

## **Bridging the SME Financing Gap in Tanzania: The Role of Microfinance Institutions**

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### **Abstract**

It is well acknowledged in a number of literatures that SMEs play a great role in social economic development of any country in the world where Tanzania is inclusive. However, it is interesting to note that most of the SMEs could not survive in the first to third years of incubation due to several factors where capital stability and inability to access formal banking services are inclusive. MFIs services have been put in place to enable the SMEs in remote areas to access financial services for their survival. This study was designed to assess the role of MFIs on the financial services towards the survival of SMEs in Tanzania. Systematic random sampling method was used in a descriptive survey to pick a sample of 213 SMEs respondents. Results indicated that MFIs play a major role in improving capital structure, increasing credit facilities, provision of loan and in provision of training where the strength of these roles is arranged in ascending order based on analysis done using descriptive mean. While MFIs is observed in this study to offer a strongest role in improving capital structure of SMEs, this study recommends that for SMEs to survive they have to join MFIs so that they can improve their business capital structure which will in turn increase their efficiency in production and marketing of the products.

**Key World:** MFIs, SMEs, Financial gap, Microfinance Institutions

### **1. Background of the study**

In many emerging markets the Small and Medium Enterprises (SMEs) sector is one of the principal driving forces for economic and job creation. As indicated by Mbogo and Muturi (2015) that SMEs constitute over 95 per cent of all enterprises and account for two thirds to

one half of total non-farm employment and gross domestic product (GDP) worldwide. The significance of SMEs in Tanzania is evident in SMEs National Policy of 2002 by which SMEs are estimated to employ more than 3 million people (URT, 2002). This was also observed in the work of Marwa(2014) who advocated that SMEs play a significant role in income generation, job creation, poverty reduction and reducing income inequality.

Despite their large contributions in social economic development, it is evidenced in the empirical studies that SMEs are mainly inhibited to access financial services to improve their capital (Oni,et al.,2012; Muiruri, 2012). On the other hand, Mbogo and Muturi (2015) advocated that, large commercial institutions have failed to serve the SMEs in both urban and rural communities. Based on the argument made on the study by Franca (2013) who argued that, lack of financial access to SMEs, has hampered their contribution towards economic growth and development as it has affected the start up, growth and survival of SMEs. To harmonize this financial gap which formal bank failed to support SMEs, MFIs which are regulated by most of governments have been observed to be instrumental in supporting SMEs and therefore bridging this financial gap. Despite of the introduction of MFIs other than banking sector to support SMEs, little is known on the contribution of these MFIs. Given the importance of SMEs to the Tanzanian economy and their exposure to risks owing to their size, this study was focused to fill the gap by investigating the role of MFI services on bridging SMEs financial gaps in Tanzania.

## **2.0 Literature Review**

### **2.1 Theoretical Literature Review**

In this study resource based theory was adopted to link the financial resources provided by MFIs in transforming the financial performance of SMEs in Tanzania as it is described below

### **2.2 Resource based theory**

The resource-based view of the firm (RBV) and the resultant resource-based theory (RBT) provide an important frame- work for explaining and predicting the basis of a firms competitive advantage and performance using resources available. The resource-based view (RBV) emphasizes the firm's resources as the fundamental determinants of competitive advantage and performance (Hart,1995).As stated by Kozlenkova, et al. (2003)that firm's

ability to establish and sustain a profitable market position critically depends on the rent generating capacity of its underlying resources and capabilities. The RBV suggests that firms' performance results are a consequence of firm specific resources that they receive for facilitation of daily business operations. Given the importance of resources in enhancing firm performance, this study intended to link the financial resources such as loan etc received by SMEs from MFIs and the way they help SMEs to bridge the financial gap and increasing their performance.

### **2.3 Empirical Literature Review**

This part is addressing the relevant studies which were carried out to assess the role of MFIs in transforming the financial services of SMEs sector. Notably example Makorere (2014) carried out a study to examine the role of microfinance in promoting SMEs in Tanzania. A total of 51 respondents received microfinance from Tanzanian commercial banks were selected for an interview using simple random and snow ball sampling techniques as well. Result showed increase on business profits, employment creations, outlets, sales volume to be statistically significant in promoting small and medium enterprises. Statistically the finding showed the increase of business capital structure to have no direct relationship with microfinance access. The enterprises whose owners also received business training, tax exemption, fair interest rate, enough grace period and infrastructures performed better than those that did not. In addition to that, the study further showed that many problems facing Tanzanian entrepreneurs are not only related to the size of their capital, rather they are related to macro-economic institutional constraints. On the other perspective, Mbogo and Muturi (2015) on their study empirical enquiry to investigate the effect of MFI Credit on Assets SMEs in NakuruTown in Kenya. The study used both quantitative and qualitative data. Primary data was collected through observation and structured questionnaires. The population was 700 SMEs in Nakuru Municipality. Out of this a sample 248 SMEs was selected on basis of Krejcie method of determining sample size. The study found out that there is a strong positive correlation between MFI credit and SMEs assets.

Muiruri (2014) carried out a study on the contribution of microfinance service to the growth of MSEs in developing countries. Through random sampling technique, two hundred and eighty-five (285) MSEs and sixteen (16) MFIs were selected. This included MSEs owners and MFI

managers, this represented 25.8 percent of the total MSE owners as of 2009 Thika Municipal record was considered representative and reliable for generalization. Data collection was done using questionnaires and interview schedules administered to different respondents. Statistics in the study demonstrated that MFIs offered services to customers (MSEs) and contributed to the growth of MSEs which has been rapid over the years. Default rate was high while MFI loan was the second main source of capital. Finally, the businesses that received MF services was reported to have growth in sales, revenue and number of employees employed. The study recommended that government should set policy which is essential in improving loan repayment period and loan amount. From research it is clear that there exists a large unexploited saving mobilization and utilization potential. Similar, Ndife (2013) on the study of the effect of microcredit institutions on the development of small and medium scale enterprises (SMEs) in Anambra State. A sample of 450 respondents was selected for the work using the judgmental and systematic random sampling methods. Although a significant relationship was observed to exist between microcredit institutions and SMEs development, the small degree of association that was found to exist suggests that capital (microcredit) is not the only factor that affect SMEs in the study population.

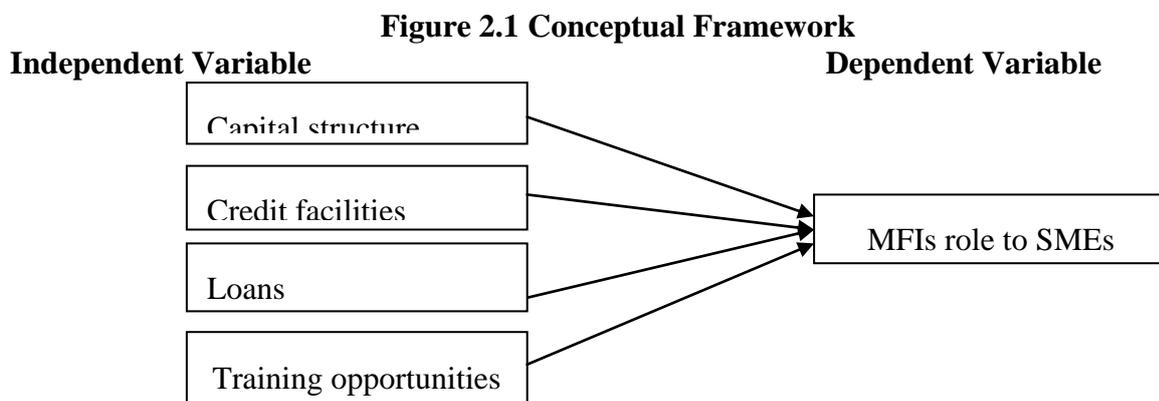
Quaye, et al. (2014) conducted a study on the role of microfinance institutions (MFIs) in helping to bridge the financing gap faced by SMEs in Ghana. The research revealed that the operations of microfinance institutions (MFIs) are having positive impact on SMEs. The study also revealed some risk mitigation tools used by MFIs in granting loans to SMEs which included provision of collateral security in the form of land or any other valuable asset, business records, credit history among others. The research concluded with some recommendations on how the SME financing gap can further be bridged by MFIs and other stakeholders which included provision of support services to SMEs by MFIs such as training services in credit management as well as the need for MFIs to improve service delivery such as faster loan approval times. Further, Ngugi and Kerongo (2014) conducted descriptive survey to assess the effects of Micro financing on growth of small and micro enterprises in Mombasa County. The study adopted stratified and systematic random sampling method. The sample size was 157 SMEs was used. Semi-structured questionnaires were designed to

facilitate the acquisition of data. Data was collected from 102 respondents with a response rate of sixty five percent. Sales, income and competitiveness were used as the independent variable while growth of SMEs as dependant variable. Results indicated that microfinance has positive effects on growth of SMEs. Majority of the owners indicated that microfinance has enabled them to expand businesses, build their business assets. Also ability of the business to complete was enhanced.

From the empirical study, the following are most cited role played by MFIs to SMEs:- Increase capital structure, increase credit facilities, access to loan and increase training opportunities.

### 2.4 Conceptual Framework

In this study, the dependent variable is MFIs role to SMEs which depend on the following variables Increase capital structure, increase credit facilities, access to loan and increase training opportunities as described in Figure 2.1 below



Source: developed by authors (2016)

### 3. Methodology

In this study descriptive research design was used. According to Aggarwal (2008) cited in Salaria (2012) advocate that, descriptive research design is devoted to the gathering of information about prevailing conditions or situations for the purpose of description and

interpretation of the phenomenal. As far as this study is concerned, descriptive research design was used to provide a good description and interpretation of the role played by MFIs to SMEs. In analysis part descriptive has enabled the researcher to evaluate the role listed base on their strength of their contribution in bridging the financial gap to SMEs using descriptive mean.

On the other hand, the targeted population of this study comprises owners and employee of those SMEs receiving service from Pride and Finca Microfinance in Iringa. As argued by Goretti(2008) that the targeted population for a study is the entire set of units for which the survey data are to be used to make inferences. Given that point,SMEs owners and employee were selected because they are the one whom they are targeted to receive services from MFIs and to bridge financial gap of their business. As it has been argued by Goretti (2008) that collecting data from a group which is affected by the phenomena will help to provide strong evidence to solve the research problem. This study was conducted in Iringa Tanzania due to the fact that in Iringa has high number of SMEs facing the financial gap. On the other angle, Systematic sampling was used with a value of 2 as an  $n^{\text{th}}$  term to pick sample from a study population, systematic sampling was suitable in this study as they assist the researcher in avoiding biasness in the process of data collection. Questionnaires were used to collect primary data to understand the role played by MFIs to SMEs. Documentary methods was used to support and give evidence of the data collected from a field survey. Thus the use of multiple data sources would serve to triangulate data (Greener, 2008), and enhance the quality of the collected data.

#### **4. Findings and discussion**

Findings of this study are divided into two areas which are firm characteristics and major findings.

##### **4.1 Firm Characteristics**

Firm characteristics were profiled in this study in order to insure that each unique characteristic are included in the process of data collection. Four characteristics were profiled based on firm size, experience with MFIs, experience in business and MFIs Institution name as it is described below in Table 4.1

Table 4.1 Firm Characteristics

Variable Name	Category	Frequency	Percent
Firm Size	1-4 Employees	100	45.7
	5-49 Employees	62	28.3
	50-99 Employees	57	26.0
Experience with MFIs	Less than 5 Years	95	43.4
	5-10 Years	79	36.1
	Above 10 Years	45	20.5
Experience in Business	Less than 5 Years	89	40.6
	5-10 Years	93	42.5
	Above 10 Years	37	16.5
MFIs Institution Name	Pride	123	56.2
	Finca	96	43.8

Source: Field Data (2014)

In table 4.1 above the results on firm characteristics indicated that out of 219 SMEs contacted, 45.7 % were having 1-4 employees, 28.3% were having 5-49 employees and 26.0% were having 50-99 employee. On the side of experience with MFIs, 43.4% comprises of firm with less than 5years experience, 36.1% comprises of firm with 5 to 10 years of experience with MFIs and 20.5% comprises of firm with above 10 years of experience with MFIs. On the other hand, 40.6% were firm with less than 5 years experience in Business, 42.5% with 5-10 years experience in business and 16.5% with above 10 years of experience in business. In this study 56.2% of the data were collected from the firm who received services from Pride and 43.8% of those firm which were receiving service from Finca. These findings imply that in this data at least there was representativeness of the sample in each unique firm characteristic.

#### 4.1 Major Findings and Discussion

The major objective of this study was to assess the role of MFIs in bridging the financial gap in Tanzania. The main findings were analyzed using descriptive mean as indicated below in table 4.2

**Table 4.2 Role of MFIs in supporting SMEs**

	N	Minimum	Maximum	Mean
Increases business capital structure	219	1	5	4.34
Increases credit facilities	219	1	5	4.28
Help SMEs for saving their money	219	1	5	4.17
Provision of training opportunities	219	1	5	4.15
Valid N (listwise)	219			

In table 4.2 it is indicated that MFIs play the major role in improving capital structure, increasing credit facilities, provision of loan and provision of training which are arranged in the ascending order of their strength. This role is arranged in order of their magnitude as indicated in table 4.2 using mean, this meaning that those with high value of mean indicate high role played by MFIs to bridge financial gap to SMEs. Capital was found to be strong role played by MFIs to SMEs by having highest mean score, this was concurred with the study which was done by Franca (2013) who indicated that capital contributed by MFIs is a major role played by MFIs which affect SMEs in the study population. On the other side, loan which was found in this study as a second major role played by MFIs to SMEs was also found to be supported by Ngugi and Kerongo(2014) who indicated that the loan which SMEs receive from MFIs has enabled them to expand businesses, build their business assets and enhanced the ability of the business to compete in the market. The finding is also similar to a study done by Muiruri (2014) in Thika in Kenya who found that MFIs contribute in provision of loan which is the main source of capital and act as pool in saving for their expansion of and growth of business. On the other side, the findings of the current study is supported by study

which was done in Ghana by Sarbah, et al.(2013) who revealed that MFIs provide support services to SMEs such as training services in credit management.

## **5. Conclusion**

As it is well evidenced that SMEs play a significant role in the economic development of developing countries where Tanzania is inclusive and the general wellbeing of the citizenry of these countries. While their growth is usually hampered by limited access to financial services and fail to transform the economy in general. MFIs have been recognized and taken advantage of the financial gap in serving the financial needs of SMEs. Hence, in this study it can be concluded that MFIs played a major role in the area of improving capital structure, increasing credit facilities, provision of loan, provision of training, ability to compete and saving which are arranged in the ascending order of their strength. This was explained further by Sarbah, et al.(2013) that due to the fact that MFIs have saving schemes which are less costly, easily accessible and take care of small amounts savers it help to bridge SMEs financial gap.

## **6. Recommendation**

As this study has found that MFIs contribute more to SMEs capital structure and loan services this study recommend the following:-

- i)The government should continue to strengthen the MFIs schemes so that it can be more friendly to SMEs and help to transform them toward better financial performance.
- ii)Those SMEs which suffer capital they should involve in accessing MFIs services so that they could access enough capital that could enable them to compete and grow in a complex and dynamic business environment.
- iii) While loan was seen as a source of fund that enable SMEs to expand businesses, build their business assets and has enhanced their ability of the business to complete was enhanced. This study recommend that SME should join MFIs so that they can have services to expand businesses, build their business assets and has enhanced their ability of the business to complete was enhanced

iv) This study was conducted in small town in Iringa using descriptive mean which limit the generalization of the finding to larger population of Tanzania, future study should be conducted using inferential statistics in big town.

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