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Research Article

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Formal Operating Mechanisms of Financial Institutions, Business-Users and Financial Inclusion in Mbeya City-Tanzania

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Abstract
The study investigates on the contribution of formal operating mechanisms of both financial services providers and users on financial inclusion. To reveal the reality behind the scene the study employed a quantitative research approach and causal research design. Furthermore the study used a systematic sampling to derive to 100 respondents from which 90 were financial users and 10 were financial service providers in Mbeya City. The study used questionnaires and documentary reviews for data collection. The collected and cleaned data were analyzed by employing rotated component matrix, multi-co linearity testing, and partial correlation coefficient data analysis tools. From the analysis it was revealed that formalization of firms both the financial services providers and users found to be positive and significant causal of financial inclusion. Moreover formal operating mechanisms of financial (business) users revealed to contribute positively and significantly towards satisfactory access to adequate, affordable and quality financial products important for sustaining financial inclusion. From the positivism and significant determination regarding financial inclusion revealed the study recommends that financial institutions, micro finances as well as financial users (individuals and firms) are to formalize their businesses.

Keywords: Formal operating mechanisms, Financial Institutions, Micro finances, Business-Users, Financial inclusion

1. Introduction

Formalization of business operations has been a debatable issue now days which has attracted attention of most of financial institutions in their operations. The formal operating mechanism needed for sustaining financial inclusion dictates to both providers and users of financial services [1]. It is through formalization of financial service providers such as micro finances in which it is expected the operations to be carried out in transparently, accountable, fairly and at a free financial environment which allow free flow of information regarding the quality and cost of financial services [2].

It is with transparency in provision of financial services in which informal burrowing and informal savings are discarded [3]. It is with transparency in which the cost and benefits to be beared by providers and users of the financial services are clearly known [4]. Through formalization interest charge over credit is explicitly known including the formula involving in computing for the interest and the principal amount. This therefore provides flexibility and choice of customer to financial services which fulfill their needs and objectives. Fair treatment to all customers increases feel of being potential customer which in turn increases demand [5]. Fair treatment increases competitive edge to the financial institutions [6]. It is because of most of microfinance, microcredit unions being not formal and transparent in their operation that is why they reveal to be not catalysts over growth of the microenterprises, SMEs, the households and other disadvantageous user group [7].

The 3.5 billions of population financially excluded from second world countries in Asia and third world sub-Saharan African countries has found to be because of most them operate informally [8]. Klaper and Demirgut-Kunt reported that the low income quintiles between 80%-90% are financially excluded because of operating informally [9]. In Nigeria and Republic of Central Africa it was reported that only 2%-4% of business firms are unbanked the reason for about 86% of them being financially excluded [9].

It was an expectation that since most of SMEs in towns are near micro-finances then it could easy for them accessed to affordable, adequate and quality financial services but the situation is vice versa. This has revealed with majority of micro credits in Tanzania violating the microfinance policy framework (Amended, 2017) requiring them register and license their businesses which then this might be because the enforcement of the policy is weak. Requirement of financial service providers formalize their operations goes the same to business-users. For instance with 43% of informal business-users in Tanzania mainland and 53% from Zanzibar [10] prove the fact why most of these businesses are financially excluded. The 21% of the financial inclusion against 79% for financial exclusion of Tanzanian population users is because most of these businesses are operating informally [11], though there could be other reasons which then are not the focus of this study. Other factors contributing to financial exclusion in Tanzania to be considered as areas for further studies are such as financial ignorance; weak enforcement over rules and regulations governing the operation of financial institutions, micro-finances, capital financial markets; digitization; management innovations. Moreover only 14% of the Tanzanian population-users is banked and therefore this means that about 86% of this population is un-banked that is informally operating ((FSDT, 2016) [10].

The study was crossectional conducted to reveal the fact behind the discrepancy that despite of urban area financial users being sparsed with financial institutions but still they are not sustainably financial included. Indeed the study uncovered the reason behind why despite the population users in towns and cities being accessed to enabled financial infrastructures but still they are not adequately accessed to financial services counting for the revealed 71% financial exclusion. This study has been a platform that has proven that by financial users being found in towns, cities and urban areas does not provide a guarantee for expected financial inclusion to be sustained. Sustaining to financial inclusion is an ad-hoc juncture that needs both financial services providers and financial users formalize their operations, the issue which has explicitly addressed by this study underhand.

Thus in general to address the knowledge gap three research objectives were developed which are i) to examine the effects formalization of firms on financial inclusion ii) to investigate the effects of formal operating mechanisms of financial institutions on financial inclusion and iii) to analyze the effects of formal operating mechanisms of financial users on financial inclusion.

2. Literature Review

2.1. Theory Guided the Study

The study employed the Modern Development Theory found by Galor and Zeira (1993). This theory suggests that the transparency, fair treatment and accountability of financial institutions to their customer is the key factor for the increase in accessibility to adequate and affordable financial services and products what was also reported by Dalton, Pamuk, Ramrattan, Van-Soest and Uras, 2019). Transparency in operating mechanisms of financial institutions increases trusts to the customer's contract with the financial institutions while increasing financial inclusiveness [12].

Moreover Modern development theory dictates on the importance of financial users to be registered, licensed and insured [13]. The guaranteed and insured business user provides an assurance of no doubt against the user to be lent money [14]. Informal business–users are vulnerable to shocks, risks thus offering with them credits is like accepting for non-performing credits which then reduces access to adequate, affordable financial services and products (Singareddy, Ranjan, Annamalai & Chandrasekaran [15].

Despite of these innovative proposals but the in-depth analysis of what benefits are to be acquired by both financial services providers and users by being formalized has not be uncovered which was then the knowledge gap this study had stipulated on. What has been uncovered by this study not said by Modern development theory is that formalization of operations create a free or optimal risk financial environment which cutter for high transaction cost. Moreover the transparent environment allows for symmetric flow of information regarding financial services for customers have better choice of the financial products which meet their needs and objectives that is he quality, affordable and adequate ones.

3. Empirical Studies

Farazi reported that the informal operating mechanism of most of microfinance, SMEs is the revealed factor that counted for acute financial exclusion of about 70% in India [16]. It was further revealed that use of loans and bank accounts for business by informal firms is very low and a vast majority finances their day-to-day operations and investments through (internal funds, money lenders family and friends) sources other than financial Institutions. About 54% more likely to have a bank account and 32% more likely to have loans. The study by Farazi moreover employed a descriptive research design and the strata-multistage sampling was used to derive to 98 sample of respondents. Furth [16] ermore the study by Farazi used mixed questionnaires and the collected data being analyzed by descriptively. With a slight difference with the study underhand is that both the informal operating mechanisms of financial institutions, micro-finances and business-users have an effect towards financial exclusion indeed to most of SMEs, the households and remote rural business users [16]. It was further described that for SMEs not being registered, licensed, guaranteed and having collateral of which its title of ownership cannot easily transferred are the reasons of why most of these business are not accessed to adequate, affordable and sound financial services/products. Moreover this study under discussion used a causal research design and systematic sampling technique to derive to 100 respondents. The collected data through the use of likert scale questionnaires were analyzed inferentially such that over use of multi-co linearity, rotated component matrix and partial correlation.

The study by Noelia, David and Pablo on extending access to formal financial system (A descriptive study) which applied the Business Correspondent Model dictated on the use of digital electronic systems in reaching unbanked informal users of financial services. The study was conducted in Madrid-Hispania proposed on opening a number of correspondent banks/bank branches, retail banks, installation and use of ATMs indeed the intelligent ones, use of Mobile Banking to capture the informally operating business –users. But the problem is with the presence of non-furnished infrastructures to facilitate e-banking businesses in developing countries like Tanzania and that is why the study was conducted to un-reveal this discrepancy [17]. Furthermore, the study under discussion examined on the dilemma of financial Institutions, Micro-finances and Business-users in operating informally in relation to accessibility to adequate and low-cost financial products different from that by Noelia, David and Pablo which was revealing on the strategies towards meeting/formalizing informal business-users [17]. While the study by Camara and his fellows adopted a correspondent business model, the study under examination used the modern development theory in explaining the significance of operating formally in relation to access to adequate and effective financial products which then the investigations was causal-effect in nature different from that by Noelia, David and Pablo which was descriptive [17].

Karen, Lemma and Rud reported that the study investigating the impacts of access to financial services on households' investments it was reported that access to formal financial services/products (such as savings, credits) led to economic growth. It is due to easy access to formal financial products in which the household is attained to the cheap and less transaction cost products and thus being able to acquire enough economic resources that foster their needs [18]. Indeed the study by Karen, Lemma and Rud was correlation while the collected data being analyzed descriptively by applying mean and standard deviation. Different from this study under discussion which is analyzing the effects of formal operating mechanisms of both financial service providers and users in achieving the sound and sustainable financial inclusion over the SMEs-processors, traders and service providers. Moreover, this under discussion was undertaken in Mbeya City, the area populated with the SMEs offering products and services but only to find they are informal operating difficult to be accessed to adequate and low-cost financial products for the growth of their businesses [18]. Furthermore, and specifically the study under discussion used causal research design and the collected information were analyzed by employing structural equation modeling.

Organization of concepts and variables from the literature reviews conducted was fostered by constructing conceptual frameworks. From the model, three independent variables and one dependent variable were identified. The independent variables were formalization of firms, formalization of financial institutions and formalization of business/financial users and the dependent variable was financial inclusion, its operationalization was as shown in figure 1

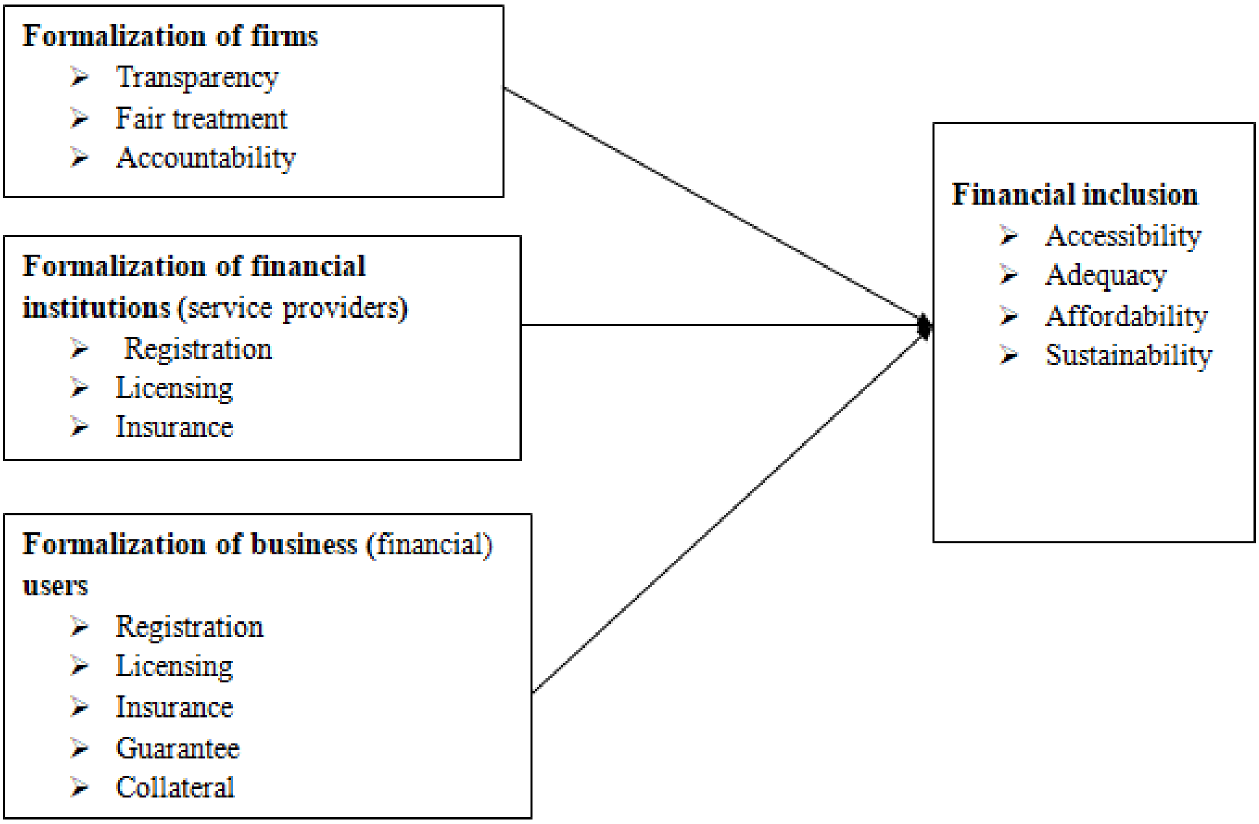

Figure: 1
Source: Galor & Zeira (1993);[18].

4. Methodology

The study employed a quantitative research approach. Moreover the causal research design was used. The study was conducted in Mbeya City in which small scale processors (30), small scale traders (40) and (20) small scale service providers (such as welders) and women entrepreneurs forming a group of financial users were involved. Moreover (10) respondents were the financial service providers obtained from Banks (i.e. CRDB, NMB); Non Banks (ie Britam insurance company), microfinance and informal financial groups. To derive to 100 respondents the study used a margin of error =0.10 while the level of confidence was 90%. Indeed the sample of 100 was obtained from 400,000 total population computed by applying Cochran formula, n=N/1+N(α)2 where n= sample size=100; N=population size=100 and α =

margin of error=0.1. Furthermore this study used a systematic sampling technique in which the interval was 4,000 was applied which means at once 100 sample of respondents was derived.

The variables employed in this study where formalization of financial institutions/business users and financial inclusion (measured through accessibility, adequacy, affordability and sustainable financial services). These variables were measured by using (ab) Likert scales as it was suggested by Jamieson in the format of "strongly achieved", "achieved", "undecided", "not achieved" and "not strongly achieved" [19]. Furthermore the facts were collected primarily by using questionnaires and secondarily by reviewing secondary documentaries such as journals, books, and encyclopedia. The collected and processed data were analyzed by employing rotated component matrix, multi-co linearity and partial correlation with the aid of SPSS AMOS version 24.

5. Results & Discussions

5.1. Formalization of Business Firms and Financial Inclusion

Under this subtitle the study aimed at revealing the effects of formalization on financial inclusion. The variables and concepts put forward defining what formalization is entailed transparency, fair treatment and accountability. What the study was trying to address was over the mechanisms contributing to free flow of financial information called symmetric information flow. As it was revealed by Kim, Zoo, Lee & Kang is that the business firms including financial institutions and financial users needing to be registered, licensed and insured purported at creating transparent and perfect financial market pattern. It was indeed revealed by Sharma Bose, Shekhar and Pathania (2019) that in the environment where there is perfection then financial need unit get into free choice of the financial services [20]. that meet their needs and objectives. The reality from the field was found and presented as shown in figure 2

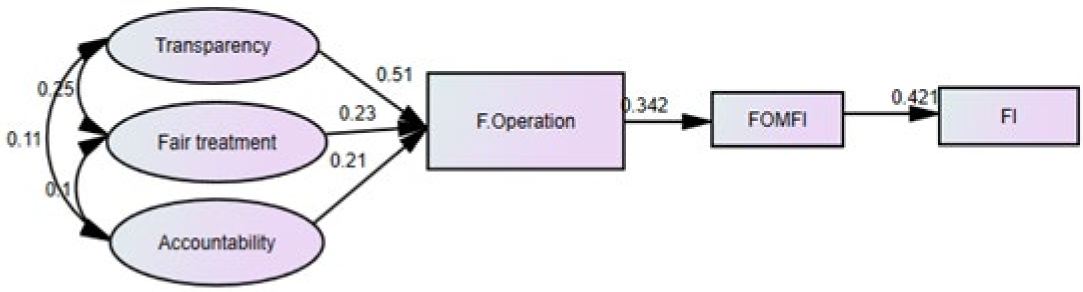

Figure 2: Rotated Component Matrix

Note: FOMFI = formal operating mechanism of financial institutions; FI = financial inclusion by financial institutions

From Figure 2 with component matrix = 0.510 shows that execution of transparency was moderately done in which simply this means that transparency is not exercised to that high level say if it could be >0.5. But the situation is still not good over fair treatment regarding different types of customers. The fair treatment implies exercise of horizontal equity for the low income earners, the households, and disadvantageous remote rural population-user different from high income earners, large firms, urban and capable business-users. For instance fair treatment of the households (who are both savers and users of credits) and firm should be different to encourage for universal accessibility. Thus fair treatment should focus the customers at different angles through vertical and horizontal equity instead of treating all progressively. Progressive treatment of customers is the reason why majority of SMEs are financially excluded. The facts which are consistent with what was said by FSDT in which it was revealed that it is only 14% of users of financial services in Tanzania formally banked [10].

As it was suggested by ManKiw and Ball (2011) is that categorizing different types of users help to be able to meet their insights and ManKiw and Ball suggested that fair treatment of the households and firm who are of different status may applies the 'NETTING' principle. Netting expect to increase financial inclusion to agro-processors from 25.9% to at least a high step >50% .And it is through fair treatment of customers in which it is expected the agri-firms accessibility to financial services and products would increase from the current 16.5% to at least higher trend.

Moreover un-attractive situation has shown with accountability of financial Institutions through component matrix =0.210.Insignificant transparency and equity led to formal operation trend of financial Institutions=0.342.The 0.342 as a rotated component matrix is little to cause a financial inclusion of 0.421 at least become >50%.

6. Formal Operating Mechanisms of Financial Institutions and Financial Inclusion

In here the study aimed at investigating the effects of formalization of financial institutions on financial inclusion. This is from the fact that to be attained to effective, sound and sustainable financial services and products both the providers and users need to be formalized. Usually unregistered and non-licensed financial institutions offers its services non-transparently, unfairly and in more exploitative manner for users not attained to affordable, adequate and low cost financial products [20]. The results in Figure 3 reveal the reality of what was extracted from the field indeed by loading the following structural equation model $F_{fi} = 12.130 - 8.742Reg - 6.812Le - 9.342Insu + e$ where F_{fi} = formal operating mechanisms of financial institutions, micro-finances; Reg = registration; Le=licensing; Insu = insurance

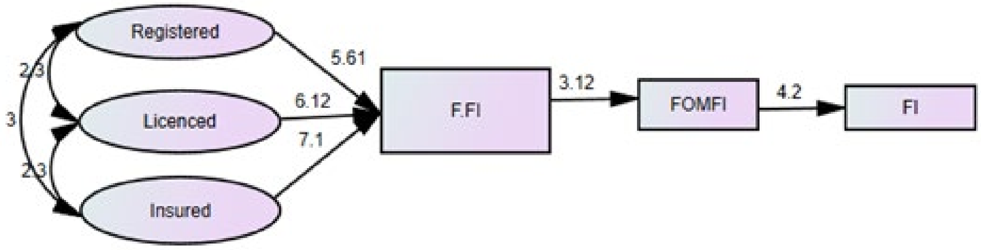

Figure 3: Multi-collinearity analysis test

Note: *, ** and *** indicate significance at 10% level, 5% level and 1% level respectively.
F. FI = Formal financial institutions; FOMFI= formal operating mechanisms of financial Institutions; FI= financial inclusion-financial institutions.

From figure 3 where β= -8.742 and t = -9.120 at p =0.000* and impact factor (VIF) = 5.61 shows a test and retest reliability to hold. While Banking and Non-Banking Financial Institutions found to register their businesses, most of micro finances found to operate informally while unregistered. Non formal operating mechanisms of the major sources of financial services to small holders farmers is the fact why both coefficient of 'β' and independent sample't' test continuous data to be insignificant .It was expected that the 'β' and't' values could be worth following the fact that majority of small scale farmers who hold about 70% of Tanzanians are operating informally and the major sources of finances to be invested in their farming activities could be micro-finances. VSLA, SACCOS, VICOBA which then does not hold true. Because they are not registered they then operate exploitatively as they are no laws, regulations and policies guiding their operations. To be not registered to them (micro credits, micro finances) is like they are exempted from principles, rules and regulations. They are found to provide their services non-transparently and at a very high price not affordable to the majority of the small scale farmers. Unregistered micro-finances are not known and as it is like subjected to rules, regulations and microfinance policy framework of 2000 amended in 2017s. Indeed the gap has shown with the Women made informal financial associations such as Kuleana, UPATU and 'Kibubu' in which its operational management in most cases is not formalized for business-women benefit from them. And since these micro-finances are the ones which are near customers and at least because of the services say credits to be accessed in short period of time that is why majority of customers are used to those financial Institutions. But only to find that they are accessed to high costing financial services which also do not satisfy their needs the same what was said by Sparreboom and Duflos [21].

Moreover with β= -6.812 and t= -5.721 at p = 0.000*** and VIF = 6.12 for licensing predictor indicated the continuity inter rater reliability to attained. This hold true from the reality revealed from the field in which most of small holders' farmers were found not registered and licensed their land, processing plant and the warehouse and trading firm. This was also revealed from micro-finances of which are correspondent financial infrastructures accessed or which are near homes of the small holders' farmers who are the needy group but to find themselves excluded financially and if accessed, they do so to inadequate , unaffordable and non-sustainable financial services and products. Non-licensed micro-finances are subjected to legal commitments in which they require to pay tax. But most of these businesses tend to evade and avoid paying tax. Thus the profit they are making may be supernormal creating non sound financial inclusion due to the reserve domestic currency created. Indeed non licensed micro-finances, VSLA are subjected to legal shocks. It is with informal operation of micro-finances in which sustainable financial inclusion is disturbed.

The non-insured financial institution is disturbed by socio-cultural (such as terrorism, fraudulent dealings and forgery) environment shocks such as fire outbreaks, not able to perform. The extreme findings of β = -9.342 and t= -8.563 at p= 0.000*** and VIF =7.1 shows that though insurances' impact factor was worthing. Despite of the VIF to be moderately significant but still the discrepancy is great with micro-finances , micro-credits, the credits and savings association for majority disadvantageous SMEs not be accessed to adequate, affordable and sound financial services. With inter-rater reliability test experiments the results above hold its consistency. The same results were also shown with R2, expected variation = 0.48 and overall formal operating mechanisms of the financial Institutions, VIF = 4.20 which then is not enough to cause financial inclusion. All the results above were analyzed against the acceptable threshold level VIF =10.

7. Formal Operating Mechanisms of Business-Users (Individuals and Firms) And Financial Inclusion

Like what the financial Institutions are accountable and responsible in protecting the customers' properties and not disclosing the customers' information the same should be exercised by customers. Customers have a duty of executing re-payment of credit plus interest on due time, observe all rules, and regulations of the contract signed. But to be accessed to adequate and quality credits then a customer is responsible to make its business formal [22].To individuals say the households then a customer should be known and identified by being registered by ID registration Regulatory Authorities such as NIDA in Tanzania. A registered individual and licensed business firms are assured with financial services providers over the money given to the customer say credits to be refunded and indeed on time. Non-properly identified credit applicant create impediment towards being accessed to financial services if not causing FI commit adverse selection. These results are consistent with what was said by Rahman et al on his study 'SME's Registration Evidence from an RCT in Bangladesh'. And this is the reason why during financial Institutions are advised to do thorough applicant assessment and credit review in order not to be committed to the so called adverse selection (Type I and Type II error). The whole concept follows under the theory Knowing Your Client (KYC) [23]. But the problem still exists in Tanzania in which majority of the households, SMEs are informal and their businesses are operating informally. Majority of Tanzanians are lacking identification, as they even do not have a National ID; they are even not known by Village (Street) Chancellor who are the first guarantor or recommender over the character of the burrower (the households) .In 2017 it was about 27millions Tanzanians who were registered at least having one out of the following identity cards, National ID, Voters ID, driving license. And this is also a discrepancy why most of formal financial Institutions do not give financial services to most of SMEs, disadvantageous remote rural population, low income earners and the household's type of customers. Furthermore other stakeholders have been dictating over having a single database or organization from which the profiles of citizens of Tanzania is found for financial institutions to be easily accessed to the information of their customers. That means customers' identification (their character, capability, condition, capital) could be easily retrieved even before asking for the business plan. Indeed the customer's databases suggested to be better is that which is electronic due to the fact that currently the world has adopted digitization. The dilemma that has been revealed is the same as what it has presented in path diagram-figure 4 below

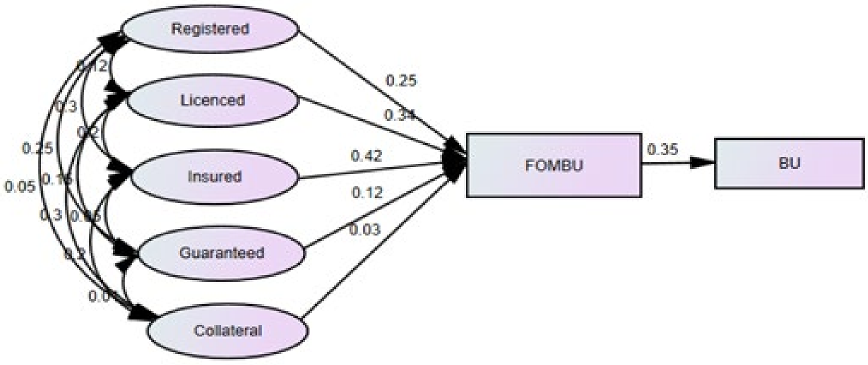

Figure 4: Partial Correlation

Note: FOMBU= formal operating mechanism of business-user; BU= financial inclusion- business user

While the registered number of customers carries a correlation coefficient, r = 0.25, the licensing of the business-users had r=0.34.Those with insurance or their businesses are insured against legal changes, economic fluctuations and environmental shocks (say flood, fire outbreaks, earthquakes) which could distort the expected returns, holds, r=0.42.The correlation coefficient displayed above are not enough to cause them accessed to quality and adequate financial services. And with insurance for instance where r = 0.42 less than at least r =0.5, this shows the extent to which business-users that is SMEs involving in processing, trading and service provision from the area of the study i.e. at Mbeya City were vulnerable to shocks(variations) in danger for their businesses not to perform. That means non-performance of their businesses is the major sources of being incapable of refunding the credit amount asked leading to another problem to financial Institutions called non-performing loans or credit losses. Moreover non-performance of the businesses because of shocks caused by changes in business not being insured decreases savings which then lead to no/little investments , little productions what it has revealed with small scale farmers in Tanzania on why agricultural activity is carried out at a subsistence level. No surplus outputs that could increase sales for the farmers to increase per head income. Subsistence farming practices is the result of little improvement over people' livelihood in which Tanzanian rural population is living under average of 48% of food poverty line (NBS,2016).The 48 percent of rural population is in >70% of Tanzanian population which is also a vulnerable group to the acute financial exclusion. The problem is great with most of women entrepreneurs in which access to land that could be used as a collateral is still is dilemma which have then fulfilled by this study.

The guaranteed users with r= 0.012 and convert ability and easily realized collateral with r= 0.03 prove the fact that majority of users of financial services are operating informally difficult to be accessed to adequate and sound financial services. In here the knowledge following this discrepancy is that they are not guaranteed. The lender need a guarantor who will work as a surety (assurer) for say a credits asked by principal debtor (the customer or user) to be paid back lenders are assured with a guarantee of a guarantor for the credit to be repaid. With the trend of say, r =0.012, this is insignificant to show that most of principal debtors (the households, micro-enterprises) are not guaranteed and therefore they are not accessible to affordable, adequate and quality financial credits which fulfill their needs and objectives.

8. Conclusion & Recommendations

Formalization of businesses was revealed to play a great role towards increasing accessibility to adequate, quality and lowly cost financial services and products. It was further found that informal operating mechanisms of majority micro finances, microcredit unions, VSLA and SMEs (i.e small scale processors, traders and service providers) is the major reason for the acute financial exclusion of 71%. It is from these revealed discrepancies therefore the study recommends the following for actions:-
i) Strong enforcement of Banking and Financial Institutions, rules, regulations (Banking and Financial Institutions Act 2006 and regulations of 2005) requiring Financial institutions and

small enterprises formalize their businesses.
ii) Promotion of financial inclusion framework of 2013
iii) Strong enforcement of Microfinance Policy Framework of 2000
iv) Management of microfinance is to be empowered with managerial tactics and techniques
v) Both FIs and users have to register and license their businesses/operations
vi) Identifying different types of customers and being able to meet the actual need of each type of user to ensure universal accessibility to adequate and quality financial products.
vii) Being used to technological innovations such as e-banking, Mobile banking, opening more bank branches, ATMs, retail/agent banking that will help in reaching un-banked, remote rural population users at an affordable price.

9. Recommendations for Further Studies

More researchable areas that can be researched related to this study are:-
i) The Financial literacy and financial inclusion
ii) Financial Institutions' Management effectiveness and innovation and Financial Inclusion
iii) Strong enforcement of rules, regulations, policy for Financial Inclusion
iv) Control of security financial market for financial inclusion
v) Digitization a way towards financial inclusion
vi) Micro finances and financial inclusion
vii) Financial Inclusion for socio-economic development
viii) Financial Inclusion for the SMEs development
ix) Financial inclusion for inclusive economic growth
x) Facilitating financial infrastructures and financial inclusion.
xi) Effective microfinance Institutions' management and Control for financial inclusion

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