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Factors that hinder access to credit by small and medium enterprises in Tanzania: a case of Dar es Salaam region

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FACTORS THAT HINDER ACCESS TO CREDIT BY SMALL AND MEDIUM ENTEPRISES IN TANZANIA: A CASE OF DAR ES SALAAM REGION

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A dissertation submitted in fulfillment of the requirements for the degree of Master of Business Administration of the University of Dodoma.

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CERTIFICATION

The undersigned certifies that he has read and hereby recommends for acceptance by the University of Dodoma a dissertation entitled **Investigation on the Factors that Hinder Access to Credit by Small and Medium Enterprises in Tanzania*:* A Case of Dar es Salaam Region** in fulfillment of the requirements for the degree of Master of Business Administration of the of the University of Dodoma.

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Dr. Francis William

(SUPERVISOR)

Date: ………………………………………………

DECLARATION

AND

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I, **Fadhili Mlaki**, declare that this dissertation is my own original work and that it has not been presented and will not be presented to any other University for a similar or any other degree award.

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I humbly thank every person whose contribution sharpened this work. However, whatever errors, omissions, unfair opinions or arguments contained in this work remain solely mine.

I am heavily indebted to my mother, Dinah Mlaki, my father, Mr Theophilus Mlaki, my sisters; Joyce, Sarah and Beatrice and brothers; Felix and Joseph for their encouragements and prayers.

DEDICATION

This dissertation is dedicated to my mother, Dinnah Joseph Maghimbi.

ABSTRACT

This study investigated factors that hinder access to credit by small and medium enterprises in Dar es Salaam region. It employed both quantitative and qualitative methods. Using purposive sampling, a total of 47 respondents were selected to take part in the study. Data were obtained through semi-structured interviews, structured questionnaire and documentary review. Quantitative data from questionnaires were subjected to descriptive analysis.

The findings show that both Small and Medium Enterprises (SMEs) are suffering from lack of information, training and poor condition for credits imposed by Financial Institutions (FIs) to SMEs.

The implications of these findings were discussed in terms of policy preparation. It was found that conditions for credits should be reduced to fit the need of SMEs. It was further suggested that complex procedures and lack of information should be taken as serious issues to be dealt with by the government, FIs and SMEs sectors. If the government manages to solve the mentioned problems, it will improve the business environment in Tanzania.

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CHAPTER ONE

BACKGROUND TO THE STUDY

1.0 Introduction

This chapter presents the background to the problem, statement of the problem, general objective, specific objective, research questions, the scope of the study, and limitation of the study.

1.1 Background to the Problem

The small and medium sectors existed in Tanzania before and after independence. Examples of these sectors include small industrial development organization and national enterprise development forum. Their establishments are easy as they require less capital, ordinary technology, management and utilities. Small and medium enterprises are found both in rural and urban settings and cover economic activities in all sectors. MITMS (2002) add that there are some sectors that are being attached to them and that those sectors are partners and linked enterprises.

In Tanzania, most established SMEs ranked access to finance the highest constraint. This happens when most of these SMEs lack management capacity. Most SMEs have a low capacity to expand technologically and upgrade their business. According to Rugumamu (1990) this constraint signaled the presence of critical bottlenecks in Tanzania's formal financial system. Lending policies and procedures in the state controlled financial institutions are not generally considered "Entrepreneur Friendly" as they tended to discriminate against the private sectors. Most of big financial institutions regard SMEs as financially crippled and non – professional as they do not keep quality financial statements or business plans and they have high risk investment portfolios that prevent them from borrowing (Khatkhat, 1989). The higher financial and managerial risks on standing and developing a small business increase the price at which debt is offered and in turn reduce the supply of external equity finance (storey et al., 1989).

Since there is no acknowledged universal definition of SME, different countries use various measures of size depending on their level of development to define it. The most used yardsticks are total number of employee's, total investment and sales turnover. Osteryoung et al., (1995) studied the characteristics of companies with about 500 employees and concluded that businesses with less than 50 employees differ from larger organizations, thus such firms should be classified as small businesses.

International Monetary fund (IMF) (2010) defines small and medium enterprises differently. For instance; the definition of SME in Germany identifies a limit of 255 employees while in Belgium 100 employees. In the United States (US), the small business is based on industry, ownership structure, revenue and number of employees (which in some circumstances may be as high as 1500, although the cap is typically 500). The US and the European Union (EU) use the same threshold of less than 10 employees in small offices in Kenya to recognize small, medium, and micro enterprises. Elsewhere in Africa, MSME stands for micro, small and medium enterprises, (MSME) which consists of 7 employees.

Industries in Canada define small enterprise as one with fewer than 100 employees (if the business is a goods producing one) or fewer than employees (if the business is service based); and a medium sized business as one with fewer than 500 employees. In Israel, a business is considered small if it has less than or equal to 50 employees. A medium business holds between 50 and 250 workers. In New Zealand, SME has at most 19 employees.

The central bank of Nigeria defines small and medium enterprises based on the number of staff employed. The criteria are assets based between N5 million and N500 million, and a staff strength between 11 and 300 employees (Rugumamu, 1990). In India, small and medium enterprise is the one whereby the investment in plant and machinery (the original cost excluding land, building and items specified by the ministry of small scale industries in its notification no. 1722 (E) dated October 5, 2006) does not exceed Rs.25 lakh. Moreover, micro, small and medium sized enterprises are defined according to their staff head count and turnover or annual balance sheet total. A medium sized enterprise employs fewer than 250 workers whose annual turnover does not exceed Eur 50 million or whose annual balance sheet total does not exceed EUR 43 million.

A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. A micro enterprise is defined as an enterprise which employs fewer than 10 persons and its annual turnover and balance sheet total does not exceed EUR 2 Million.

1.1.1 Establishment of SME World wide

Worldwide, the history of SME did not start out as a manufacture of audio components. The original company was formed in 1946 under the title; the scale model equipment company limited which was meant to manufacture scale models and detail parts for the model engineering trade. During the 1950, SME moved away from model making to precision engineering, principally parts for aircraft instruments and business machines. In 1959, Alastair Robertson – Aikman, the company founder and managing director, required a pick up arm for his own use and an experimental model was built. It received such an enthusiastic reception from friends in the sound industry that it was decided to produce it commercially and it appeared in September 1959. The production was 25 units per week composed entirely of individually machined components. At this time, a new factory situated in mill road, Steyning was opened and the company name was changed to SME Limited, a less committal title to suit its new activities.

SME, now, has over 60 years experience in high quality precision engineering and the company plant at Steyning is now probably the largest and best equipped devoted to the manufacture of precision pick up arms and turntables. SME precision pick up arms are exported to almost every country of the world, (www.sme.ltd.uk)

In the context of Tanzania, micro enterprises are those which engage up to 4 people or employ capital amounting to Tshs 5 Million. Small enterprises are mostly formalized undertakings engaging between 5 and 49 employees or with capital investment from Tshs 5 million to 200 million. Medium enterprises employ between 50 and 99 people or use investment from Tshs 200 million to Tshs 800 million.

1.1.2 Challenges of SME Activities in Developing Countries

There are several challenges that face SME. Machacha (2002) outlines a few of them include: First is the financial management capacity. This is an essential lack of access to financial opportunities in the country by SMEs. This constraints SME's from accessing financial interventions. It is important to understand that capacity building interventions might be more effective if linked with access to finance;

Secondly, SME balk at high interest rates reflect issues on demand and supply sides. Interest rates are consistently cited as a top barrier to SME borrowing as high interest rates mean that only the most profitable SME investments can justify a loan. Banks may overestimate the risk of the SME market but in many cases the pricing of loans by banks appear rationally given the expected inflation and high historical default rates.

The problem of high interest rates is exacerbated when SMEs does not have the skills required to make project financial decisions, including the ability to weigh the potential return on an investment against the cost of capital. Another one is the stringency of collateral requirements that may be the primary barrier to SME's ability to access finance even in developed markets. Collateral requirements are the rule rather than exceptions; the level of collateral required is often as high in developed economies as compared to the developing ones.

Furthermore, SME's access to collateral is more limited, reflecting lower rates of property ownership and lack of appropriate titling. In Tanzania, most established SMEs ranked access to finance the highest constraint. This happened where by their financial needs are not being met and hence most of SME's perception is that banks do not have a good understanding of them. This inhibits their capacity to expand technologically and upgrade their business. The banks may provide bank facilities but hesitate to offer long term loans or the type of working capital facilities that SME need to grow (khatkhat, 1989).

Undoubted, this constraint signaled the presence of critical bottlenecks in Tanzania's formal financial system whereby these lending policies and procedures in the state controlled financial institutions is not generally considered as entrepreneur friendly. These occur when most of these credit guarantee schemes targeting SMES assume that a thriving SME sector is a critical element needed for a strong and growing economy, and that access to finance is the major constraint to SME's growth. Most of these lending policies include:

(a) The extended credit facility; it is meant to succeed the poverty reduction and growth facility as the main funding tool for providing medium term loans to support SMEs with protracted balance of payment problems.

(b) The standby credit facility that provides financial assistance to SMEs with a short term balance of payments and

(c) The rapid credit facility that provides rapid financial assistance with limited conditionality to SME.

These tended to discriminate against the private sector as biggest financial institutions regard SMES as financially crippled and non professional enterprises. They do not keep quality financial statements or business plans; and they have high risk investment portfolios that prevent them from borrowing (Khatkhat, 1989). The lending policies are not good friend users due to the fact that most of these financial institutions' utilization of guarantees depends on the circulation of profitability that incorporates the full range of costs associated with the guarantee. The higher the financial and managerial risks on standing and developing a small business increases, the higher the price at which debt is offered and in turn reduce the supply of external equity finance (Storey et al., 1989).

1.1.3 Challenges of SME in Eradicating Poverty in Developing Countries

Although SMEs are largely considered as fountains of creativity in the production chain and reduction of poverty, they fail to make their dream come true due to lack of collateral which restricts them to secure their bid for loans. As the result, they run their business without capital and consequently fail to grow. The full potential of the SME sector has not yet been tapped due to several constraints which hamper the development of the sector. Such constraints include unfavorable legal and regulatory framework, underdeveloped infrastructure, poor development of business services and limited access to finance (MITMS, 2002) and poor access to capital (Machacha, 2002).

The study done by Mushi (2006) revealed that there was a promising market for the machines made based on producing bricks. However, the SME failed to produce more because of the limited capital base. According to SIDO report (2002), the rural poors do not lack energy ideas or entrepreneurial spirit, what they lack is access to credit facilities and the choice of an opportunity to fulfill their own dreams for a better future. This shows that in Tanzania the biggest problem is lack of capital.

Many measures have been taken to enable SMEs achieve their dreams especially getting financial support. For instance, the self government microfinance project has been established by the government to offer entrepreneurial loan facilities. The project has spread its wings to 14 regions on Tanzania main land but still it is not promising (EBRF, 2005). Also Need was established by the parliament of the United Republic of Tanzania in 1994 to provide loans to SMES in Tanzania (Rugumamu, 2002). SMES do not utilize the opportunity they have or they do not see. Mobilizing domestic savings is critical for sustained high rate of investment and economic growth (EBRF, 2005). It is difficult for SMEs to access credit due to the following factors: The sector is perceived as a highly risked one. Lack of collateral requirement implies that most banks operate in limited geographical areas; they have inexperienced staffs on issues related to micro finance and lack of the guarantee scheme to back up banks financing SMES.

The high cost of screening and administering small loans spread over big areas and inabilities of borrowers to prepare applications that meet bank's requirements. Regardless of the difficulties they are facing, SMEs have made some efforts to access capital from different financial institutions. SMES are biggest clients' base which make up to 80 percent of our books, says UBA, chief manager (SMES, 2006).

1.2 Statement of the Problem

The ability of SMEs to survive in an increasingly competitive global environment is largely predicated upon their capacity to leverage financial source. One of the most notable obstacles limiting their capacity is access to timely, current, relevant and adequate financial credit for carrying out their daily activities and investing. Studies done by World Bank (2000) and ILO (2001) show that many SMEs lack access to finance to start operating and expanding their businesses. In Tanzania, most established local and foreign entrepreneurs ranked access to finance the highest constraint. It inhibited their capacity to expand technologically and upgrade their business (Rugumamu, 1992).

Rapid expansion of SMEs sector in Tanzania needs finance and ability to access financial services. The majority of finance schemes for small business sectors in Tanzania are uncertain as they are financially crippled and non professional. They do not keep quality financial statements or business plans and they have high risk investment portfolios that prevents these them from borrowing (Khatkhat, 1989). Although the SMEs are right customers of the financial institutions such as banks, they face barriers in accessing financial services from these institutions.

Although various studies concerning SMEs have been conducted in Tanzania, most of them had different focuses other than assessing factors hindering access to credit by SMEs. This study is therefore focused on the appraisal of the SMEs that are the right customers of the banks in Tanzania context through establishing their status and ability to overcome the financial constraints in businesses. The purpose of this explanatory study was to assess factors hindering access to credit by SMEs in Tanzania.

1.3 General Objective

The study was intended to get information on the status of the SMEs in Tanzania hence establish their recent financial abilities and achievements in their business.

1.4 Specific Objectives

The study was conducted to attain the following specific objectives:

i. To identify the forms of ownership for SMEs.

ii. To assess the sources of capital for SMEs to operate business profitably.

iii. To investigate the ability of SMEs to sustain in an increasingly competitive global environment without credits.

1.5 Research Questions

The study aims at answering one general question and three specific questions:

1.5.1 General Question

i. What are the factors that hinder access to financial credit by SMEs?

1.5.2 Specific Questions

Three questions were formulated in this study as guidelines to address relevant issues emerging in the study. These questions are:

i. What are forms of SMEs ownership?

ii. What are the sources of capital for SMEs to operate business successfully?

iii. Can SMEs sustain in an increasingly competitive global market without credits?

1.6 Significance of the Study

The findings of this study contributed to the growth of knowledge of small and medium enterprises in Tanzania. Specifically, the study revealed the underlying factors that hinder easy access to financial services by SMEs.

Furthermore, the study results are beneficial for businessmen and women, researchers, policy makers and development agencies intending to venture into this kind of research of SMEs.

The study adds up to knowledge on the topic and stimulate other scholars and students of Economics and Business studies to undertake further research and can be used as reference material by students in matters relating to the topic.

1.7 Scope of the Study

The study was concerned with assessing the factors that hinder access to credit by SMEs. The study focused on small and medium enterprises especially, examining the owners of the small and medium enterprises in Barclays Bank -Dar es Salaam.

1.8 Limitations of the Study

Respondents were reluctant to respond on time and some information seemed to be confidential in a way that they could not respond. Since questionnaires were personally administered, the researcher created a friendly atmosphere to capture the best of intended data. Lack of enough time and fund had also been the limiting factors to the researcher to cover a wide range of area in Tanzania. Therefore, Dar es salaam region was selected as the case study.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter covers two aspects namely theoretical and empirical literature. The parts reviewed what has been done in terms of theories and empirical studies in relation to the current research topic.

2.1 Theoretical Literature review

A considerable body of research identified the difficulties that new and young firm's experience in raising finance. The Macmillan committee (1931) identified lack of long-term risk capital termed “equity gap” as a significant constraint on the viability and growth of SMEs in the UK. Small firms relative to large ones are characterized as having weaker liquidity, lower and more volatile levels of profitability and over-dependence on short-term finance and an insufficiency of shareholders’ funds or equity (Botton, 1971: Buras & Dewhurst, 1993).

An increasing body of analytical work attempted to explain the functioning of credit markets using new theoretical development and challenges of credit markets using the paradigm of competitive equilibrium. They have explored the implications of incomplete markets and imperfect information for the functioning of credit markets in developing countries. These provide a new theoretical foundation for policy intervention. Most of this body of literature has followed the pioneering work of Stiglitz & Weiss (1981).

The work by Stiglitz and Weiss (1981) marks the beginning of attempts to explain credit rationing in credit markets. In this explanation, interest rates charged by a credit institution are seen as having a dual role of sorting potential borrower (lending to adverse selection) and affecting the action of borrowers (lending to incentive effect). Interest rates thus affect the nature of the transaction and do not necessarily clean the market. Both effects are seen as a result of the imperfect information inherent in credit markets.

Adverse selection occurs because lenders will like to identify the borrowers who are more likely to repay their loans since the banks' expected return depend on the probability of repayment; banks are likely to use the interest rates that an individual is willing to pay as a screening device. However, a borrower who is willing to pay high interest rates may, on average, be at worse risk thus as the interest rate increases the risk of incentive effect occurs. This is because as the interest and other terms of contract change, the behavior of the borrower is likely to change since it affects the returns of their project. Stiglitz and Weiss (1981) further show that the higher interests induce firms to undertake projects with lower profitability of success but higher payoffs when they succeed.

2.1.1 Financial Structure System and Access to Credit in Tanzania

The effect of the financial system is essential for promoting growth in small and medium firms in any country (Satta; Fishazion, Eise and Lutz 2000). Financial system performance and structure in Tanzania is experiencing a high level of transportation over time due to changes in government regulations and policies (Mutaitina, 1999; Kimei, 1998). Access to finance by SMEs is not easy - it is complicated by financial institutions mainly through their lending policies. This is displayed in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes.

For small scale enterprises, reliable access to short-term and small amounts of credits is more valuable; in other words, it may be more appropriate in a credit program aimed at such enterprises. The type of financial institutions and its policy will often determine the access problem. Where credit duration of payment required security and when the provision of supplementary services do not fit the needs of the target group, potential borrowers will not apply for credit even where it exists and when they do they will be denied (Schemidt & Kopp 1987).

Gramren Bank (GB) has reversed conventional banking practices by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity. The GB experience shows that most of the conditions imposed by formal credit institution like collateral requirements do not actually stand in the way of smallholders and the poor in obtaining credit. The poor can use the loans and repay if effective procedures for disbursement, supervision and repayment have been established. On the issue of interest rates, the bank supports the view that high interest rate credit can help to keep away the influential non-target group from a targeted credit programme. This further demonstrates the need to develop appropriate institutions for delivery of loans to small scale borrowers (Hossain, 1988).

Loan security is one of the important aspects of credit to SMEs. Most lending institutions to small scale enterprises require security based without any regard to potential cash flow. However, organizations lending to micro enterprises have devised alternative forms of collaterals. These include group credit guarantees where organization lend to individuals using group guarantees; and personal guarantee where individual are given loans based on guarantees' pledge.

2.1.2 Problems Facing SMEs in Accessing Credit

Despite their number and importance in job creation, SMEs tradition is facing difficulties with commercial bank loans. SMEs are often limited to a period far from short to pay off any sizeable investment. Meanwhile, access to competitive interest rates is reserved for only a few selected blue-chip companies while loan interest rates offered to SMEs remain high (Chijoriga, 2000). Moreover, banks in many developing countries have traditionally lent overwhelmingly to the government which offered less risk and higher return. Such practices have crowded out of most private sector borrowers and increased the cost of capital for them.

Governments cannot expect to have a dynamic private sector as long as they absorb the bulk of private savings. In the case of venture capital funds, they have been concentrated in high technology sectors. Likewise, the international financial institutions have ignored the plight of SMEs, for example, the BASEL capital accords have not been analyzed and framed with any consideration for their impact on the ability of the commercial banks to service the SMEs sectors. These presences and tendencies have exacerbated the lack of financing for SMEs (Chijoriga, 2000).

According to chijoriga (2001), the traditional commercial banks and investors are reluctant to service SMEs for a number of well- known reasons, which include the following:

- SMEs are being regarded by creditors and investors as high- risk borrowers due to insufficient assets and low capitalization vulnerable to market fluctuations and high market rates.

- Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans makes it difficult for creditors and investors to assess the creditworthiness of potential SMEs proposals.
- High administrative / transaction costs of lending or investing small amounts do not make SMEs a profitable financing business. As a result, commercial banks are generally biased towards large corporate borrowers who provide better business plans, have credit ratings, have reliable financial information, and have better chances of success and higher profitability for the banks. When banks lend SMEs, they tend to charge them a commission for assuming risk and apply tougher screening measures which drive up cash on all sides. This problem can further be categorized as caused by the supply side, demand side and environmental side.

Supply –Side

- Most MFIs operate in urban areas with relatively well developed infrastructure; denying access to rural MSEs and those in backward regions.
- Almost all MFIs are donor funded and donors require them to target the poorest of the poor leaving out MSEs with growth potential.
- Loan sizes are too small
- There is a bias towards short-term activities such as trading and services.

Demand –Side

- SMEs lack collateral which is demanded by banks.
- Most SMEs have no permanent premises or addresses

Environment –Related

- The judiciary system is weak in dealing with breach of judiciary contracts to the extent that banks are reluctant to lend.
- The Land Act of 1999 makes foreclosure of property on land overly complex thus making the land and lent property almost useless.
- Credit Culture is underdeveloped partly due to the socialist experience that some MSE operators take loans as growth.
- Interest rates are so high (25% compared to an inflation rate of 5%).

Commercial banks in developing countries and country with economies in transition often prefer to lend to the government and thus the public sector crowds out the private sector. Many governments and international financial institutions have tried to address the problems of high transaction cost and risk by creating subsidized credit programs and / or providing loan guarantees such as projects which have often fostered a culture of non- repayment or failed to reach the target group or achieve financial self – sustainability (Chijoriga 2001). It is now, generally, easy for MSEs to access small loans (up to Tshs 2000, 000) from MFIs so long as they are ready to follow the group lending requirements. Models, which allow small business to borrow larger amounts without collateral are not known in Tanzania.

2.1.3 Formal and Informal Institutions' Lending Policies

Care International: Focuses on pre-existing organized rural group. It is a credit program emphasizing women owners of micro enterprises. Clients are required to raise equity cash of 25% of the total loan required. The loan security is the group members who guarantee each other and are collectively guaranteed by the group.

ICDC - operates credit schemes including that which cater for retails and wholesale traders for working capital.

KRIEP – it has a credit program targeted at ROSCAs who then lend to their members. The loan received by the groups is equivalent to ten times the groups' savings. Savings are important components of the program and there is also an insurance fund.

PRIDE – it provides credit to small enterprises especially those in the informal sector without access to other sources of credit.

ROSCA – it provides credit to borrowers who would normally be unlike to borrow from other sources. It also mobilizes savings for members. Rural enterprises rely more on ROSCAs since they present easier access to other sources of credit.

SACCOSS - it provides both savings and credit facilities to their members. The amount of credit provided depends on the amount of the individual member's savings.

2.1.4 Challenging Situation in Raising External Finance for SMEs

Firms may suffer from credit rationing which essentially means that they do not get as much credit as they want although they are willing to pay the market interest rate and meet other conditions set by lenders (Stiglitz &Weiss 1981). To understand why this is possible, recall that in most markets excess demand would lead to a price increase which in turn increases supply and reduces demand until equilibrium between the two is achieved. But in credit markets, lenders may be unwilling to raise the interest rate and increase the supply of loans even if there is unsatisfied demand. The key to understanding credit rationing are information asymmetries between lenders and borrowers.

Information asymmetries may prevent lenders from observing the true nature of the borrowers; they may also prevent lenders from influencing the behavior of borrowers once the credit contract is signed. In principle, lenders could raise the risk premium on loans, but doing so may increase the probability of default by attracting risky borrowers and/or by encouraging risky behavior of borrowers. Since adverse selection and moral hazard could cause the lenders' expected payoff to diminish when raising the interest rate, they may refrain from rising rates beyond a certain level even if this does not fully satisfy the demand for credit.

The negative welfare effects of such credit rationing are underinvestment and lower growth. There are a number of reasons why smaller firms could be vulnerable to credit rationing. One reason is that small and young businesses often have no access to capital markets and, therefore, rely heavily on credit markets to finance investment projects when internal funds have been exhausted.

Another reason is that smaller firms, typically SMEs, suffer more from information asymmetries than larger ones. Many smaller firms are younger and have less credit history. In addition, they face less rigorous reporting requirements and, as a result, information on them is less easily available. More fundamentally, small firms may be more reluctant than large ones to be fully open about their business structure, growth opportunities, and strategic orientation. Family-owned businesses, for instance, are sometimes reluctant to make their ownership structure public. A final reason why smaller firms could be particularly vulnerable to credit rationing is that they often have less collateral that could shield creditors from the harmful effects of adverse selection and moral hazard.

Credit rationing and external finance tend to be more expensive for small firms than for larger ones. An obvious explanation is that fixed costs of lending - which are not proportional to the size of the loan inevitably make small loans more expensive than large loans. One could also argue that small firms are, on average, risky for the lender than large ones and, thus, need to be charged a higher interest rate. But the argument is not as straightforward as it appears at first sight. It is true that small firms may have a higher probability of failing; in particular, startups have a high probability (more than 50 percent) of perishing within their first five years and consequently small and young firms are rightly perceived as risky (OECD 1997).

Small and medium sized firms often have less collateral to underpin the repayment of the loan. Considering all these effects, even a diversified SME loan portfolio could be riskier than one consisting of loans to large companies. A more mundane explanation for relatively high costs of SMEs lending is a possible lack of competition among lenders which enables them to charge interest rates that are in excess of what the underlying credit risk requires. In general, it is plausible to argue that SMEs have fewer options when raising external finance and this makes them depend more on a limited number of financial institutions. But there is also a specific dimension; small businesses are usually entirely dependent on the local bank market whereas large firms can shop around on global financial markets. In this context, it is worth noting that there is evidence for a clear relationship between bank size and SMEs lending with large banks devoting a lesser proportion of their assets to small business loans (Berger *et al.* 1998).

2.2 Empirical Literature review

This part of literature, empirically attempted to examine the constraints that our SMEs are facing in access to credits from FIs. In his study of limited access to finance for micro and small enterprise in Tanzania, Abbebe (2006), revealed that non – existent training and support components and the provision of small credit to inexperienced start up entrepreneurs are the drawbacks of the scheme of offering credit to SMEs. But this study does not assess factors hindering access to credit. Lack of qualified staff for providing loan, poor customer care, competition from other MFIs group guarantee model problems, lack of trustfulness among customers and poor performance of the business are the factors which hinder access to credit by SMEs (Aswile, 2006). This research was, however, too broad to cover well the studied population.

An assessment on the roles of the micro- finance institution in supporting growth of SMEs in Tanzania, the case of micro business in Dar es salaam by Mpoto (2003) reveled that MFIs have tried to support programme for the growth of SMEs in Tanzania. It is now generally easy for SMEs to further the group lending requirements. However, the study covered only micro business and ignored the small and medium businesses. Msengwa (2006) conducted a study of assessment of roles of micro finance institutions in poverty alleviation among women in Tanzania, a case of FINCA in Dar es salaam. The study revealed that some banks, though few, are lending credits to SMEs. For example, NMB provides loan to SMEs ranging from Tshs 50000 with the interest rate of 2% per month. The study also revealed that most of women through development groups get loans which they could not get it before as they did not have enough collateral.

Warema (1996) in his study of the factors leading to unavailability of credits to small – scale industries in Tanzania recommended that there is a need to make a perform belted in the economy and the role of financial assistance it plays in ensuring the existence of the sector. The research forms a necessity to find only empirically the factor / challenges hindering smooth access to commercial banks with the use of various dimensions namely cost, range, reliability, convenience, continuity and flexibility of commercial banks (Clauses, 2005).

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter outlines the research procedures which were used in this study. It includes a description of the study area, data source and collection, the sample and sampling techniques, target population, the survey design, type, instrumentation, data and data analysis.

The study sought to assess the present status of the SMEs after being credited. The information based on the ability to maintain employment opportunities and quality production of goods and services was assessed. The assessment was done based on the incremental change in terms of physical and financial capitals that could give the indicator of the increase in the ability of the SMEs to sustain competitively. This is the study of variables such as workers, physical resources and profit generation in terms of numbers. Therefore, quantitative research approach was adopted. It was adopted in order to test how variables influenced each other by determining varying perceptions of the stakeholders in the study area. The study investigated the status of the SMEs after being credited and their ability to sustain in the increasingly competitive global environment. This is a qualitative aspect that involved views from various people in the SMEs. Therefore, the study employed both qualitative and quantitative approaches.

3.1 Research Design

Based on the research objectives, the cross-sectional survey design was considered appropriate for the present study. Cross-sectional survey was suitable for this study because the research was limited in terms of finance and time, hence collecting data at one point in time was suitable (Babbie, 2005).

Surveys are used for descriptive, explanatory and exploratory purposes. The survey is the best method of collecting original data for describing a population which is too large to observe directly. Surveys are also appropriate for collecting information or data required at one point in time for a researcher who is faced with time and financial limitations like the present one (Babbie, 2005; Neuman, 2003). Taylor, (2006) adds that cross sectional surveys are excellent vehicles for measuring perceptions and orientations in a large population by selecting and studying samples in order to discover facts, opinions, figures, incidences, and interrelations of variables (Creswell, 1998).

3.2 Location of the Study

The study was conducted in Dar es Salaam. The reason for choosing Dar es Salaam was the fact that there are several SMEs that are operating. Also, there are several financial institutions like CRDB, BANK M, NMB, MBS, and BACKLYS that are rendering SMEs with financial capability for their businesses. The preliminary investigation showed that Dar es Salaam had more than 150 SMEs that are seeking money from these banks.

3.4 Population

The target population for the study was all SMEs in Dar es Salaam which borrow money from large financial institutions. All managers and workers in the said institutions were considered a target population. The rationale for choosing these study population is the fact that the managers and the workers are the ones that could manage and ensure the sustainability of the SMEs.

3.4 Sample, Sample Size and Sampling Procedures

The sample for this study comprised of Districts in Dar e s salaam region, SMEs managers and workers and bank loan officers. The total sample of the respondents from different SMEs was 47 respondents.

3.4.1 Districts

Ilala district was purposively selected because it has more SMEs than other districts in Dar es Salaam region. Ilala is also the central part of Dare s salaam region that is favorable for the SMES operators. Its population is bigger than that of other districts. This favors many people to operate the SMEs. It was, therefore, easy for the study to find few SMEs for the study.

3.4.2 Banks

Several banks that grant SMEs with financial abilities namely CRDB, BACKLAYS, NMB, and NBC, were purposefully selected to be in the study. The rationale for choosing Barclays is the fact that its lending policy is in favor of the

SMEs. Also, the researcher had more access to the bank than in others that could require other people to assist him in obtaining the confidential information.

3.4.3 SMEs

Fifteen (15) SMEs were purposefully selected to be included in the study. They were supposed to have financial access with Barclays bank within past 4 years since that is the allowable period of the borrowers to return the loans. This enabled the study to get reliable and recent information based on financial access ability of the SMEs.

3.4.4 Bank Loan Officers

All loan officers in the selected banks were purposefully involved in the study. This is because they are the ones who offer loans. They have the information on the loan criteria.

3.4.5 Loan Collectors

All the present loan collectors in the selected banks were involved in the study. This is because they have the necessary information on the return of the loans.

3.5 Data Collection Methods

This study collected both qualitative and quantitative data. The qualitative data were collected through the use of interviews, observations, and documentary review. Quantitative data were collected through questionnaires and observational checklist.

3.5.1 Observations

Observational data are those which can directly be seen, heard or felt by the researcher noting who, what, when, where, and why and particularly relating them to the research question although the eye sees a lot and misses a lot (Stake, 2010). The observation by the researcher was used to study the status of the SMEs as well as the present physical capital that indicates the worthiness of the SMEs.

3.5.2 Documentary Review

The book value was reviewed to check for the loans granted and pay back returns. Ability to return interest in a prescribed period of time, production versus sales were also reviewed. This helped the researcher to achieve a better understanding of the present status and practices and issues of SMEs in relation to their sustainability in the competitive world market.

3.5.3 Interviews

The interview was administered to the loan officers, SMEs manages and loan collection officers to get an overview of the progress of the SMEs in relation to their ability to raise financial capital to operate their businesses profitably and sustain in the competitive world market. Their suggestions on the possible strategies that the SMEs can undertake to successfully access loans from big enterprises were obtained.

3.6.4 Questionnaire

Structured questionnaire was used to get information regarding the status of the SME after being credited by banks, ability to raise financial capital after being credited, ability to sustain in the global market using the credited loans and their ability to operate profitably.

3.6 Validity and Reliability of the Research

According to Nieveen (2010), triangulation enables minimization of the weaknesses in each single datum by counterbalancing with the strength of another data source. In this regard, the use of varieties of data collection methods for the similar theme enabled to collect similar information from the same respondents in order to check consistency. The responses from the interview protocols were used to verify the observations from documentary review and questionnaire. Similarly, the instruments were piloted before use in the field. The findings from the pilot study were used to improve the instruments.

3.7 Data Analysis Procedures

Kombo and Tromp (2006) describe data analysis as the process of examining what has been collected from the study and making decisions and inferences to the study. Quantitative data which were collected using questionnaires and observation checklist were analyzed by using the Statistical Package for Social Sciences (SPSS) version 17. Qualitative data collected through the interviews and documentary reviews were analyzed in relation to their content. The information obtained were organized according to their intensity and then organized in quotations.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION OF THE FINDINGS

4.0. Introduction

This chapter presents the analyses and discussions of the findings from collected data based on the research questions. In this chapter, tables have been used to present the findings of the research. In general, this research intended to assess factors hindering access to credit by SMEs.

4.1 Respondents Social Demographic Characteristics and General Information

The social demographic characteristics of the respondents were analyzed in terms of sex and level of education.

4.1.1 Location of Enterprises

The research was conducted in Ilala Municipal. Respondents who are SMEs owners were selected randomly from different wards of Ilala District. It was revealed that most of them are found in Kariakoo, Mchafukoge, Kisutu, Upanga and Jangwani; few of them could be found in Tabata and Buguruni.

4.1.2 Distribution of Respondents by Sex

Respondents were asked to indicate their sex. The study revealed that more men engage in SMEs business than women. The findings reveal that 66.0% of the 47 SMEs surveyed were men while only 34.0% were women. The trend depicts the fact that in Tanzania the resources are owned by men and that women are there to take care of children and not business. However, we cannot ignore the efforts made by women. The study revealed that out 47 respondents surveyed, 16 were women entrepreneurs who could be recognized as successful. Table 1 below presents the distribution of respondents by sex

Table 1: Distribution of Respondents by Sex

Sex	Frequency	Percent
Male	31	66.0
Female	16	34.0
Total	**47**	**100.0**

Source: Surveyed data, (2013)

4.1.3 Position of the Respondents

Respondents were asked to state their positions. The first one was assistant director, the second was head of department and the last one was an ordinary employee. All of them responded positively to the questionnaire and gave the best answers. Two of them were University graduates while the other had attended just a course in credits manage. Table 2 below indicates the position of the respondents.

Table 2: Position of Respondents

Respondent	Frequency	Percent
Assistant Director	1	33.3
Head of Department	1	33.3
Ordinary employee	1	33.3
Total	**3**	**100.0**

Source: Surveyed data, (2013)

4.1.4 Level of Education

Results from table 3 below indicate that most SMEs owners were people who are well educated. From 47 people who were surveyed, 42.6% had levels of education at first degree, 21.3% ordinary diploma, 19.1% master degree and only 2.1 % were at the level of primary education. This level of education showed gives a sign that SMEs owners can understand and learn anything new quickly and also can express their ideas clearly and can be understood by other people. This makes easy processing of credits from FIs. Therefore, the difficulties to access credits are not caused by illiteracy of people.

The findings, however, do not concur with the findings by Chijoriga (2001) who argues that traditional, commercial banks and investors are being reluctant to service SMEs for a number of the well known reasons which include SMEs being regarded by creditors and investors as high risk borrowers due to insufficient assets and low capitalization vulnerable to market fluctuations and high market rates. Information asymmetry, lack of accounting records, and inadequate financial statements/business plans make difficult for creditors and investors to assess the credit worthiness of potential SMEs proposals.

Chijoriga (2001) adds that high administrative / transaction costs of lending or investing small amounts do not make SMEs a profitable business to be financed. As a result, commercial banks are generally biased towards large corporate borrowers who provide better business plans, have credit ratings, have more reliable financial information, and have better chances of success and higher profitability for the banks. When banks lend to SMEs, they tend to charge them a commission for assuming risk and apply tougher screening measures which drive up cash on all sides. Table 3 below presents the educational level of respondents.

Table 3 Respondents' Level of Education

Educational Level	Frequency	Percent
Primary education	1	2.1
Secondary education	7	14.9
Ordinary diploma	10	21.3
First degree/advanced Diploma	20	42.6
Master degree	9	19.1
Total	**47**	**100.0**

Source: Surveyed data, (2013)

4.2 Forms Ownership for SMEs

Forty seven (47) SMEs managers were asked on the kind of partnership that they own their business. Table 4 below presents the form of venture ownership by SMEs owners.

Table 4 Form of Business Ownership by Respondents

Respondent	Frequency	Percent
Sole proprietorship	14	29.8
Partnership	20	42.6
Family business	3	6.4
Limited liability company	10	21.3
Total	**47**	**100.0**

Source: Surveyed data, (2013)

From table 4 above, it is evident that most of SMEs are jointly owned. This is due to the difficulties of raising capital to start up business that are facing SMEs. To solve this challenge of lack of capital, they conclude to form either partnership whereby more than one person contributes to the capital of the firm. However, sole proprietors opt to run small business due to the difficulty of expanding their business which is mainly caused by the difficulty of raising external funds to use as a capital. The study revealed that 42.6% of all surveyed SMEs are owned under partnership, followed by 29.8% of sole proprietorship, and 21.3 % are owned by limited companies and only 6.4% are owned by families.

These findings concur with the findings by Stiglitz &Weiss (1981) who assert that they do not get as much credit as they want although they are willing to pay the going market interest rate, and meet other conditions set by lenders. To understand why this is possible, they add that, in most markets, excess demand would lead to a price increase which in turn increases supply and reduces demand until equilibrium between the two is achieved. But in credit markets, lenders may be unwilling to raise the interest rate and increase the supply of loans even if there is unsatisfied demand. The key to understanding credit rationing are information asymmetries between lenders and borrowers.

Information asymmetries may prevent lenders from observing the true nature of the borrowers. They may also prevent lenders from influencing the behavior of borrowers once the credit contract is signed. In principle, lenders could raise the risk premium on loans, but doing so may increase the probability of default by attracting riskier borrowers and/or by encouraging riskier behavior of borrowers. Since adverse selection and moral hazard could cause the lenders' expected payoff to diminish when raising the interest rate, they may refrain from raising rates beyond a certain level even if this means not fully satisfying the demand for credit.

Stiglitz &Weiss (1981) add that, the negative welfare effects of such credit rationing are underinvestment and lower growth. There are a number of reasons why especially smaller firms could be vulnerable to credit rationing. One reason is that small and young businesses often have no access to capital markets and, therefore, rely heavily on credit markets to finance investment projects when internal funds have been exhausted.

Another reason is that, smaller firms typically SMEs suffer more from information asymmetries than larger ones. Many smaller firms are younger and have less credit history. In addition, they face less rigorous reporting requirements and, as a result, information on them is less easily available. More fundamentally, small firms may be more reluctant than large firms to be fully open about their business structure, growth opportunities, and strategic orientation. Family owned businesses, for instance, are sometimes hesitant to make their ownership structure public. A final reason why smaller firms could be particularly vulnerable to credit rationing is that they often have less collateral that could shield creditors from the harmful effects of adverse selection and moral hazard (Ibid).

The findings are also supported by the findings by OECD (1997) report which contends that credit rationing, apart from external finance, tends to be more expensive for small firms than for large ones. An obvious explanation is that fixed costs of lending (which are not proportional to the size of the loan) inevitably make small loans more expensive than large ones. One could also argue that small firms are, on average, risky for the lender than large ones and, thus, need to be charged a higher interest rate. But the argument is not as straightforward as it appears at first sight. It is true that small firms may have a higher probability of failing; in particular, startups have a high probability (more than 50 percent) of perishing within their first five years and consequently small, young firms are rightly perceived as riskier.

Berge et al., (1998) also support the findings by arguing that, small and medium sized firms often have less collateral to underpin the repayment of the loan. Considering all these effects, even a diversified SME loan portfolio could be riskier than one consisting of loans to large companies. A more mundane explanation for relatively high costs of SMEs lending is a possible lack of competition among lenders, which enables them to charge interest rates that are in excess of what the underlying credit risk requires. In general, it is plausible to argue that SMEs have fewer options when raising external finance and this makes them depend more on a limited number of financial institutions. But there is also a specific dimension: small businesses are usually entirely dependent on the local bank market whereas large firms can shop around on global financial markets. In this context, it is worth noting that there is evidence for a clear relationship between bank size and SMEs lending with large banks devoting a lesser proportion of their assets to small business loans.

Furthermore, the study shows that many SMEs are using bank services from different financial institutions especially commercial bank, 89.4% of the total SMEs surveyed strongly agree that they are using bank services to run their business. It is evident that those SMEs need or are ready to process credit from financial institutions but are discouraged by difficult and ambiguous procedures and conditions to get credits. Table 5 indicates the extent to which SMEs use banking services.

Table 5: Uses of FIs Services by SMEs

Response	Frequency	Percent
Yes	42	89.4
No	5	10.6
Total	**47**	**100.0**

Source: Surveyed data, (2013)

The table above shows that only 5 of SMEs do not use FI services which are just 10.6%. This support the assumption of the author that it might be true that SMEs are ready to take credit from FIs at the market prevailing rate, but they are not given that opportunity just because FIs perceive the sector as the highly risky one.

These findings are in congruence with the study by Warema (1996). In his study, he recommended that there is a need to make a perform belted in the economy and the role financial assistance play in ensuring the existence of the sector. The research forms a necessity to find only empirically the factor / challenges hindering smooth access to commercial banks' finance with the use of various dimensions namely cost, range, reliability, convenience, continuity and flexibility of commercial Banks finance.

4.3 Sources of Capital for SMEs to Operate Business Profitably

The study revealed different sources of capital SMEs as presented in table 6 below.

Table 6: Source of Capital to start a Business

Respondent	Frequency	Percent
Personal funds	13	27.7
Loans from friends	3	6.4
Family funds	6	12.8

Bank loan	16	34.0
Venture capital	5	10.6
Government client	2	4.3
Credit unions	2	4.3
Total	**47**	**100.0**

Source: Surveyed data, (2013)

The study showed that it is still a problem for SMEs to raise external finance. This is because in the real world situation, to finance business by money from individual pocket is abnormal situation unless the business is very small. The study found that 27.7% of total SMEs surveyed finance their business with little money they have. SMEs which opt to raise their capital through bank constitute 34% which is below average. It is a sign of difficulties for SMEs to raise capital externally. Venture capital is accessed by just 10.6% of the total population surveyed. This might be caused by its novelty or lack of information to SMEs. All in all, SMEs are facing difficulties in raising external finance due to lack of information, tough condition for loan, difficult procedures of processing credit and unfair interest rate imposed on the loan/ credits by FIs.

This finding concurs with those by Stiglitz &Weiss (1981) that information asymmetries may prevent lenders from observing the true nature of the borrowers. They may also prevent lenders from influencing the behavior of borrowers once the credit contract is signed. In principle, lenders could raise the risk premium on loans, but doing so may increase the probability of default by attracting riskier borrowers and/or by encouraging riskier behavior of borrowers. Since adverse selection and moral hazard could cause the lenders' expected payoff to diminish when raising the interest rate, they may refrain from raising rates beyond a certain level even if this means not fully satisfying the demand for credit.

4.3.1 FIs from which SMEs Obtain Credits

Table 7 presents the institutions from which SMEs obtain loans.

Table 7: FIs from which SMEs Borrowed

Variables	Frequency	Percent (%)
Bank	37	78.7
Private financing companies (other than bank)	5	10.6
Venture capital companies	1	2.1
Private investors	2	4.3
Others	2	4.3
Total	47	100

Source: Surveyed data, (2013)

The surveyed data, as shown in table7 above, revealed that most SMEs prefer to borrow from banks. This in another way of manifesting that there is a lack of information among people concerning other kinds of financial institutions. On the other hand, it might be caused by the government's policies that give conducive environment to banks. A good example we can refer to is that of fund offered by president Jakaya Kikwete for entrepreneurs popularly known as *Mabilioni ya JK* (The billions of Jakaya Kikwete). The fund was directed to banks where the condition was sited. Entrepreneurs were able to access the money through banks and not other financial institutions. The bad thing was that the condition of the loan was set according to the rules and requirements of the respective banks. The main concern here is that we expected that after establishment of other sources of finance where the conditions were fair; there could be a shift of SMEs from being financed by bank to being financed by SACCOSS. The conclusion here is that SMEs need more information and training before anything else which will help them to make appropriate decisions.

4.3.1.1 Services Offered by FIs

Table 8: Frequency Distribution of Services Offered by FIs

Respondent	Frequency	Percent
Yes	40	85.1
No	2	4.3
I don't know	5	10.6
Total	**47**	**100.0**

Source: Surveyed data, (2013)

Results from table 8 show the categorical response of respondents to bank services offered to SMEs. Having known that most of SMEs are using FIs services, respondents were asked if their bank offers credit services to SMEs. 85.1% agreed, 4.3% disagreed, while 10.6% said they do not know. This finding strongly supports the argument that SMEs have enough knowledge about credits and its availability but higher interest rate, difficult condition imposed by FIs and the wrong perception of FIs are the most hindering factors for access to credit by SMEs. Most SMEs of small magnitude, especially those employing less than 5 people, use the procedure of group model to get credits, but this did not show any positive contribution instead were strongly criticized by the respondents themselves.

The above findings are supported by the findings by the IMF, (2010) which defines SMEs differently. For instance, the definition of SME in Germany had a limit of 255 employees while Belgium it could have 100. In the United States, the small business is based on industry, ownership structure, revenue and number of employees (which in some circumstances may be as high as 1500, although the cap is typically 500).

The US and the EU use the same threshold of less than 10 employees in small offices in Kenya SME is used for small, medium, and micro enterprises. Elsewhere, in Africa, MSME stands for micro, small and medium enterprises which consist of maximum number of employees.

4.3.1.2 SMEs Application for Credits

Table 9: SMEs Application for credits from FIs

Response	Frequency	Percent
Yes	39	83.0
No	8	17.0
Total	**47**	**100.0**

Source: Surveyed data, (2013)

Respondents were asked if they had ever applied for credits from FIs. The findings indicated that 83.0% agreed that they had had applied for credits for even more than 3 times while only 17% said they have never applied for credits. The reasons were that some have sufficient fund, another said that time has not yet come, which means they still in early stages of the business development. The interesting issue is some of SMEs did not apply for credits because they are afraid to be liquidated when they fail to repay a loan. This perception of SMEs concerning condition and all procedures of getting credit, act as a hindering factor to smooth access to credit by SMEs. In Tanzanian context, the loan is highly afraid due to the fact that most credit institutions use an auctioning system for recovering the loss from the borrowers.

The findings do not concur with the findings by Macmillan committee (1931) who identified lack of long term risk capital termed "equity gap" as a significant constraint on the viability and growth of SMEs in the UK and by Botton (1971) and Buras & Dewhurst (1993) who argues that small firms relative to large ones are characterized as having weaker liquidity, lower and more volatile levels of profitability, an over-dependence on short-term finance and an insufficiency of shareholders finds or equity.

4. 3.1.3 Types of Credits which can be accessed by SMEs from FIs

In response to the question on the types of credit (range) which an entrepreneur can access from FIs, results showed that all FIs are offering only working capital. It means that they offer credits to SMEs which are already operating a business. The reasons behind are to give credit to people who do not have the business increase and that the borrower might use the money for other purpose which is not the target of the loan. To monitor that condition, FIs demand the SMEs to submit the copy of certificate of incorporation/registration, business license and Taxpayer Identification Number (TIN) when they are applying for credits.

This is supported by the study by Care International (n.d) that focuses on pre-existing organized rural group. Its credit program emphasized women owners of micro enterprises. Clients are required to raise equity cash of 25% of the total loan required. The loan security is the group members who guarantee each other and are collectively guaranteed by the group. ICDC operates credit schemes including on that carter for retails and wholesale trader for working capital, KRIEP has a credit program targeted at ROSCAs who then lend to their members. The loan received by the groups is equivalent to ten times the group savings. Savings are important components of the program and there is also an insurance fund. PRIDE, on the other side, provides credit to small enterprises especially those in the informal sector without access to other sources of credit, ROSCA provides credit to borrowers who would normally be unlike to borrow from other sources and also mobilize savings from members. Rural enterprises rely more on ROSCAs since they present easier access to other sources of credit. SACCOSS provides both savings and credit facilities to their members. The amount of credit provided depends on the amount of the individual members' savings but the amount of money is not restricted.

4.3.1.4 Mechanisms Employed by FIs to offer Credits to SMEs and Time for Loan Processing and Sources of Fund for SMEs

FIs have the mechanisms employed to offer credits to SMEs. Two of the financial institutions employ a combination of individual and wholesale system to provide credits/ loans to SMEs. The remaining FI employ a combination of individual and group lending mechanisms. However, the group lending mechanism has been criticized a lot by MSMEs simply because some of their team members are not committed; they take credit and use it for unintended purposes. As the result, they fail to repay the credits. Sometimes, one of the members might pass away while she/he has not completed repaying the credits yet. In this case, members are required to pay on behalf of the deceased. What they said is that credits should be provided to individual SMEs rather than on group lending mechanism.

Also, the time taken to process credits was identified by the respondents. The longest one was 30days while others said that just within 6 to 14 working days is enough. By this finding, it was noted that the time is not too long to discourage SMEs from loaning. However, FIs should look forward to improve the situation by minimizing the period used. This is because the results showed that credits are not released on time.

However, financial institutions were asked to specify the source of funds used to provide credits to SMEs. The responses were as follows; Azania Bank has special fund reserved for the same purpose. This means that the bank operates for the purpose of generating profits. EADB Bank does not have that reserve but instead they get that fund from central bank because it does not operate SMEs window. In the case of Kinondoni SACCOSS, they are just getting the fund from customers through deposits. In other words, FIs do not have a shortage of fund; they are able to finance SMEs at any point in time but after SMEs have fulfilled their conditions for credits.

The above findings are in line with those by Botton (1971) and Buras & Dewhurst (1993) who argue that financial institution employ individual and group approaches to provide loans. They also assert that time for loan disbursement differs from one financial institution to another due to differing by-laws and regulations. They add that, major sources of finance for SMEs are micro finances such as SACCOS and banks.

4.3.1.5 Conditions for Credits to in FIs

Table 10 below presents the conditions for credits to SMEs.

Table 10: What were the Conditions of the Credits to SMEs

Variables	**Frequency**	**Percent**
Collaterals	8	17
Guarantors	3	6.4
Both	36	76.6
Total	**47**	**100**

Source: Surveyed data, (2013)

The finding from the study that FIs perceive SMEs sector as high risk one, therefore, to minimize the risk, FIs impose strict and difficult conditions including demanding collateral, guarantors, business license, certificate of incorporation or using group lending models. These discourage borrowing by SMEs because most of them fail to fulfill these conditions. Most of the respondents argued that SMEs can survive without any credits. This entails the situation whereby growth and expansion of the firm will be deteriorated.

These findings are against the study by Msengwa (2006) who argues that national and international financial institutions such as CRDB, NBC, NMB, BARCLAYS and ACB banks are the sources of finance for SMEs. This is due to the fact that, through experience, banks have been considered to be the source of capital for many small, medium and large enterprises. Other studies regard SACCOS, PRIDE, FINCA, and BRACK as sources of microfinance for SMEs.

4.3.1.6 Respondents' Comments on the Conditions for Credits

Table 11 presents the responses by informants.

Table 11: Comments by Respondents on Conditions for Loan

Variable	**Frequency**	**Percent**
Poor	41	87.2
Satisfaction	2	4.3
Good	4	8.5
Total	**47**	**100**

Source: Surveyed data, (2013)

From table 11 above, 87.2% of the population agreed that conditions are poor while 8.5% reported that the conditions are good and only 4.3% said that they are satisfactory. The study revealed that the conditions for the loans are poor and measures should be taken to revise the situation. Findings show that the system used by micro lending institution of giving loans to groups (group lending) proved a failure. The respondents criticized this by saying that it is limiting individuals who are aiming to develop. Group members suffer because of the fault committed by one of their member something which is not fair at all. These results are not in line with those of Msengwa (2006) who revealed that some banks, though few, are lending credits to SMEs. Such banks include NMB which provides loans to SMEs ranging from Tshs 50000 with the interest rate of 2% per month. The study also revealed that most of women, through development groups, get loans which previously they could not get as they did not have enough collateral.

4.3.1.7 Reasons for Not Applying for Credits by SMEs

Table 12: Table Showing Reasons why SMEs do not apply for Credits

Variables	Frequency	Percent
I have sufficient capital	8	17
I am afraid to borrow because of the difficult procedure	15	31.9
I have never applied for credits from any financial Institution	4	8.5
I am afraid of failing to repay the loan	20	42.6
Total	**47**	**100**

Source: Surveyed data, (2013)

The study revealed that SMEs do not apply for the credits because of the factors mentioned in table 12 above. 17% of SMEs said that they do not want to apply for credits because they have sufficient capital. When they were asked what they meant by sufficient capital; the answer was that they do small business which can be handled by the little money they have. Others said that they have small group from which they lend money to each member in the rotating manner without charging any interest. 31% did not apply because they were afraid of complex procedures when applying for credits, the issue of collaterals, guarantors or using of group lending mode are the things which discouraged them. However, some SMEs admitted that they had never applied for credits from any financial institution. The largest population of my sample was afraid of repayment conditions or procedures used by FIs.

The above findings are against those by Hossain (1988) who points out that the Gramen Bank (GB) has reversed conventional banking practices by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity. The GB experience shows that most of the conditions imposed by formal credit institutions like collateral requirements should not actually stand in the way of smallholders and the poor in obtaining credit. The poor can use the loans and repay if effective procedures for disbursement, supervision and repayment have been established. On the issue of interest rates, the bank also supports the view that high interest rate credit can help to keep away the influential non target group from a targeted credit programs.

This further demonstrates the need to develop appropriate institutions for delivery of loans to small scale borrowers. Loan security is one of the important aspects of credit to SMEs. Most lending to small scale enterprises is security based without any regard to potential cash flow. However, organizations lending to micro enterprises have devised alternative forms of collateral. These include group credit guarantees where organization lend to individuals using group guarantees; and personal guarantee where individual are given loans based on guarantees pledge.

4.3.1.7.1 Credit Packages Offered by FIs and its Status

Table 13 below presents the lending credit packages offered by FIs

Table 13: Credit Packages offered by FIs

Variables	Frequency	Percent
Adequate	1	2.1
Inadequate	8	17
Adequate and released in time	11	23.4
Inadequate and not released in time	27	57.4
Total	**47**	**100**

Source: Surveyed data 2013

The study found the problems with the packages offered by FIs. As indicated in table 13 the respondents strongly agreed that the package is not adequate and is not released on time. Difficulties faced by SMEs in accessing credits are increased by circumstances such as inadequate package, poor condition and lack of appropriate information. As in the table 13, 2.1% agreed that the package is adequate, 23.4% were of opinion that credits are adequate and released on time, 17% said that it is inadequate and 57.4% were of opinion that it is inadequate and not released on time. Studies such as that of Warema (1996) and Clauses (2005) supported this argument by stating that even the amount of money that is financed does not suffice the growth of SMEs.

4.3.1.7.2 Basis of Loan Repayment and Transaction Charges

Table 14 below presents the basis for loan repayment and transaction charges.

Table 14: Basis of Obtaining and Repaying Loan and Loan Transaction Charge

Variable	Frequency	Percent
Fixed terms and charges	27	57.5
Negotiation	18	38.3
Don’t know	2	4.3
Total	47	100

Source: Surveyed data, (2013)

The respondents were asked to state how they are repaying the loan and its interest rate. As indicated in table 14 above, 57.5% said that they are paying the total amount of the loan plus interest rate at par while 38.3 % they are paying depending on the negotiation and the remaining 4.3% they do not know. This situation is not good for business people. Respondents were claiming that FIs are offering short term loans which make them not gaining anything from their efforts and sometimes threatening to auction their business due to failing to repay the loan. Something should be done to restructure the situation. The FIs should reduce their condition and offer loan terms. These results are in line with the study by Mpoto (2003) who contends that there is high interest rate set by micro financing institutions that lowers the ability of the SMEs to make appropriate returns.

4.3.1.7.3 Effectiveness of FIs in Loan Processing and Delivery

Table 15 presents the areas where bank officials are effective as revealed by informants.

Table 15: Areas where Bank Officials are Effective

Variable	Frequency	Percent
In making follow-up on loan repayment	38	80.8
In giving consultancy service to their client	6	12.8
In assisting preparation of project write-ups	3	6.4
Total	**46**	**100**

Source: Surveyed data 2013

The study revealed that FIs especially bank official are effective in making follow – up on loan repayments. As in table 14, 80.8% of all respondents agreed that the main task of a bank is to make a follow – up on loan repayment, 12.8% agreed to the statement that bank officials are effective in giving consultancy to their clients while 6.4% agreed that banks are effective in assisting SMEs in preparation of project write – ups.

The conclusion was that FIs should offer training first before providing credits to SMEs. Also, it was found that some banks require SMEs to submit and present their business plans as a requirement for getting a loan. After proven by project experts that the business will offer good return to owners, the banks provide credits, which actually is the best thing. On the other hand, the study revealed that both sectors want to favor their interests first before anything.

These findings seem to be true due to the observation made by the current researcher. Many loan officers are very careful with loan returns for various SMEs. Some of the assets owned by SMEs such as motorcars, buildings and land, have been confiscated and auctioned after being given the notice of returning the loan. Generally, some of the loans are monitored by the banks for example through a computer system that deducts the loan and its interest automatically from the system for SMEs which use the same banks for their savings. However, it was found that some of the identified areas where bank officials are more effective include making follow-up on loan repayment, giving consultancy service to the clients as well as project write up assistance. This is possible such officials had had received certain training programs as discussed below

Special Training Programs for Staff Dealing with SMEs

When respondents were asked if there were any special training programs to staff dealing with SMEs, both responded “yes” there is that program. But measuring the effectiveness of that training becomes difficult due to the fact that the two sectors are not operating in a friendly manner. However, banks such as EAD bank Tanzania have a good scheme for large business whereby the businessmen who apply for loans are given special attention. They supported to manage the uses of the loan in the intended business. Frequent follow-up is made by the bank to make sure that the business yields profitable returns to help the customer to repay the loan. Therefore, the customer does not operate the business himself or herself. He/she gets support from banks. This strategy reduces the default rate because the time taken by the borrower to repay the business is owned jointly by EADB bank and the customer. Another interesting issue is that the bank does not release all amount of credits at the same time, instead it gives only the amount required at that time. This helps to reduce the possibility of the borrower to use the money in other affairs out of business.

4.4 The Ability of SMEs to Sustain in an Increasingly Competitive Global Market without Credits

Table 16 indicates the SMEs' ability to survive without credits.

Table 16: Possibility of Surviving of SMEs without Credits from FIs

Variables	Frequency	Percent
Yes	22	46.8
No	25	53.2
Total	47	100

Source: Surveyed data 2013

As in table 16, 53.2% of respondents disagreed with the statement that SMEs cannot survive without credits while who agreed with the statement were 46.8%. This is the sign that FIs have an important role to play in creating a good environment for the growth of commercial sector especially SMEs in Tanzania. The government should interfere the current situation by creating a mechanism which will favor both sectors. FIs should ignore their wrong perception because they can service SMEs sector profitably. The only thing to do is to offer training first before providing credits.

These findings are in congruence with the study by Abbebe (2006) who revealed that non – existence of training and support components and the provision of small credits to inexperienced start up entrepreneurs are the drawbacks of the scheme for offering credits to SMEs. However, this study does not assess factors hindering access to credit. Lack of qualified staff for providing loans, poor customer care, competition from other MFIs group guarantee model problems, lack of trustfulness among customers and poor performance of the business are the factors which hinder access to credit by SMEs. These factors, among others, contribute to the failure of SMEs.

Abbebe concludes that it is difficult for SMEs to survive in an environment which do not have micro financing support.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The findings of this research clearly indicated that SMEs are suffering from lack of information, training and advice about business in general, poor conditions for credits imposed by FIs to SMEs, bad perception by FIs. For example, consulting services are offered at the high cost which does not allow SMEs to attend or use this service.

The mechanism of the group lending model has proved failure or it needs some modification. For example, in this study, many respondents criticized this system; the main problem of the mechanism is that some of the group members are not committed to what they are doing. They take the credits and use it in their personal affairs out of business. When it comes the time to repay the credits, their colleagues becomes responsible for irresponsible actions of their fellows. The consequence is retardation of the group member from where they were. They suggested that this should be abolished; individual persons should be given the credits because this will increase the level of care and activeness in handling the credits and business activities.

The government, through the central bank, should introduce the policies or schemes to ratify the situation. FIs should be told not to segregate SMEs. They are supposed to treat them like other large business enterprises. Training must be provided before credit is supplied to them. On the other hand, SMEs should repay their loan at the right time and be honest when providing information about their business and themselves.

Conditions for credits should be reduced to fit the needs of SMEs, complex procedure and lack of information should be taken as the serious issue to deal with by the government, FIs and SMEs sectors. If the mentioned problems are solved, the business environment in Tanzania will be improved. This is because the study revealed that SMEs cannot stand by themselves without the availability of credits. Capital cannot be raised easily from individual pockets. The only place to obtain a loan is from FIs given the fact that the conditions for loan are rectified, charging low interest rate is put into practice, training has been provided, and information is available to public.

5.2 Recommendations

The conduct of open market operation by the Bank of Tanzania continues to be the key component of any successful liberalization and modernization of Tanzania banking system. However, further progress needs to be made in achieving a more efficient and competitive financial system to have a wide range of instruments and an even wider range of financial intermediaries in order to promote sound competition in the domestic market.

This presents an opportunity for a demand driven support. Even if financial support to SMEs is in the form of grants not loans, it is still important to learn from financial institutions on their experiences in issuing loans to SMEs. This would enable to have an idea of funds absorption capacity of SMEs and their ability to make profitable and wise use of their fund obtained.

This study recommends that the Bank of Tanzania (BOT) should draw special loan conditions which are particularly suitable for the poor SMEs. These include:

(a) Very small amounts of loans given without any collateral.

(b) Loans repayable in installments for the loan period

(c) Individual self chosen and quick income generating activities which employ the borrowers who already posses loans.

(d) Stress on credit discipline and collective borrower responsibility or peer pressure.

(e) Special safe grants through compulsory and voluntary savings to minimize the risk that the poor contract.

(f) Transparency in all banks

The above proposed strategies, can help to determine the kinds of organizational and product strategies that are effective in allowing specialized MFIs to provide extensive outreach. They are also helpful in achieving financial viability to adapt their operation to serve this potential market profitably and open up lucrative business opportunities which result in greater outreach.

5.2.1 Suggestion for further Research

This study can be extended by using a different methodological approach such as the use of questionnaire to further substantiate the qualitative issues around the problem of limited access to finance SMEs.

Another interesting suggested area of study is the review of interest rate spreads for FIs in Tanzania with an objective of finding out if they are justifiable or whether can be used to help fight poverty in the country.

A comparative study for SMEs in two regions; one with many SMEs like Dar es Salaam and another with very few SMEs like Kigoma region should be conducted so as to reveal the efficiency of loan delivery in Tanzania.

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APPENDIX

A QUESTIONNAIRE FOR SMES' WORKERS TO DETERMINE THE STATUS OF THE BUSINESS

Fill in brackets with *(x)* wherever is appropriate in each of the following questions. Please ensure accuracy of your answers. The information provided will be confidential and used for academic purpose only.

A: Characteristics

1. Sex of the Respondent.

1=Male (   )   2=Female   (   )

2. In which Age category do you belong?

1= 18-28 ( ) 2= 29-39 (   ) 3= 40-50 (   ) 4= 51+ (   )

3. What is your highest level of education?

1= other education (   ) 2= Primary education (   )

3= Secondary education (   ) 4=Diploma education (   )

5= Postgraduate education (   )

4. What are your working experience years?

1= below 1yr (   ) 2= 1-5yrs (   ) 3= 6-10yrs (   )   4= 11yrs+ (   )

5. Where is the location of your business?

____

B: Business Information

6 i. Did you get any kind of loan?

1. Yes (   )   2. No   (   )

ii. If yes, from which bank or financial institution?

1. Bank (   ), 2. Financial institution (   ), 3 SACCOS / VIKOBA (   )

7. i. Can you state sales of your product /services monthly?

1. Yes (   )   2. No   (   )

ii. If yes, mention your monthly sales _________________

8. i. Can you state your monthly profit?

1. Yes (   ) 2. No   (   )

ii. If yes, what is your monthly profit?

9. i. Do you have records for your business shares in number?

1. Yes (   ) 2. No   (   )

ii. If yes, what is the shares number of your business?

10. i. Do you promote or advertise your product / service?

1. Yes (   ) 2. No (   )

ii. If no, state how you market your product / service.

11. i. Do you put records in the market shares?

1. Yes (   ) 2. No (   )

ii. Enlist the sales of volume of your business segments

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12. i. Have you formalized your businessman?

1. Yes (   )   2. No (   )

ii. If yes, would you show the number of your lessen?

____

13. i. Do you have any little deeds of your assets?

1. Yes (   ) 2. No   (   )

ii. Do you have any account number for your business?

1. Yes (   ) 2. No   (   )

iii. Do you make all financial transitions through business account?

1. Yes (   ) 2. No   (   )

14.i Do you know any requirements for your business to get a big loan?

1. Yes (   ) 2. No   (   )

ii. Mention the requirements.

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____

Thanks in advance for your corporation and participation!