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   REVIEW OF LITERATURE

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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

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IMPACT OF DEBT CAPITAL ON OUTREACH AND EFFICIENCY OF MICROFINANCE INSTITUTIONS: A SURVEY OF SOME SELECTED MFIs IN TANZANIA

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ABSTRACT
Financial and development economics researchers, practitioners, and donors are debating on the rightful effect of debt capital on the performance of MFIs in terms of outreach. Some argue that microfinance involvement in commercially procured funds is likely to cause the sector raise interest rates or increase loan sizes to maintain a certain level of operational return or profitability to be able to pay interest expenses on borrowed capital. Changes in either dimension could result into exclusion of some type of potential poor borrowers. Still others argue that debt capital enhances efficiency through economies of large scale when massive debt funds are used to expand operation. Thus, MFIs can reach more poor clients at low costs. This paper is a survey of secondary data from selected MFIs in Tanzania. Empirical evidences from this paper show that debt capital reduces outreach to poor clients of MFIs in Tanzania context. The policy implication for the paper is that since MFIs are perceived as people's development tool and poverty alleviation strategy, donation or government grants should be sustained in a long term in order to enable MFIs reach the poor who cannot afford high interest rates charged by debt financed MFIs.

KEYWORDS
Debt Capital, Microfinance Institutions.

1.0 INTRODUCTION
In Tanzania context, microfinance institutions have been in operations since colonial period though were not taken as important means of enhancing development. In the 1990s the government of Tanzania, through the support of the World Bank and the International Monetary Fund adopted economic reforms aimed at increasing growth, encouraging private sector development, market integration and industrial competitiveness. In the financial sector the reforms has included liberazation of interest rates, elimination of administrative credit allocation, strengthening the central bank's (Bank Of Tanzania) role in regulating and supervising the financial institutions, restructuring state owned financial institution, allowing entry of private sector (foreign and local) banks into the market, creation of the capital market security authority (1994) and the Dar es salaam stock exchange (1998). To enhance the access of financial services by large segment of the rural and urban population, the government initiated a micro finance policy in 2001. The policy invites the government in collaboration with the donor community to facilitate the development of micro finance institutions .The policy articulates the vision and strategy for the development of sustainable micro finance industry as an integral part of the financial sector, specifying the respective role of the key stake holders- the government and its principal agencies , institutional providers of micro finance services and the donor community (URT, 2001).

Since 2001, a number of micro finance institutions have been established and according to the BOT statistics there are more than 1800 microfinance institutions operating in Tanzania to date (BOT, 2012, www.bot.tz).These institutions include donor funded micro finance institutions (NGOs), community banks, village or ward banks and cooperative societies. The principal micro finance providers (especially in rural areas) include the Savings and Credit Cooperatives (SACCOS), SIDO , government assisted community banks and foreign donor- assisted Non – governmental Organizations (Examples are the PRIDE, FINCA, DUNDULIZA, SEDA to mention a few; Fraizer and Kazi, 2004).

Despite all these initiatives access to microfinance remain to be a critical problem to most people in the country (Satta, 2006). According to a study undertaken by BOT in 1997, it was found that 82 percent of households were saving in their homes, 79 percent of the households were willing and able to save if appropriate products and savings mechanism were there, where as 94 percent were willing to borrow more if more resources and appropriate methodology were available (Olomi, Chijoriga and Mori, 2009: p.132). In another study by Finscope (2007) it was confirmed that a large part of the population has no access to microfinance institutions, with over half of the population being completely excluded. Only 5% of the rural populations have access to formal main stream banks, and only 2% of the rural population have access to microfinance institutions. Among many reasons for the limited access to financial services is high interest rates charged, low financial capital base among MFIs (Fraizer and Kazi, 2004). Majority of MFIs are operating in small scale and some are donor dependant (Olomi, Chijoriga and Mori, 2009).

In an attempt to increase the capital base, microfinance institutions are now accessing a broad range of private capital from the financial markets. High profile financing transactions are now taking place; including securitization, local bond issues (bank borrowings), the first initial public offering of shares, bank – microfinance partnerships. Additionally, where legal structure permits, MFIs are launching large scale deposits mobilization campaigns as a core funding strategy (Meehan, 2004; CGAP, 2007). However, the key challenge ahead of MFIs managers is the sustenance of IMF's objectives of reaching the poor using commercially procured funds and blending it with donor funds (Morduch *et al*., 1999; Woller and Brau, 2004).

2.0 STATEMENT OF THE PROBLEM
Financing decisions among MFIs is a salient issue yet to be explored in depth. Access to private capital such as bonds, initial public offering of shares, and the use of large scale deposits among microfinance institutions calls for efficient capital structure management and an understanding of its possible inherent mission drift. Different sources of funds have different costs implication and risks that may impact a firm's operations and mission (Modiglian and Miller, 1963, Jensen and Meckling, 1976). The argument is that microfinance involvement in private capital (e.g. debt) is likely to cause MFIs raise either interest rates or increase loan sizes to maintain a certain level of operational return or profitability (in order to pay interest and fees on debt). Changes in either dimension could result in the exclusion of some types of potential poor borrowers.

Still others (Morduch, *et al*. 1999; Morduch , 2000) argue that the use of debt will enhance efficiency through economies of large scale and the agency problem of debt, thus MFIs will be able to reach more poor clients at low costs[1]. There is still limited empirical evidence both in Tanzania and internationally on the rightful nature and extent of the effect of private capital (bonds, deposits and equity shares) on MFIs performance. The impact of capital structure decisions on MFIs performance, in terms of outreach, efficiency and financial sustainability are currently researchable areas. Previous studies and theories on capital structure have focused on profit motivated businesses (Modigilian and Miller, 1963; Jensen, 1986 etc). This paper provides additional knowledge and evidence on the effect of capital structure decisions in the microfinance industry and in a developing economy context of Tanzania. The paper is organized as follows: The next section provides a brief review of information on microfinance outreach in Tanzania. This is followed by a review of related literature. The fourth section deals with methodological approach of the paper. The fifth section presents the findings and the sixth section which is the last section concludes the paper.

[1] See Welfarist and Institutionist theories under related literature section.

3.0 RELATED LITERATURE

3.1 DEFINITIONS AND CONCEPTUAL ISSUES OF THE STUDY

Financing decisions

Financing decisions of an organization are decision regarding the proportion of the various sources of funds used by a firm to finance both its fixed assets and operating activities (Brealey and Myers, 2003). Three major sources of funds are available namely equity funds (shareholders), debt funds, and retained earnings (*ibid*). In the microfinance industry donations has been a major source of funds (Morduch, 1999). A firm can issue large amount of debt (bonds) or very little debt. It can issue equity shares in an attempt to maximize its overall market returns and performance (Lindsay, and Sametz, 1963; Brealey and Myers, 2003, Abor, 2005).

Debt Capital

Debt capital is a type of long term funds a firm obtains by borrows from a financial institution or a company and commits itself to payment of a fixed interest at specified period and repayment of principal amount on maturity. Debt capital may also include short term funds obtained by firms or institutions from the issue of securities such as commercial papers, promissory notes, bills of exchange and others. Some debt issuers require collateral (secured debt) still other do not require collateral (Brealey and Myers, 2003; Majundar and Chhibber, 1999).

Microfinance institutions

Microfinance is a general term describing the practice of extending small (micro) loans and other financial services, such as savings accounts and insurance to low income borrowers for financing income generating self- employment projects (CGAP, 2004). Microfinance institutions are organizations that are engaged in the provision of micro loans, savings, insurances services, and sometimes remittances of funds to small and medium entrepreneurs and low income earners. Microfinance institutions seek to pursue and achieve two objectives. To achieve and demonstrate social as well as financial performance. The role of micro finance differs from one context to another and may encompass filling gaps in financial markets, providing risk tools to vulnerable groups or individuals, allowing micro-entrepreneurs to take advantage of economic opportunities, building social networks, and others. (CGAP, 2004, Schreiner, 2001; Otero *et al.,* 1994).

Outreach

Outreach in microfinance refers to the clientele characteristics of the MFIs. It is about the number of active clients served and the poverty level of the clients (Schreiner, 2004). For robustness purposes this study employs several indicators to measure outreach. These are: the number of clients served, nature and type of activities undertaken by borrowers, and gender of clients served by the MFIs. These variables are used as proxies for poverty level of the clients served.

Efficiency

Operational efficiency of an MFI is the degree to which it minimizes cost when delivering services. Operational efficiency depends on administrative and managerial decisions. Lending methods, efficient procedures and productive staff (Schreiner, 2001; 2002; 2003; CGAP, 2003). Several indicators can be used to measure efficiency. These are the Cost per client ratio, operating expense ratio, and number of borrowers per loan officers' ratio.

3.2 FINANCING THEORIES

3.2.1 Theories in profit motivated businesses

In their seminal work on the irrelevance of capital structure, Modigliani and Miller (1958) were the first financial economists to propose a theory on financing decisions. In their paper they argued that under perfect markets conditions (where there are no transaction cost, and no taxes and bankruptcy costs) the composition of the capital of the firm does not affect the value of the firm or its performance. They stated that what affects the firm's value is the earning potential of its assets but not the securities it issues. However, following critical challenges on the unrealistic assumption of perfect markets Modigilian and Miller (1963) revised their position by incorporating tax benefit on debt as an influencing variable on capital decisions. In this new dimension, they argued that capital structure matters under imperfect economies and suggesting that there is a relationship between financial leverage and economic performance of the firm, thus firms should use as much debt as possible in order to enhance their performance.

Subsequent to Modigillian and Miller works several theories have emerged on the relationship between capital structure and firm economic performance. One of those theories is the agency theory.

The Agency theory

The separation of ownership and control in firms normally result into agency problems. The seminal paper by Jensen and Meckling, (1976), hypothesis that high leverage (more debt) reduces the agency problem and increases firm value by constraining or encouraging managers to act more in the interests of shareholders.

Harris and Raviv (1991), and Majundar and Chhubber, (1999) tested the agency theory and reported that debt allows shareholders to discipline management because defaults allows creditors the option to force the firm into liquidation. In similar direction Jensen (1986) asserts that the pressure to generate cash flows to pay interest expenses on debt reduces the agency cost. Debt exposes firms to external scrutiny in the financial market, thus improving accountability and efficiency use of resources by managers (Easterbrook, 1984; Fosberg, 2004).

Generally, the tax benefit of debt and the pressure arising from free cash flow of debt provide acceptable explanation for shareholders (owners) to prefer debt than equity funds when firms need to finance their new investments.

3.2.2. Theories in the microfinance industry

The welferist and institutionst theories

Private capital financing in the MFIs industry has created an interesting debate among finance and social economic researchers. The centre of the debate is on whether private capital can deter MFIs from reaching the poor. The debate has consolidated into two theories know as the institutionist theory and welferist theory.

According to institutionists theory, microfinance should be integrated into formal financial systems, so as to ensure colossal and permanent access to financial services to increase clientele base. They advocate that in order to reach majority of the poor, MFIs should attract private investors by being commercially minded, operate at large scale and profitable. The role of donors should be to build the institutional capacity of MFIs and to support the development of experimental services and supporting the overall infrastructure of the financial system, (CGAP, 2004; 2007)

Institutionists do not believe in the effectiveness of subsidized credit programmes. They believe that such credit schemes will end up in the hands of those not-so-poor households which have enough influence and connections to divert scarce credits to them, while depriving the poorest (Gibbons and Meehan, 2000; Meehan, 2004).

The welfarist approach is explicit and focused to reaching the very poor first. They are less interested in banking per see than in using financial services as a means to alleviate directly the worst effects of deep poverty among participants and communities, even if some of these services require subsidies (Ferreira, 2004, p 9 , Woller et al, 1999). Welfarists argue that donations serve as a form of equity, and as such, the donors can be viewed as social investors. Unlike private investors who purchase equity in a publicly traded firm, social investors do not expect to earn monetary returns. Instead, these donor-investors realize a social, or *intrinsic,* return. Welfarists tend to emphasize poverty alleviation, place relatively greater weight on depth of outreach relative to breath of outreach, and gauge institutional success more so according to social metrics (Woller and Brau, 2004).

The Welfarists fear that the commercialization of microfinance, more precisely, the need to be profitable in order to attract private capital, will divert the industry from its paramount goal of poverty alleviation (Woller *et al*, 1999). They believe that there are many borrowers, who are poorer and harder to reach, that are unable to pay high interest rates. Thus, the win-win situation advocated by institutionists is, in practice, much more complicated to achieve than they claim (*Ibid*).

On the whole, theories explaining the rationale for the selection of financing sources in profit making firms have been tested in depth in both developed and developing countries. There is general consensus that profit motivated firm finance their operations with due regard to risks associated to each source of funds. Thus firms finance their operations first with equity, then with retained earnings before resorting to debt capital. The combination of the various sources of funds takes into account the risks implication of each source to the firm. The challenge ahead of practitioners in MFIs and academic researchers is the application of debt capital in the microfinance industry. Debt capital is associated with fixed interest rate payments and repayments of principal on maturity. Sometimes debt capital is linked with restrictive covenants which might hamper the implementation of poverty related policies in the long run. The implication of risks associated with debt capital has not been studied in depth both internationally and in Tanzania. Thus this paper presents the empirical evidence on the implication of debt capital on financial and social performance of MFIs in some selected MFIs in Tanzania.

4.0 METHODOLOGY

This paper used quantitative data and through a sample survey of MFIs operating in Tanzania. Time serried -cross sectional data was used. The time series cross-sectional annual data enabled the study to track changes on financial capital used, outreach and efficiency among sampled MFIs Historical data over the period from 2005 to 2009 (a five years period) was collected on issues such as sources of funds, cost implication of each financing source, outreach structure, client selection methodology, lending methodology, clients poverty status, assets structure, staff capacity, loan portfolio, and other related information. The required secondary data was collected from a web site of the MIX market an international organization dealing with evaluation of microfinance institutions where most MFIs report their financial statements and other operational performance information annually. The MFIs included in sample were those which consistently contained all the necessary information needed in the study over the study period. Those with missing information were dropped in the sample. The sample size was 8 MFIs which resulted into 48 observations (8 MFIs over 6 years). These MFIs were the only ones that met the needed conditions in the sampling plan.

DATA ANALYSIS

The analysis was guided by the following hypotheses:

Hypothesis H1: There is a significant relationship between capital structure and outreach of MFIs.

The theoretical statement[2] of this model is that the performance of MFIs in terms of outreach (both breadth and depth) is influenced by debt and other funds used by MFIs. That is: Outreach, = f (Y[debt ratio, Subsidies/donations ratio, deposit ratio, equity ratio], X [firm size, funding costs, age, profitability,]), thus;

OUTREACH = $\beta_0 + \sum_{i=1}^{n} \beta_i X + \sum_{j=1}^{m} \beta_j Y + LENMETDUM + \epsilon$ 2................ (2)

β_0 represents intercept, X , represents MFIs characteristics control variables, ϵ = error term representing the residue of the disturbance in the model, $\beta_i =$ Coefficients of the independent variables

This hypothesis was analysed using regression techniques of pooled ordinary least square, random –affect GLS, and fixed effect regressions

Hypothesis 2: There is a significant relationship between capital structure and efficiency of MFIs.

The theoretical statement[3] of this hypothesis is that the performance of MFIs in terms of efficiency is influenced by debt and other funds used by MFIs. That is: Efficiency = f (Y[debt ratio, Subsidies/donations ratio, deposit ratio, equity ratio], X [firm size, funding costs, age, profitability,]), thus;

EFFICIENCY = $\beta_3 + \sum_{i=1}^{n} \beta_i X + \sum_{j=1}^{m} \beta_j Y + \epsilon$3................................. (3)

This hypothesis was analysed using regressions (Pooled OLS, and GLS).

5.0 RESULTS AND DISCUSSIONS

Three regression techniques were used to test the effect of capital structure on outreach and efficiency of MFIs. Since the study uses panel data, the analyses could possibly be done using pooled OLS, fixed effect regression, or random effect (GLS) regression. The major concern was to test which regression type could produce consistent and unbiased coefficient estimates. The Breusch-Pagan Lagrange multiplier (LM) test is used to test random effects. The null hypothesis of the one way random group effect model is that individual-specific or time –series error variance are zero. If the null hypothesis is not rejected, then the pooled OLS regression model is appropriate. To test whether a fixed effect model or its counterpart random effect model is appropriate, the Hausman specification test is used. Normally these two test are available with STATA a statistical package used in this study. These two tests were used to identify the most appropriate regression model for each analysis of the model.

5.1 THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND OUTREACH OF MFIs

The outreach variables were regressed on capital structure variables together with MFIs characteristics variables as control variables. Table 1 presents the results of random –effect GLS (Generalized Least Square) regression, and the pooled OLS (Ordinary Least Squares). Three variables were used to measure outreach of MFIs. These are the natural log of number of borrowers (indicating breadth of outreach), percentage of women members (indicating depth of outreach) in MFIs , and log of loan sizes (depth of outreach). These three variables were regressed one at a time on capital structure variables together with the MFIs specific characteristics variables as control variables.

TABLE 1: COEFFICIENT ESTIMATES OF THE EFFECT OF CAPITAL STRUCTURE OF MFIs ON OUTREACH

	Dependant variables; N= 42					
Regressors	Eq.1 ;LOGBORROWER (Random- effect GLS Regression)		Eq.2: %WOMENBORROWER (Random-effect GLS regression)		Eq.3: LOGLOANSIZE (Pooled OLS regression)	
	Coeff.	Z-values	Coeff.	Z-values	Coeff	T-values
Age	0.177	2.02**	-1.83	-1.66*	0.19	1.76*
Sze	0.010	0.25	1.28	1.52	0.20	2.46**
Tdr	1.903	2.08**	29.9	1.74*	-0.41	-0.40
Dr	-2.08	-0.61	123.9	3.29***	-4.90	-2.92***
Const.	7.455	6.50***	24.66	1.40	5.84	3.59***
R2	0.28		0.3035		0.4459	
Prob>F	0.003		0.000		0.000	

*; **; ***. Significant at the level of 10%; 5%; and 1% respectively.

Where:

Age= Age in years of MFIs since establishment

Sze= Size of MFIs in terms of log of total assets

Tdr= Total debt ratio (debt /total assets)

Dr= Donation ratio (total donation/total assets)

Loan size= Average loan per borrower in Tshs

Borrower= Outstanding total number of borrowers

Women= Percentage of women borrowers (Women/total borrowers)

[2] The study hypothesis that as funding cost increases outreach structure (depth of outreach) tend to change, MFIs are forced to drop small loan borrowers (the poor) who are costly to administer and tend to lend to well off customers-relatively less poor customers. Thus a negative relationship is expected between outreach variables and funding costs, (debt variables). However a positive relationship is expected between depth of outreach with Donations or subsidies.

[3] The study hypothesis that as MFIs access more funds in terms of debt capital their scale of operations increases thus enjoy economies of large scale hence reduction in overall operating cost per unit. Thus a negative relationship is expected between efficiency variables and debt capital. However a positive relationship is expected with Donations or subsidies.

As shown in Table 1 the coefficient of the variable for log of number of borrowers is positively correlated with total debt ratio at a statistically significance of 5% (Z= 2.08; p = 0.037) in equation 1. The implication is that debt capital increases breadth of outreach by increasing the number of active borrowers. Similar results were reported by Kyereboah-Coleman (2007) in Ghana. Debt financed MFIs increased their client base significantly than donor dependant MFIs.
This paper results however show that debt capital marginally increases depth of outreach (outreach to the very poor) as measured by percentage of women members in MFIs as indicated in equation 2. The statistical strength of the influence is 10% level (t=1.74 ; p= 0.082). However the influence of debt capital in relation to log of loan size is not statistically significant as shown in equation 3.
Results in Table 1 also show that donations increases depth of outreach (as measured by percentage of women and loan size) of MFIs. As indicated in equation 2 the effect of donations on percentage of women members is positive and statically significant at zero percent level (t= 3.29; p= 0.001). The implication is that MFIs with more donations have deep outreach (reach poor clients especially women) as measured by high percentage of women members. As shown in equation 3 the effect of donation on average loan size is negative and statistically significant at zero percent level (t = -2.92; p = 0.006). The implication is that more donations low average loan sizes, thus MFIs with more donation issue small loan sizes hence an indication of reaching poor clients. This finding conforms to welferist theoretical expectations.

5.2 THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND EFFICIENCY OF MFIs
The hypothesis in the analysis was that capital structure affects MFIs efficiency. To test this hypothesis two pooled OLS regressions were run. Pooled OLS regressions were found producing unbiased and consistent coefficient estimates compared to fixed or random effect regression models. The first regression involved regressing natural logarithm of cost per borrower (LOGcpb) on capital structure variables of debt ratio (tdr) and donations ratio (dr) together with MFIs specific variables of age and size as control variables. The second regression was run on operating expenses per loan portfolio (opelp) as dependant variables on same regressors as the first equation.

TABLE 2: POOLED OLS COEFFICIENT ESTIMATES OF THE EFFECT OF CAPITAL STRUCTURE ON EFFICIENCY OF MFIs

	Dependant Variable; N= 44			
Regressors	**Eq1: LOGcpb**		**Eq. 2: Opelp**	
	Coeff.	T-values	Coeff.	T-values
Age	0.33	2.57***	0.505	0.45
Sze	0.40	5.75***	1.036	2.24**
Tdr	4.44	2.60***	29.86	1.60*
Dr	-9.10	-1.97**	-72.83	-1.68*
Pwb	-0.004	-0.30	0.224	1.04*
Const	-2.25	-1.94**	2.003	0.19
R2	0.6483		0.3788	
Prob> F	0.000		0.000	

*; **; ***. Significant at the level of 10%; 5%; and 1% respectively.
Where:
Pwb= Percentage of women borrowers
Opel= Annual Operating expenses per loan portfolio in Tshs
Cpb= Annual Cost per borrower in Tshs
Sze; Tdr; Dr; Age = As defined in Table 1.
Results in Table 2 show that the effect of total debt ratio on cost per borrower is positive and statistically significant at 1% level (t= 2.60; p= 0.013). The implication is that debt capital reduces efficiency of MFIs as indicated by increasing cost per borrower. The effect of debt capital on efficiency of MFIs as measured by operating expenses per loan portfolio (openlp) is also positive and marginally statistically significant at 10% level (t= 1.60; p =0.109). The implication is that debt capital increases operating expenses on both loan portfolio and cost per borrower contrary to expectation. The expectation was that debt capital can make MFIs efficient through the agency theory. Intuitively the positive relationship found here shows debt funding expenses increases cost per borrower as well as operating expenses per loan portfolio, this is obvious. The reduction in cost arising from agency theory would depend on the trade-off between economies of large scale and the funding cost. Funding costs are likely to exceed the benefit from economies of scale at the early stages of debt utilization. However, in a long run a negative relationship between debt capital and cost per borrower or loan expenses may arise due to reduction in cost per unit as MFIs expands their operations.
The effect of donation on cost per borrower and loan expenses per portfolio is negative and statically significant at 5% and 10% level respectively. The interpretation is that MFIs with more donations in their capital structure have low cost per borrower or expenses ratio per loan portfolio compared to those with debt capital. The finding suggests that MFIs with more donations have low or no debt expenses and hence overall cost per borrower or loan expenses is low. However, this does not suggest efficiency. In the long run if donations stagnate economies of large scale cannot apply to such MFIs. They will have high cost per borrower compared to MFIs with expanded scale of operations arising from use of debt capital. Thus the observed relationship could be a temporary phenomenon. It is therefore not appropriate to refute the theoretical expectations underlying the study analysis.

6.0 CONCLUSION
The effect of debt capital on depth of outreach of MFIs is evident in this study. Highly leveraged MFIs issue large loans sizes and lend to less poor borrowers to mitigate loan losses and enhance interest income to increase their ability to meet debt interests. On the other hand MFIs with high donations ratio in the capital structure issue small loan size thus indicating deep outreach. The results of this study therefore support the welfarists theory on mission drift arising from commercialization of MFIs.
The agency theory suggests that debt capital exposes managers to external scrutiny and makes them use resources efficiently to minimize losses and wastes and be able to mitigate debt obligations. Results from this study indicate that MFIs managers reduces wastes buy including more clients some of which are non-poor clients in their clientele to reduce the agency problem with lenders and shareholders. Funding costs (interest on debt) seem to off-set the marginal benefits arising from large scale operations of debt –financed MFIs. Thus, operating cost per borrowers does not decline in the short run as expected. Therefore, the study fails to show that debt capital affects efficiency in MFIs as per theoretical expectations.

7.0 RECOMMENADATIONS
The poor in both urban and rural areas are not homogeneous. Some are less poor and others are desperate poor and all need financial services. To avoid mission drift among MFIs there is need for market segmentation among MFIs institutions. Clients of MFIs should be categorized according to their poverty levels. Each type of funds procured by MFIs should be closely aligned to a particular (purpose) type of clients to be served. Debt capital should be used by MFIs to lend and finance operations related to less poor clients while donations and grants be used to lend and finance operations associated with the very poor. Interest rates charged be adjusted accordingly. This may enhance access to all classes of the poor in Tanzania. Government subsidies and donations from donor community to MFIs should be sustained over the foreseeable future and MFIs should not be fully commercialized.

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