة، مما يُمكن معه تحقيق هدف الوصول إلى معظم الفقراء الذين يعتمدون على مؤسسات تمويل المشاريع الصغيرة للحصول على الخدمات المالية.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Accounting).

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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*This dissertation is dedicated to my beloved children; Shadya Abdulkarim,
Nuriat Abdulkarim, Affan Abdulkarim and Arrif Abdulkarm*

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LIST OF ABBRIVIATIONS

BRAC	Bangladesh Rural Advancement Committee
CHAWATE	Chama cha Walimu Temeke
COASCO	Cooperative Audit and Supervision Corporation
CUs	Credit Unions
FINCA	Foundation for International Community Assistance
IMF	Islamic Microfinance
IMFIs	Islamic Microfinance Institutions
MBAGASO	Mbagala Sokoni
MC2	Means and Competency of Community
MEDA	Micro Enterprise Development Agency
MEs	Microenterprises
MF	Microfinance
MFI	Microfinance Institutions
OIE	Old Institutional Economics
NGOs	Non-Governmental Organizations
NIE	New Institutional Economics
NIS	New Institutional Sociology
PRIDE	Promotion of Rural Initiative and Development Enterprises
ROA	Return on Asset
ROE	Return on Equity
ROSCA	Rotating Savings and Credit Association
SACAs	Saving Credit Associations
SACCOS	Saving Credit Cooperative Society
SEDA	Small Enterprises Development Agency
SHGs	Self-Help Groups
TAMPRO	Tanzania Muslim Professional Organization
VICOBA	Village Community Bank

CHAPTER ONE

INTRODUCTION

BACKGROUND OF THE STUDY

Most of the people in the world are isolated from financial services provided by the banking sector (Bhanot & Bapat, 2015). According to Marwa and Aziakpono (2015), about 88% of people are not served by standard banks. Having this large number of people not served with financial services leads to the rise of concern among stakeholders such as government and financial institutions on how the financial system should be structured to help this group, given that poverty alleviation and economic growth can be achieved by having a healthy and well-functioning financial system (Tego, 2012). Due to this, microfinance as an alternative in the financial system has been adopted in different environments based on needs and economic situation of people (Ahmad & Ahmad, 2009). Hence, Microfinance Institutions (MFIs) has become a reliable financial service provider to a large population in developing countries, who cannot get such services from mainstream banks (Adongo & Stork, 2005; Marwa & Aziakpono, 2015).

By definition, microfinance represents “small-scale financial services to clients that are economically active in various urban and rural areas” (Harran, 2008). Services provided include microcredit, savings, insurance, pension and money transfer (Bhaskarin, 1957). Usually, microfinance is characterized by small size transactions, collateral free loans, group lending, focus on the poor, focus on women, a simple application processes, provision of service to the client’s own community and reflecting market level interest (Armendariz, 2011). Therefore, microfinance relates to

the provision of financial services such as saving and credit to low-income earners to enable them to continue generating income as a means to sustain their livelihood (Abekah-Nkrumah, Abor, Abor, & Adjasi, 2011).

Furthermore, MFIs are meant to reduce poverty by giving loans to micro enterprises (MEs) which provides employment as well as business opportunities to poor people and enable them to afford basic needs of life such as food, health, and education (Borbora & Kumar Sarma, 2007). MFIs allow for needy individuals to realise their financial plans by saving and getting a loan (Marwa & Aziakpono, 2015). Moreover, credit to poor people helps them to create self-employment opportunities which affects the economy in general, by increasing consumption and investment. In other words, it provides a ground for entrepreneurship, as it enables poor people with business ideas to get small capital for the startup of the business (Satta, 2006). In general, microfinance programs are considered to be a continuous strategy and policy for poverty alleviation in different parts of the world (Siwar & Talib, 2001).

Various models can be applied to operate MFIs. These models include the Grameen bank model, Means, and Competence of Community (MC2) model, The Village Banking Model, and the SKS-Microcredit Model (Rulindo, 2012). In Tanzania a mix of these models are adopted by different MFIs given the legal operational structure. Moreover, MFIs in Tanzania operate in various forms such as financial-NGOs, cooperatives and standard financial institutions including commercial banks, non-bank financial institutions, and regional and rural unit banks.

MFI can either be conventional or Islamic. Conventional MFIs involve the element of interest in its transactions while the exploitative nature of such operations is not found in the Islamic model (of finance) (Rahim & Rahman, 2010). When they give a loan to their members, they tend to charge interest as well as when customers

need additional capital, they tend to ask for interest loans as well (Tego, 2012). Islamic microfinance (IMF) is asset-based financing using tools such as a benevolent loan, *bai muajjal*, *musharakah*, *mudarabah* and *salam* (Harran, 2008). Any other source of income for IMF should consider the shariah aspects of such transactions. According to Rahim and Rahman (2010), although the main focus of microfinance is to alleviate poverty, IMF does it ethically through various financing schemes. IMF provides poor people with the access to funds, without the burden of interest and hence contribute to poverty alleviation.

Tanzania is an East African country. It is a combination of two British colonies which are Tanganyika and Zanzibar and in 1964 they formed the United Republic of Tanzania. Tanzania's area is 364,900 square miles with a total population of 51,557,365 (National Bureau of Statistics, 2017). About 90 percent of the people in Tanzania cannot get access to financial services from banks (Marwa & Aziakpono, 2015). Alternatively, they are served by different MFIs such as the Village Community Bank (VICOBA), Rotating Savings and Credit Associations (ROSCAS) and Saving Credit Corporative Society (SACCOS). Therefore, MFIs operating in different forms such as Non-Governmental Organizations (NGOs), cooperatives and standard financial institutions have been established to serve such a large population (of the poor) in the country.

In Tanzania, the Islamic financial products market started in 2008. In such a year, one of the conventional banks known as Kenya Commercial Bank (KCB) launched an Islamic window. At present, there are four Islamic banks, three of them operate as a window, and one is a full-fledged financial institution. Given the three types of MFIs operating in Tanzania, such as standard financial institutions, NGOs and cooperatives, only the cooperative has been adopted to offer IMF services. It

means, currently, there is no standard financial institution nor NGO that offers IMF services in Tanzania. Therefore, Islamic Microfinance Institutions (IMFIs) in Tanzania started in 2010 as cooperatives such as Islamic SACCOS which managed to provide a limited number of microfinance products to the people. Up to this date the sector/market is still growing.

Taking into consideration the vital role played by MFIs in the economy, its financial sustainability is essential to safeguard provision of financial services to the majority of the poor (Marwa & Aziakpono, 2015). In this regards, financial sustainability refers to ability of MFIs to produce enough profits to cover both, operation and financing costs and at same time remain with surplus (Ayayi & Sene, 2010; Marwa & Aziakpono, 2015). This sustainability is especially for Islamic MFIs which are not exploitative financial institutions to their customers or members. Hence these IMFIs are responsible for their own financial sustainability.

1.1 STATEMENT OF THE PROBLEM

The problem of poverty in developing countries has led to various strategies to reduce or eliminate this problem. It has been argued that to alleviate poverty and to have economic growth, and a well-functioning economy, there is a crucial need for a secured financial system as the basis (Tego, 2012). MFIs as part of the financial system has been one of the strategies for poverty alleviation in developing countries. Since the establishment of these institutions with the aim of serving the targeted group in such societies, we are referring to the poor, then these financial institutions need to work to achieve this goal. Hence the role of MFIs both, the conventional institutions and its Islamic alternative in the form of an MF geared towards poverty reduction has been a focus by researchers. Such researchers include; Abideen Adeyemi (2010),

Rahim and Rahman (2010), Teggo (2012), Hassan (2014), Abbas (2014) showing how MFIs were able to meet the expectations such as serving the poor. However, some of the researchers explained the negative impact of MFIs depending on their methodological approach can become a burden to the poor, instead of helping them. Example, the use of high interest based financial services by MFIs, has proved to be exploitative especially to the poor, hence not of real value to them (Teggo, 2012). Due to this, some scholars such as Rahim and Rahman (2010) requested for an alternative which is IMF, as its methodological approach is designed and structured to help the poor, since it does not involve interest instead because it provides asset-based financial services. Hence, currently, both conventional and IMF exist in different parts of the world with the primary aim of providing financial services to the poor.

After having these MFIs operating in different forms, models and different methodological approaches, there have been concerns about their sustainability. As argued by Marwa and Aziakpono (2015), organizational financial sustainability tends to help in achieving other form of sustainability easily; then it is necessary to know whether MFIs are financially sustainable, as this will support other types of sustainability and continuously help to serve the poor.

Most of MFIs in developing countries including Tanzania lack financial sustainability. This issue has been addressed by various scholars such as Adongo and Stork (2005); Thapa (2006); Borbora and Kumar (2007); Nyamsogoro (2010); Marwa and Aziakpono (2015) and Gebremichael and Gessesse (2016). However, most of the studies on the financial sustainability of financial cooperatives in Tanzania have been focusing on conventional ones. Generally, there are several studies on financial sustainability in MFIs in different countries. However, there has not been much discussion of the financial sustainability of IMFIs specifically Islamic SACCOS in

Tanzania. With comparison to conventional SACCOS, this study examined the financial sustainability of Islamic SACCOS in the Tanzanian context.

1.2 MOTIVATION OF THE STUDY

Previous studies on the MFIs have been conducted in different parts of the world focusing on various topics. Sustainability is one of them, and some specifically address issues in the financial viability of MFIs. This study also aims to provide empirical evidence relating to the financial sustainability of Islamic MFIs since financial sustainability in short run, it helps organizations to attain other types of sustainability for example market sustainability and human resources sustainability (Marwa & Aziakpono, 2015).

Most of the studies on SACCOS's financial sustainability are general in terms of their sample selection, this indicates a need for a deeper analysis. For example, the sample used in such studies did not state whether Islamic SACCOS were also included. Example, the survey by Marwa and Aziakpono (2015) examined the financial sustainability of SACCOS in Tanzania and used 103 sample SACCOSs. Even though the findings out of such a study can also apply towards other audited Islamic SACCOS in Tanzania, but due to different operational features there is a need to assess the financial sustainability of Islamic SACCOS separately. Also, in Tanzania there are many SACCOS (more than 5,000), and most of them are conventional, so looking at this competitive situation of very few (to date, only two) registered Islamic SACCOS operating in Tanzania, raises a need to examine their financial sustainability separately, as it can enable Islamic SACCOS to determine if they can continue to exist and achieve their objectives in years to come.

1.3 RESEARCH OBJECTIVES

The research is centered in tracing the financial sustainability of Islamic SACCOS in Tanzania since the begin of their operations in 2010. Thus, specifically the objectives of this study are; -

- i. To assess and compare the financial sustainability of Islamic and conventional SACCOS in Tanzania by utilizing a five-year financial trend analysis.
- ii. To identify the factors determining Islamic SACCOS financial sustainability.

1.4 RESEARCH QUESTIONS

In line with the objectives of this study, the following are the research questions; -

- i. To what extent are Islamic SACCOS in Tanzania financially sustainable as compared to conventional SACCOS in five years' time?
- ii. What is (are) the factor(s) affecting their financial sustainability?

1.5 SIGNIFICANCE OF THE STUDY

This study is important for three main reasons. First, it provides the chronological trail regarding financial sustainability of Islamic SACCOS, since its start in 2010 to the next five years. Meaning that it allows for some empirical data on whether Islamic SACCOS are financially sustainable or not.

Secondly, the findings from this study will be useful to various stakeholders, starting with SACCOS both conventional (especially for selected sample) and Islamic, as they can assess themselves through this study and to get information about where it is necessary to take the appropriate measures towards attaining their objectives. This

may involve restructuring their operational system in addressing issues addressed towards attaining institutional efficiency and stability to serve and improve the poor better and continuously. The regulatory body such as Cooperative Auditing and Supervision Corporation (COASCO) can also find this study useful in the event that this study can provide insights and a clearer understanding and enable them to provide consultancy services to this type of cooperatives.

Lastly, the study will also contribute to the existing knowledge of the same topic such as researchers may refer to since this study provides additional literature on the financial sustainability of MFIs. It studies the financial trend of Islamic financial cooperatives in Tanzania, since its establishment and factors that contribute to strengthening or weakening of their financial viability.

1.6 STRUCTURE OF THE STUDY

There are six chapters in this study.

Chapter 1: **Introduction.** This chapter provides the main ideas of the study. Background of the study, problem statement, motivation, and objective of the study, research questions and significance of the study are all presented briefly in this chapter.

Chapter 2: **Literature review.** This chapter discusses the concept of microfinance and sustainability, history and practice of microfinance in Tanzania, prior studies on MFIs sustainability, as well as the gap in the literature which this current study attempts to fill.

Chapter 3: **Theoretical framework.** This chapter discusses the theoretical and conceptual framework that guides the study. It first explains the theory used in this study, i.e., institutional theory and how this theory explains

the concept of financial sustainability in MFIs. Secondly, it provides the conceptual/theoretical framework that summarizes the main idea of the study.

Chapter 4: **Research Methodology.** This chapter introduces the research methods for the study. It explains the research design used, sample selection, data collection procedures as well as data analysis methods.

Chapter 5: **Findings and discussion.** This chapter presents the findings and discussion about the findings in detail.

Chapter 6: **Recommendations and conclusion.** Lastly, this chapter provides the summary, conclusion, limitations, and recommendations out of the findings and suggestions for future research.

1.7 CHAPTER SUMMARY

This chapter addresses, in brief, the role of microfinance in the general economy as well as specifically on the economy of the poor. Due to its role in the economy, the sustainability of microfinance institutions has become a key issue that is addressed and also discussed in different part of the world. Furthermore, assessing the financial sustainability of Islamic microfinance institutions is becoming more critical due to the different operating structures compared to conventional microfinance institutions. Hence with comparison to conventional SACCOS, this study assesses the financial sustainability of Islamic SACCOS in Tanzania. Next chapter presents a literature review of microfinance institutions and financial sustainability

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

In this chapter, a review of the prior literature on Microfinance (MF) and sustainability is presented. The chapter is structured as follows. Section 2.2 provides definitions and concept of MF together with an overview of MF in Tanzania. Section 2.3 discusses Saving, Credit Cooperative Society (SACCOS) as one of the types of MF institutions operating in Tanzania. Section 2.4 explains the development of the Islamic financial market in Tanzania, as well as the differences between conventional and Islamic MF. Section 2.5 discusses the concept of sustainability. Section 2.6 reviews prior studies on the sustainability of MFIs, followed by Section 2.7 that highlights the gap in the literature and lastly section 2.8 provides a chapter summary.

2.2 MICROFINANCE (MF)

MF is “small-scale financial services to clients that are economically active in various urban and rural areas” (Harran, 2008). It involves providing various financial products to people who do not qualify in the traditional financial system as they are from a lower socio- economic status (Abdul Samad, 2014; Obamuyi, 2009). MF is an alternative financial service set to unbanked poor people (Armendariz, 2011). MF is a way to attain economic development in a manner that addresses the financial needs of the isolated poor people (Tego, 2012). The institutions providing these services are referred to as Microfinance Institutions (MFIs) (K. Ahmed & Khan, 2016). These MFIs as one of the microenterprises offers various functions such as microcredit,