

**THE EFFECT OF MICROFINANCE CREDIT ON THE GROWTH OF SMALL  
AND MEDIUM SCALE ENTERPRISES IN MWANZA REGION, TANZANIA**

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## DECLARATION

I declare that this work has not been previously submitted for the award of a degree by this or any other University. To the best of my knowledge and belief, the Research project contains no material previously published except where due acknowledgement has been made in the text.

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## **DEDICATION**

I dedicate this work to my beloved daughter Hellen Benjamin who was born in the year 2010, a year before I start this Master program. Her endurance and smiles every time I call back home made it possible for me to successfully complete my research project and the Master Program as a whole.

I also dedicate this work to my loving husband Benjamin Ngassa, and my precious mother Christina for their inspiration, encouragement and support in diverse forms that will always be remembered and cherished.

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## **LIST OF ABBREVIATIONS**

ACB	Akiba Commercial Bank
BOT	Bank of Tanzania
CBO	Community Based Organization
CRDB	Cooperative and Rural Development Bank
FINCA	Foundation for International Committee Assistance
GDP	Gross Domestic Product
IFC	International Finance Company
MFI	Microfinance Institutions
MSEs	Micro and Small Enterprises
NGOs	Non- Governmental Organizations
NMB	Nation Microfinance Bank
PRIDE	Promotion of Rural Initiative and Development Enterprises
PTF	Presidential Trust For self reliance
SACCO	Saving and Credit Cooperative Society
SMEs	Small and Micro Enterprises
TAMFI	Tanzania Association of Microfinance Institutions

## **ABSTRACT**

Small and Medium Scale Enterprises play an important role in the Economic Development of both developed and developing nations. Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses. The objective of this study was to establish the effect of Microfinance credit on the growth of Small and Medium scale Enterprises in Mwanza Region, Tanzania.

Descriptive design was used in the study and the targeted population for this study was all SMEs in Mwanza, Tanzania. The study used a sample size of 70 SMEs in Mwanza from five business categories. The primary data was obtained from the owners of SMEs. Statistical Package for Social Sciences (SPSS) was used to solve the multiple regression equation for the study and also aided in data analysis.

The research finding indicates that a unit increase in access to Microfinance credit led to a decrease in enterprise growth. With regard to access to Microfinance credit which was a key variable in this study, the result from the regression model shows that there is negative relationship between the growth of the SMEs and access to microfinance credit in Mwanza Region. This is to say the cost of loan tend to exceed the revenue obtained from the investment due to payment of high interest rate and the principal amount. Apart from that, the findings of the study shows that most of SMEs owners tend to divert the purpose of the loan and use it for unintended purposes as the result most enterprises seem not to change their status from micro to small and from small to medium.

Considering the control variables, Profit margin, Total asset accumulation, and employment level all have positive relationship with growth of the SMEs and therefore contributed to the growth of SMEs in Mwanza Region. In conclusion, this result shows that when acting jointly, improvement in profit margin, Asset accumulation and Employment level would improve Enterprise Growth.

The study recommended that policy review should be followed by legislative review. As it has been shown, SMEs in Tanzania are operating in a very informal way. There is a need to review the existing laws in order to establish an enabling legal and regulatory environment responsive to the needs and contexts in which SMEs are operating.

The policy and legislative review should envisage introduction of the structures of the Microfinance credit regulatory institutions that have in mind the needs and expectations of the SMEs. In this sense, a recommendation to establish the Microfinance credit Support Desk should be institutionalized in the national policy as well as the governing legislation.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

Small and medium scale enterprises (SMEs) are lifeblood of most economies. On average SMEs represent over 90% of the enterprises and account for 50 to 60% of employment in most African countries. Empirical evidence shows that a dynamic and growing Micro and Small Enterprises (SMEs) sector can contribute to the achievement of a wide range of development objectives, including: the attainment of income distribution and poverty reduction, Kessy and Temu (2010), creation of employment Daniels and Ngwira (1993); savings mobilization Beck et al (2005); and production of goods and services that meet the basic needs of the poor, Cook and Nixson (2000). While estimates vary greatly depending on definitions, recent work by the World Bank suggests that almost 30 per cent of employment in developing countries and Tanzania alike is generated by the informal economy, while an additional 18 per cent is provided by (formal) small and medium enterprises. Together these two groups contribute 63 per cent of the GDP, Ayyagari et al. (2003).

Despite of SMEs large contribution in countries development and economic growth, their growth and development in developing countries were mainly inhibited by access of finance, poor managerial skills, lack of training opportunities and high cost of inputs, Cook and Nixson (2000). Further studies conducted suggest that finance is the most important constraint for the SME sector, Green et al., (2002). The SMEs have very limited access to financial services from formal financial institutions to meet their working and investment needs Kessy and Temu (2009).

In a study done by Rweyemamu et al. (2003) revealed that, formal financial institutions have failed to serve the SMEs in both urban and rural communities. Financial problem of most SMEs arise due to poor financial management; existence of information asymmetry and bank credit rationing, Chijoriga and Cassimon (1999). Ogawa and Suzuki (2000) pointed out that bank do not want to offer loans to SMEs because the nature of loans

required is too small and those banks find it more expensive to offer such loans. According to Chijoriga and Cassimon (1999), most formal institutions regard low-income households as too poor to save, and are not personally known to them, do not keep written accounts or business plans, they usually borrow small and uneconomic sums, while administration and carrying costs are almost as high as for large loans, Kuzilwa and Mushi (1997). Commercial banks, which were traditionally looked upon as powerful catalyst of economic development through mobilization and the provision of credit to profitable ventures do not offer credit to the rural poor or small business.

According to Wangwe and Semboja (1997), SMEs in Tanzania contribute 16% and 34% of rural and urban employment respectively as well as up to 32% of the country GDP. Therefore the Government of Tanzania in recognizing the contribution of SMEs in country economy developed the National Microfinance Policy which aims at enabling low-income earners to access financial services, URT (2000).

### **1.1.1 Microfinance Credit**

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses. Microfinance credit is mostly used in developing economies where SMEs do not have access to formal sources of financial assistance, Robinson (1998). In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self confidence and the training of members in that group on financial literacy and management, Ledgerwood (1999). There are different providers of microfinance (MF) services and some of them are; Non-Governmental Organisations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non bank financial institutions.

This concept of micro financing institutions originated in Bangladesh, around 1976 through a pioneering experiment by Muhammad Yunus (winner of the 2006 Nobel Peace Prize). Small groups of people called Self Help Groups (SHG), group lending, individual lending and village banking were established to ease capital accessibility through savings.

Yunus proposed an interest rate of 20% which is typically used by the Grameen Bank , Grameen Bank (2000). MFIs provide similar products and services to their clients as formal financial institutions (FFIs) provide. The scale and method of delivery differ, but the fundamental services for savings programs, extending loans, and offering insurance are the same. Extending loans (or microcredit) is the dominant product of MFIs, Nelson (2001). Since these early microcredit programs, some MFIs have begun to offer additional products such as education and equity services

Microfinance institutions operating in Tanzania provide financial services to the SMEs mainly in the form of micro credit with an exception of cooperative based microfinance institutions, which are predominantly savings based. The main Microfinance Institutions can be categorized as Non Governmental Organizations (NGOs), Cooperative based institutions namely SACCOs and SACCAAs while the third category is banks. The major players in the NGOs category include PRIDE Tanzania, FINCA (Tanzania), Small Enterprise Development Agency (SEDA) and Presidential Trust for Self-Reliance (PTF). Others, which are relatively smaller in size, include Small Industries Development Organization (SIDO), YOSEFO, SELFINA, Tanzania Gatsby Trust, Poverty Africa and the Zanzibar based Women Development Trust Fund and Mfuko. There rest consists of very tiny programmes scattered throughout the country mainly in the form of community based organizations (CBOs).

Banks that are actively involved in microfinance credit delivery include the National Microfinance Bank (NMB), CRDB bank, Akiba Commercial Bank (ACB) and a few Community/regional banks namely, Dar es Salaam Community Bank, Mwanga Community Bank, Mufindi Community bank, Kilimanjaro Cooperative Bank, Mbinga Community Bank and Kagera Cooperative Bank.

### **1.1.2 Growth of SMEs**

The purpose or goal of any firm is to generate sustainable shareholder value and growth. A firm is defined as an administrative organization whose legal entity or frame work may expand in time with the collection of both physical resources, tangible or resources that

are human nature, Daniels (1993). The term growth in this context can be defined as an increase in size or other objects that can be quantified or a process of changes or improvements, Daniels (1993). The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state, Daniels (1993). The growth of a firm can be determined by supply of capital, labors and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of resources to the firm, Cook and Nixson (2000).

According to USAID (2002), the standard measure of growth used in studies of SMEs firms is the change in the number of workers since start up. This variable is relatively easy for respondents to remember and does not need to be deflated. In addition, Liedholm and Mead (1999) contend that job creation is an important social goal and development objective and policies to support small enterprises are frequently justified on their supposed employment effects, Liedholm and Mead (1999); Voulgaris et al (2003). This study also emphasizes employment growth. The definition of employment includes working owners (entrepreneurs) because of job creation for owners may be equally valuable as jobs created for others from a social welfare point of view. Workers on external contracts are also included. It also includes paid part-time and full time family members. On the other hand, unpaid family helpers and apprentices are excluded, because their relationship is more frequently part time and casual and because they cannot be reliably measured in all years, USAID (2002).

Some studies, however, show the biases that might arise from use of employment as an exclusive measure of growth instead of alternative indicators such as changes in sales, outputs, or assets, USAID (2001). This is because of the seasonal nature of most SMEs employment, from the prevalence of part time work and from the extensive use of unpaid family labor including children as well as the slowly growing nature of employment, which appears to increase with a lag after a sizeable growth in real sales, USAID (2001).

Accordingly, Acs and Audretsch (1990) define SMEs growth as an average change in sales. However, according Voulgaris et al (2003), enterprise performance and profitability is not related to growth of sales, since some companies may be able to maintain high profits, even with a declining growth rate. Some analysts of the growth of small businesses suggest the need to define employment effects to the context and aspirations of the potential beneficiaries. Poor jobs, which require few skills, and are short term, intermittent and lowly paid may still be better than nothing for the unemployed and underemployed. In addition, they can provide flexible options for individuals, such as women, who have extensive competing obligations. They may also provide opportunities for men to live with their families, rather than migrating for work. Liedholm and Mead (1999), contend that the growth of employment remains to be a substantial measure of firm growth. Studies, which took employment as an indicator of enterprise growth, indicate that small firms are contributing to a greater degree for annual number of jobs created.

### **1.1.3 The Effect of Microfinance Credit on Growth of SMEs**

Arguments by various researchers have been advanced to suggest there is a positive relationship between Microfinance credit and growth of SMEs. MFIs that are financially sustainable with high outreach have a greater livelihood and also have a positive impact on SME development because they guarantee sustainable access to credit by the poor, Rhyme and Otero (1992). Availability of credit to small business and low income households greatly enhance their economic strength and eventually break the vicious circle of low income – low saving – low investment – low income Yunus (1984). According to Grade (1984), loans enable the individual's member or enterprises to enjoy the benefit of economies of scale and new technology.

Nichols (2004) used a case study approach to investigate the impact of Microfinance credit upon the development of Small and Medium Enterprises and the lives of the poor in the rural China, he found that the participation of poor in MFI program had led to positive impact in their business and their life. Their income have increased, spending on educational and health have increased hence improved their standard of living and also

women have benefited out of this program. There were visible sign of higher wealth level within the village.

Luzzi and Webber (2006) argue that Microfinance has attracted much attention in the recent years. It has been seen as the panacea to underdevelopment. By resting on market incentives, microcredit is able to promote small scale investment that generates sufficient revenues from otherwise unrealized market activities, while yielding a return on the amount lent. This is a powerful lever to provide credits and deposits possibilities to poor people who are largely ignored by commercial banks and other lending institutions

#### **1.1.4 SMEs in Tanzania**

The SMEs nomenclature is used to mean Small and Medium Enterprises. It is sometimes referred to as micro, small and medium enterprises (MSMEs). The SMEs cover non-farm economic activities mainly; small scale manufacturing, mining, commerce, services (food vending, transport, hair and beauty saloons etc) and agriculture (crop farming and animal husbandry), URT (2003). According to kessy and Urio (2006), SMEs can be defined as a productive activity either to produce or distribute goods and or services, mostly undertaken in the informal sector.

The Tanzanian government defines SMEs according to sector, employment size, and capital investment on machinery. A micro-enterprise is one with fewer than five employees, a small enterprise with 5-49 employees, a medium enterprise with 50-99 employees and a large enterprise with more than 100 employees. Capital investments range from less than Tshs 5 million to over Tshs 800 million. This definition would exclude a number of informal economy enterprises, peasant farmers, and Tanzanians engaged in lower-level income-generating activities URT (2003). It is estimated that there are close to 8 million small and micro entrepreneurs who need financial services and the number is growing by 4% annually, the majority of whom are found in the rural areas.

Given this overview of SMEs definition the general consensus has been that the statistical definition of SMEs differs by country and mostly based on the number of employees or the value or capital investment. However, one should be overly concerned about the lack of consistency in employment based SMEs definitions, since the number of employees, viewed in isolation from the size of markets or the economy, may be misleading. For example, a 50 employee firm in the advance countries like U.S. would be considered 'smaller' (relative to the size of the economy) than 50 employees firm in developing countries like Tanzania. Moreover, other characteristics of the firm, such as the degree of informality or the level of technological sophistication, may matter more than the number of employees as a segmentation factor in advanced countries.

### **1.2 Research Problem**

Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that access to credit increases income levels, employment and thereby alleviates poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production, Hiedhues (1995). The main objective of microcredit according to Navajas et al, (2000) is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions. Diagne and Zeller (2001) argue that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME's risk-bearing abilities; improve risk-copying strategies and enables consumption smoothing overtime. With these arguments, microfinance credit is assumed to improve the welfare of the poor.

The introduction of MFI's in Tanzania is seen as the best alternative source of financial services for low income earners and their SMEs as a means to raise their income, hence reducing their poverty level and contributing in country economy, Kessy and Urio (2006). Along this line the service of Microfinance Institutions to majority of Tanzanians who are low income earners have given them a number of possibilities including managing scarce household and enterprises resources more efficiently, protection against financial risks by

taking advantages of investment opportunities and gaining economic returns, Chijoriga (2000).

Several studies on Microfinance Credit have been conducted. Among the studies done include; Martine (2001), studied the economic implications of lending of MFIs on SMEs. Rweyemamu et al (2003), studied the performance and constrains facing semi-formal microfinance institutions in providing credit in Mbeya and Mwanza regions. In the analysis of their study the interest rates were found to be a significant barrier to the borrowing decision. Godfrey (2002) studied influence of credit rationing by MFIs on the operation of SMEs. Stevenson and Lundstrom (2001), studied the role of public policies and strategies in promoting SMEs sector. Jarambe (2005), studied the response of MFIs in Tanzania to the unstable business environment.

The researcher did not find any studies done which focuses on the effects of Microfinance Credit on the growth of SMEs in Tanzania, despite of several studies done on Microfinance credit sector. This study therefore, will seek to fulfill the identified research gap in knowledge concerning the effects of microfinance credit on the growth of SMEs in Tanzania. Thus, the study is sought to answer the following research question; what is the effect of Microfinance Credit on the growth of SMEs in Tanzania?

### **1.3 Research Objective**

To establish the effect of Microfinance credit on the growth of SMEs in Mwanza Tanzania.

### **1.4. Value of the Study**

This study is expected to benefit the Microfinance institutions and other interested bodies associated with finance sector in Tanzania hence improve the quality of credit services to their clients. MFIs and its stakeholders will gain an understanding of their shortcomings so that they can offer services which add value to their clients, and have a competitive advantage over their rivals.

This study is intended to shed light on the relationship between microfinance credit and growth of Small and Medium Enterprise particularly with the focus on their livelihoods

for both planners and policy makers in government agencies and NGOs. This will help them to come out with substantive possible alternative policy interventions which might help to address challenges facing SMEs in accessing credit and be able to implement better effective programs.

Like any other research, the findings would serve as a source of reference for other researcher or members of the general public who need information in the subject. More importantly, entrepreneurs in the category of SMEs may find it useful in the successful operation of their enterprises as the study will unveil some of the reasons why some SMEs fail.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The chapter opens with an overview of theoretical review, followed by determinants of Small and Medium Enterprises. It goes further by providing a review of empirical studies, and then the chapter concludes with summary of literature review.

#### **2.2 Theoretical Review**

##### **2.2.1 Transaction Cost Theory**

Transaction cost approach to the theory of the firm was created by Coase (1960) in his article "The Problem of Social Cost" "In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on". More succinctly transaction costs are: Search and information costs, bargaining and decision costs, and policing and enforcement costs. The transaction cost can be conceptualized as a non financial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan.

The cost incurred by the lender include; cost of searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinizing loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts. On the other hand, the borrowers that is SMEs for this case may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings, Bhatt and Shui-Yan (1998). The parties involved in a project will determine the transaction cost rate. They have the sole responsibility to reduce the risk they may come across, Stiglitz (1990).

### **2.2.2 Passive Learning Model**

In the Passive Learning Model (PLM), Javanic (1982), a firm enters a market without knowing its own potential growth. Only after entry does the firm start to learn about the distribution of its own profitability based on information from realized profits. By continually updating such learning, the firm decides to expand, contract, or to exit. This learning model states that firms and managers of firms learn about their efficiency once they are established in the industry. Firms expand their activities when managers observe that their estimation of managerial efficiency has understated actual levels of efficiency. As firm ages, the owner's estimation of efficiency becomes more accurate, decreasing the probability that the output will widely differ from one year to another. The implication of this theoretical model is that smaller and younger firms should have higher and more viable growth rates, Cunningham and Maloney (2001).

### **2.2.3 Stochastic and Deterministic Approaches**

The other set of growth theories of firms include the Stochastic and Deterministic Approaches. The stochastic model, which is also known as the Gibrat's Law, argues that all changes in size are due to chance. Thus, the size and age of firms has no effect on the growth of SMEs. According to Becchetti and Trovato (undated) empirical of the law has indicated that it only considers size and age as potential variables which may significantly affect firm growth by neglecting other explanatory variables which may significantly affect firm growth. The deterministic approach assumes, on the contrary, that differences in the rates of growth across firms depend on a set of observable industry and firm specific characteristics, Becchetti and Trovato, (undated).

### **2.3 Determinants of Growth of SMEs**

The standard measure of growth used in studies of SMEs firms is the change in the number of workers since start up, USAID (2002). This variable is relatively easy for respondents to remember and does not need to be deflated. In addition, Liedholm and Mead (1999) contend that job creation is an important social goal and development objective and policies to support small enterprises are frequently justified on their supposed employment effects, Liedholm and Mead (1999); Voulgaris et al (2003). This

study also emphasizes employment growth. Liedholm and Mead (1999), contend that the growth of employment remains to be a substantial measure of firm growth. If there is a need for an objective, neutral, and relatively easily applied definition for use in research, employee number is probably the best unit of measurement. Alternative indicators such as changes in sales, outputs, or assets, may be used as measure of growth, USAID (2001).

According to Sebstad et al, (1995) there is different range of indicators of growth of SMEs. This study will use average change in accumulation of business assets, profitability level, employment level, education level and age of the firm as determinants of growth for Small and Medium Enterprises. Asset accumulation, for firm to grow there must be an investment this may include accumulation of tangible and intangible asset. This means that total current investment is expected to have positive relationship with the growth.

## **2.4 Review of Empirical Studies**

### **2.4.1 International Evidence**

Fatchamps (1997) noted that with insufficient funds, farmers and fishers cannot invest in new equipment and machinery, and it becomes difficult to reach out to new markets and products. He further contends that without financial assistance, small farmers and fishermen cannot cope with temporary cash flow problems, and are thus slowed down in their desire to innovate and expand. The general perception is that access to external finance is critical for poor entrepreneurs, who may never have funds proportional to their ambitions.

Pitt and Khandker (1998) reasoned that given the small loan size and the type of activities undertaken by micro-entrepreneurs, it is unlikely that capital intensity has increased. Given that the labor and the capital intensity of rural non-farm production are unchanged, increased microfinance implies that employment can be expected to rise. However, if increased income as a result of microfinance programmes results in a decrease in labor supply (income effect), it can negatively affect labor supply of particular type, for example male labor supply. As a result employment may decline, given the demand for labor. Therefore, the net impact cannot be determined a priority. Microcredit programmes

seem to reduce wage-employment and income, but raise self-employment and corresponding income for programme- participating households. One might expect that a reduction of employment in the wage market might increase wages, but this may not happen because the wage-employment gap may be filled by previously unemployed or underemployed wage workers.

Coleman (1999) also finds little evidence of an impact on the programme participants. The results, Coleman further explains, are consistent with Adams and von Pischke's assertion that "debt is not an effective tool for helping most poor people enhance their economic condition" and that the poor are poor because of reasons other than lack of access to credit.

According to Mosley (1999), microfinance makes a considerable contribution to the reduction of poverty through its impact on income and also has a positive impact on asset level. But the mechanism through which poverty reduction works varies between institutions. Generally, institutions that give, on average, smaller loans reduce poverty much more by lifting borrowers above the poverty line, whilst institutions giving larger loans reduce it much more by expanding the demand for labor amongst poor people.

Amin et al (2003) used a unique panel dataset from northern Bangladesh with monthly consumption and income data for 229 households before they received loans. They find that while microcredit is successful in reaching the poor, it is less successful in reaching the vulnerable, especially the group most prone to destitution (the vulnerable poor).

Nichols (2004) used a case study approach to investigate the impact of microfinance upon the lives of the poor in the rural China and found that the participation of poor in MFI program had led to positive impact in their life. Their income have increased, spending on educational and health have increased hence improved their standard of living and also women have benefited out of this program. There were visible sign of higher wealth level within the village.

### **2.4.2 Local Studies**

Chijoriga (2000) evaluated the performance and financial sustainability of MFIs in Tanzania, in terms of the overall institutional and organizational strength, client outreach, and operational and financial performance. A sample of 28 MFIs and 194 SMEs were randomly selected and visited in Dar es Salaam, Arusha, Morogoro, Mbeya and Zanzibar regions. The findings of this revealed that, the overall performance of MFIs in Tanzania is poor and only few of them have clear objectives, or a strong organizational structure. It was further observed that MFIs in Tanzania lack participatory ownership and most of them are donor driven. Although client outreach is increasing, with branches opening in almost all regions of the Tanzanian mainland, still MFIs activities remain in and around urban areas. Their operational performance demonstrates low loan repayment rates. In conclusion, the author pointed to low population density, poor infrastructures and low house hold income levels as constraints to the MFIs' performance.

Rweyemanu et al (2003), he evaluated the performance and constrains facing semi-formal microfinance institutions in providing credit in Mbeya and Mwanza regions. The primary data were collected through a formal survey of 222 farmers participating in the Agriculture Development Programme in Mbozi and the Mwanza Women Development Association in Ukerewe. In the analysis of their study the interest rates were found to be a significant barrier to the borrowing decision. Also the borrowers cited other problems like lengthy credit procurement procedures and the amount disbursed being inadequate. On the side of institutions, Mbeya and Mwanza credit programme experienced poor repayment rates, especially in the early years of operation, with farmers citing poor crop yields, low producer prices and untimely acquisition of loans as reasons for non-repayment.

In a study conducted by Kessy & Urio (2006) on contribution of MFI on poverty reduction in Tanzania, the researchers covered four regions of Tanzania which are Dar es Salaam, Zanzibar, Arusha and Mwanza. Both primary and secondary data were collected; primary data were collected from 352 SMEs's through questionnaires, interviews were also conducted. PRIDE (T) Ltd which is a microfinance institutions were used as a case

study so as to get the insight of MFI operations. The study findings pointed out that to large extent MFI operations in Tanzania has brought positive changes in the standard of living of people who access their services, clients of MFI complained about high interest rate charged, the weekly meeting was pointed out as barrier as the time spent in weekly meeting could be used to other productive activities. The study recommended MFI to lower its interest rate, increase grace period and provide proper training to SMEs.

## **2.5. Summary of Literature Review**

From the empirical review above, it is evident that several studies have been conducted on Microfinance credit. Generally the studies suggest that Microcredit programmes seem to raise self-employment and income for participating households. Focusing on the local studies the closest study done to this was that by Kessy & Urrio (2006) on contribution of MFIs on poverty reduction in Tanzania. None of the study has carefully concentrated on the relationship between Microfinance credit and growth of SMEs. Thus, there exists a gap in current literature about the effect of Microfinance credit on the growth of SMEs in Tanzania.

This study will focus on Microfinance credit and the growth of SMEs. Investigating this issue from Tanzanian perspective could provide additional insights on how Microfinance Credit affects the growth of SMEs. From the theoretical review authors described different range of determinants of growth of SMEs. For the purpose of fulfilling the research gap in knowledge as identified by the researcher earlier, this study will use access to Microfinance credit as key explanatory variable. Other variables was, change in profit level, change in asset accumulation, employment level, education level and age of the firm as the determinants of growth of SMEs.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter explains about the research techniques adopted for this study which aimed at achieving the research objective. The chapter elaborates the research design, population of interest, sampling procedures, data collection methods and techniques that was used to analyze the data.

#### **3.2. Research Design**

Descriptive method was used in the study. Descriptive study help to show the different facts that are connected with the nature of the status of the current problem or condition as it happens at the time of the study. This is the reason why, it is considered as one of the most applied methodology in most studies. Furthermore, it offers the researcher a profile or to describe relevant aspects of the phenomenon of interest from an individual, organizational, industry oriented or other perspectives.

#### **3.3. Population**

The targeted population for this study was all SMEs in Mwanza. There were 235 SMEs in Mwanza Region, drawn from The Central Bank of Tanzania (BOT) data base and Tanzania Association on Microfinance Institutions (TAMFI). The SMEs are categorized into 8 categories; General trade, Wholesale, Retail shops, food processing, services, Transport, Manufacturing, Accommodation and catering and Storage and Communication.

#### **3.4. Sample**

The sampling frame for the study consisted five business categories, namely; Accommodation and catering, wholesale, retail shops, food processing, services and transport. A stratified random sampling technique was used to select a sample size of 70 SMEs in Mwanza from the five business categories. The study adopted a purposive

sampling technique for generating the primary data. Kombo (2006) suggested that purposive sampling involves selecting people whose views are relevant and reliable.

### **3.5. Data Collection**

The study used primary data collected from the owners of SMEs. Both open ended questionnaire and close ended questionnaire were administered to respondents. Questionnaires were divided into three parts; section A provides detail for respondent demographics, Section B provides details on access to Microfinance credit and growth of SMEs with the aim of giving answers to research objective and section C enquires relevant comments of respondents to the study. An interview method of administering questionnaire was used.

#### **3.5.1 Data Reliability and Validity**

The researcher used opinions of expert in the field of study especially the researcher supervisor. This facilitated the necessary modification of research instrument as the result of enhancing validity. Addition to that the researcher selected a pilot study of few respondents from the targeted population to test the reliability of research instrument. Before data entry into computer a series of pretest was conducted, the data scanning and scrutiny technique was employed from available questionnaires from respondents to examine and validate the survey instrument so as to ensure content validity and reliability.

**Validity:** To ensure validity the study applied the triangulation technique by using interviews, questionnaires and secondary data analysis concurrently and this was done through piloting of the data collection instruments used to collect data. The data collection instruments were designed in such a way that they measure attitudes and opinions of respondents towards MFIs loans to the maximum degree possible. Issues developed from conceptual framework were compared with issues obtained during interview and answers obtained from questionnaires so as to ensure construct validity.

**Reliability:** Data reliability is a cornerstone of making a successful and meaningful study. In order to collect reliable data, the researcher designed the interviews and questionnaires

through an elaborate procedure which involved a series of revisions under the guidance of the study supervisors to ensure that fieldwork was conducted by use of high quality data collection.

### 3.6 Data Analysis

The questionnaire responses were grouped into various categories for analysis using descriptive statistics. The Statistical Package for Social Sciences (SPSS) was used to solve the multiple regression equation for this study and also aid in data analysis. T test and F statistics test was used to test the significance of variables. R bar squared was used to test fitness of the data with the model. The multiple regression model specified below was used to determine the relationship between the effect of microfinance credit and the growth of the SMEs in Mwanza, with variables described as either dependent or Independent variable.

#### 3.6.1 Analytical Model

This study employed regression analysis to establish the effect of Microfinance Credit on the growth of Small and Medium Enterprises. Taking into account explanatory and control variables that may affect growth of SMEs, the multiple regression model took the form of;

$$EG_i = \beta + \beta_1 AMC + \beta_2 PL + \beta_3 AA + \beta_4 NE + \beta_5 EL + \beta_6 AF + \epsilon$$

Where:

EG = Enterprise Growth measured by change in annual investment turnover/ sales

AMC = Access to Microfinance Credit measured by the amount of microcredit received by SMEs owners from the MFIs

PM= Profit margin computed as;  $\frac{\text{Net Income}}{\text{Sales}}$

AA= Asset accumulation measured by summation of both current asset and non current asset of the enterprise

NE= Number of employees measured by change in the number of workers since start up of the enterprise

AF = Age of the Firm measured by number of years the firm has been in operation

$\beta$  = a constant/the proportion of various elements

$\varepsilon$  = the error term

$\beta$ 's = are multiple regression coefficients estimated.

In the model above, growth of the firm was the dependent variable. The key explanatory variable in this study was access to Microfinance Credit. Access to Microfinance credit refers to SMEs that have availability of credit from informal sector like Microfinance Institutions.

Control variables that were expected to have explanatory power on growth of SMEs includes; asset accumulation, profit margin of enterprise, number of employees and Age of the Firm.

## **CHAPTER FOUR**

### **DATA ANALYSIS, RESULTS AND DISCUSSION**

#### **4.1 Introduction**

This chapter presents research findings to establish the effect of microfinance credit on the growth of Small and Medium scale Enterprises in Mwanza Region, Tanzania. The results of the analyses were presented per study objective and described in tables where stated. The sample size for the analyses was 70 respondents. Once the respondents answered the questionnaire, data was then coded and analyzed using SPSS to generate various regression analyses as stipulated in the methodology.

#### **4.2 Findings**

##### **4.2.1 Participation Rate**

The study targeted 235 SMEs in Mwanza Region. From the study, 45 respondents out of the 70, making a response rate of 64%. According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% rated very good. This also concurs with Kothari (2004) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This implies that based on this assertions; the response rate in this case of 64% is good.

**Table 4.1 Response Rate**

	<b>Questionnaires administered</b>	<b>Questionnaires filled &amp; returned</b>	<b>Percentage</b>
Respondents	70	45	64

**Source: Research Findings**

## 4.2.2 Demographic Information

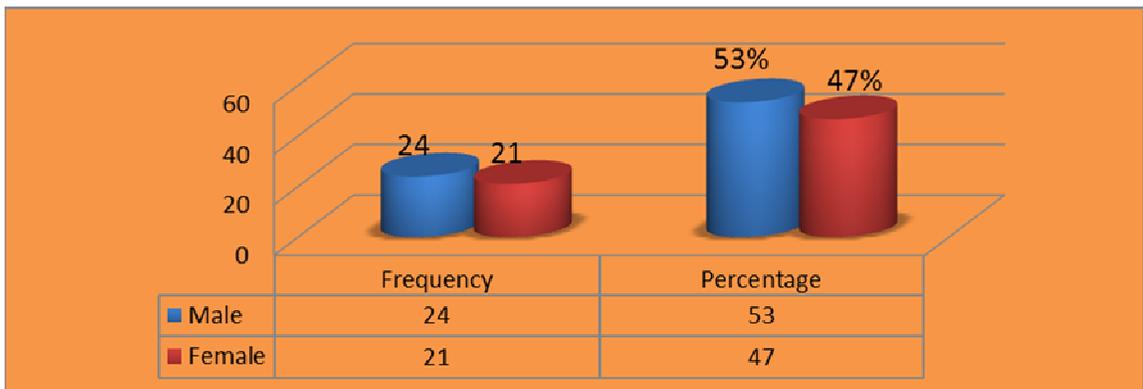
**Figure 4.1 Age Distribution.**



**Source: Research Findings**

The respondents were required to indicate their age where the study findings indicated that majority (57.8%) indicated that their age bracket was between 30 and 39 years. Analysis of findings also indicated that 28.9% of the respondents were between 20 and 29 years of age. The findings further indicated that 13.3% were 40 years and above .The findings of the study are illustrated in figure 1.

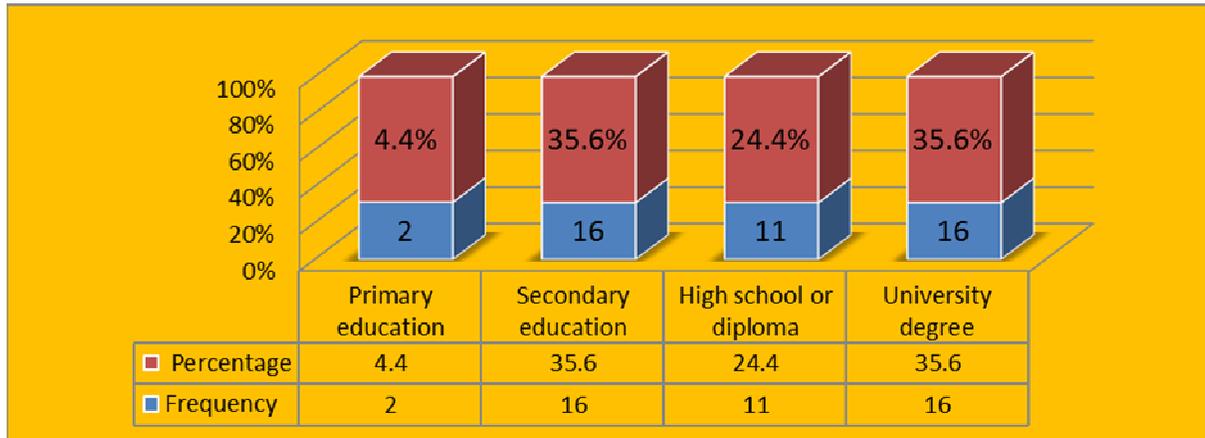
**Figure 4.2 Gender of the Respondents**



**Source: Research Findings**

The researcher determined gender of the respondents. The findings of the study indicated that the dominant group are the males who accounted for 53% and were followed by their female counterparts who also accounted for 47.6%.

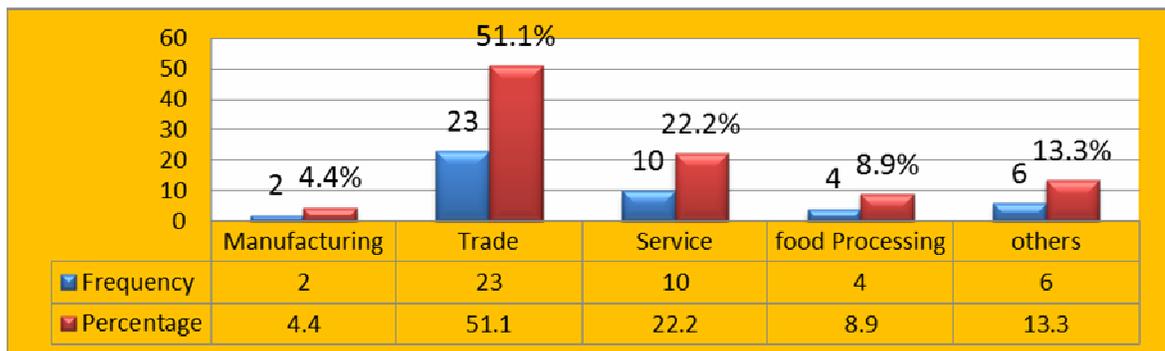
**Figure 4.3 Level of Education**



**Source: Research Findings**

The study sought to find out the respondents level of education. The findings of the study are displayed in figure 3. From the findings, University degree and secondary education had 35.6% each respectively, 24.4% high school or diploma and the remaining 4.4% indicated that they had primary level of education. The results are illustrated in figure 3.

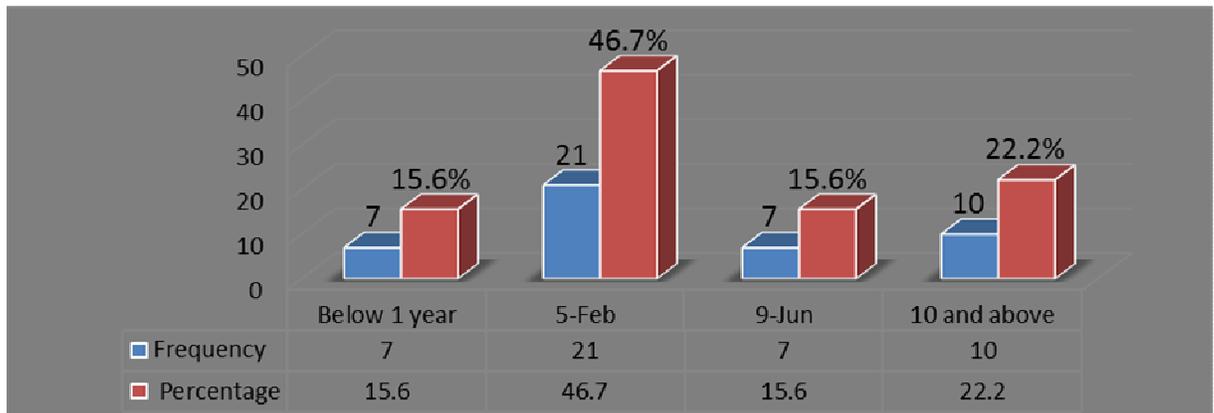
**Figure 4.4 Line of Business**



**Source: Research Findings**

The study also determined from the respondents their respectful line of businesses. According to the analysis of the findings, majority (51.1%) are trading, 22.2% are in the service industry, 8.9% food processing and 4.4% manufacturing respectively. The study further revealed that the remaining 13.3% indicated other line of businesses. The results are illustrated in figure 4.

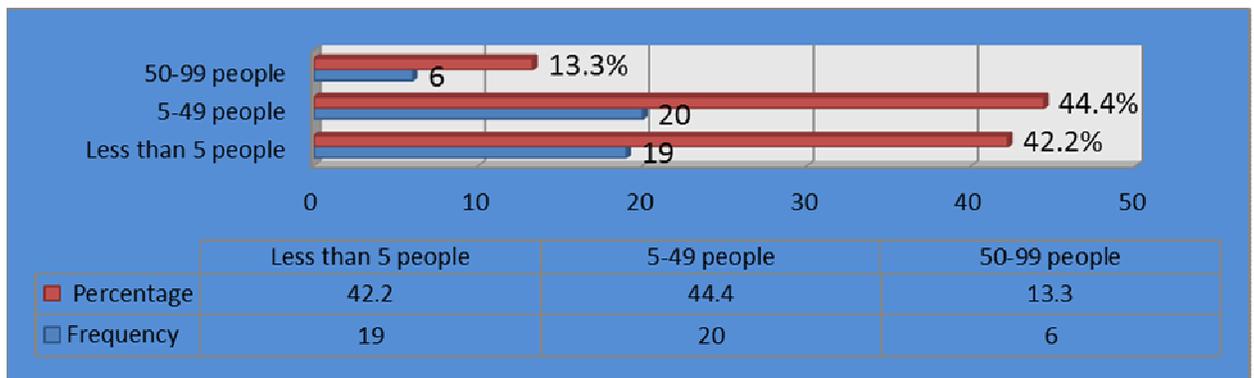
**Figure 4. 5 Duration in the Business**



**Source: Research Findings**

The researcher also determined duration of each respondent has been in the business. According to the analysis of the findings it is evident that 46.7% 2-5 years, 22.2% 10 years and above and 15.6% was being by below 1 year and between 6-9 years respectively. The results are as shown in figure 5

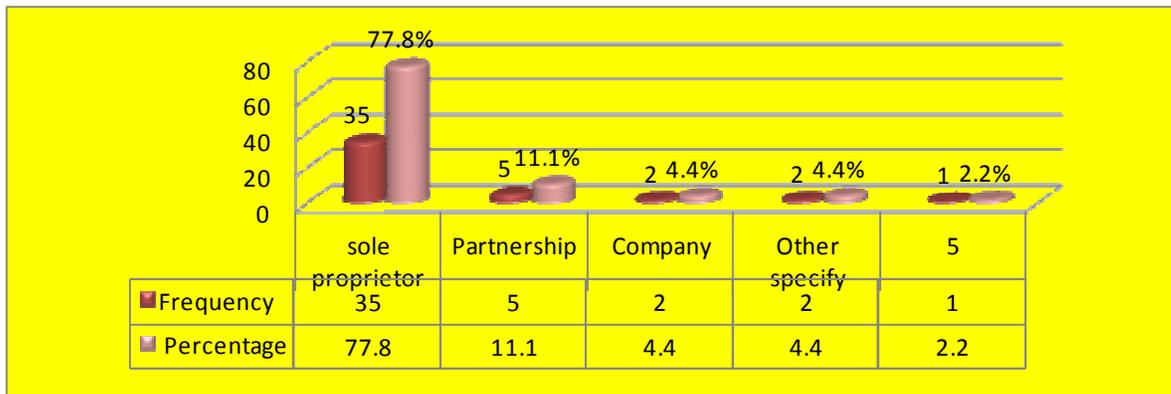
**Figure 4.6 Number of Employees in the Enterprise**



**Source: Research Findings**

The study further determined from the respondents on the number of employees the business had. It was observed that 44.4% indicated 5-49 people who accounted the majority, 42.2% said less than 5 people and the remaining 13.3% revealed that it is between 50-99 people. The results are as shown in figure 6.

**Figure 4.7 Form of Ownership**



**Source: Research Findings**

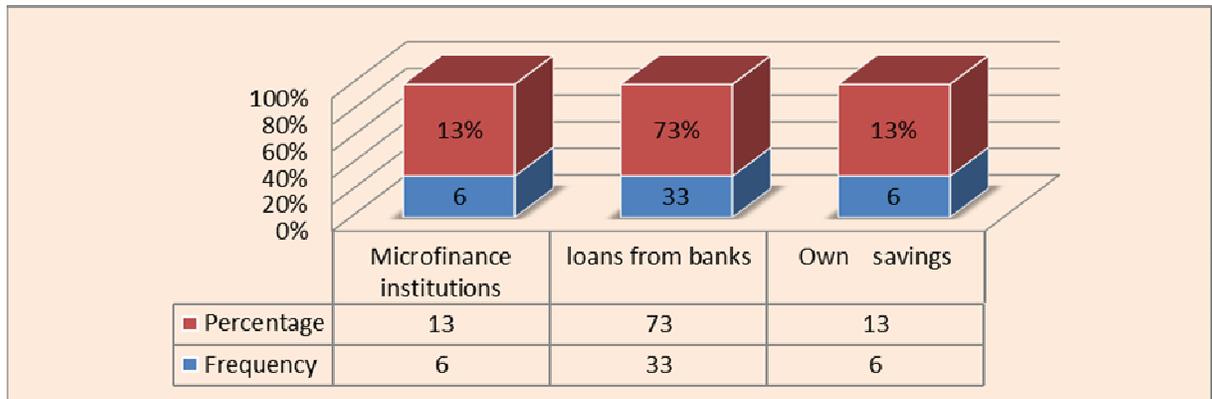
The study investigated the form of ownership of the business from the respondents. The data was collected coded and analyses as per the study objective. Based on the analysis of the findings 77.8% indicated that they are sole proprietors and 11.1% partnership, 4.4% indicated company and others respectively.

#### **4.2.3 Access to Microfinance Credit and the Growth of SMEs**

The researcher from the respondents was required to indicate the major reasons for establishing business. According to analysis of the findings, the participants indicated that it is due of seeking additional income, increase asset base, provide services to the society, meeting daily consumption, lack of white collar jobs, Increase money for investment, accumulation of profit, Earning more money to establish a company, and also to support the family.

The researcher also found of paramount importance to determine Proportion of funds the business obtained. From the results of n the findings it was evident that some respondents recorded that from micro-finance institutions is 45%,loans from the bank 20%,savings 96% and on friends and relatives was 60%.

**Figure 4.8 Sources of Business Capital**

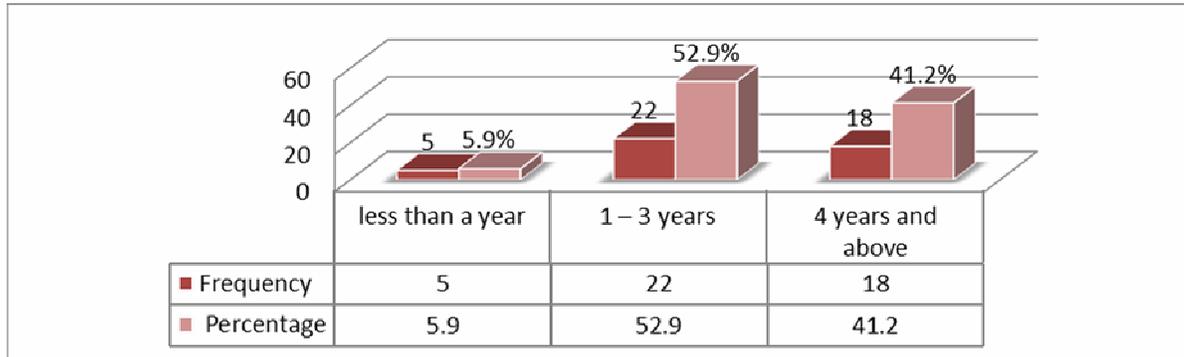


**Source: Research Findings**

The respondents were required to indicate their respectful sources of business capital. According to the analysis of the findings 73% indicated loans from banks and 13% revealed that its microfinance institutions and own savings respectively. The result of the findings is as shown in figure 8.

The researcher required from the respondents to provide details relating enterprise before accessing Credit from the Microfinance Institutions at least for latest 2-3 years of operation. The details recorded down was as year 1=900,000,year 2=1,350,000,year 3=1,560,000. The analysis of the findings further reveals that some of the participants indicated year 1=800, 000, year 2=600,000 and year 3=1,200,000.

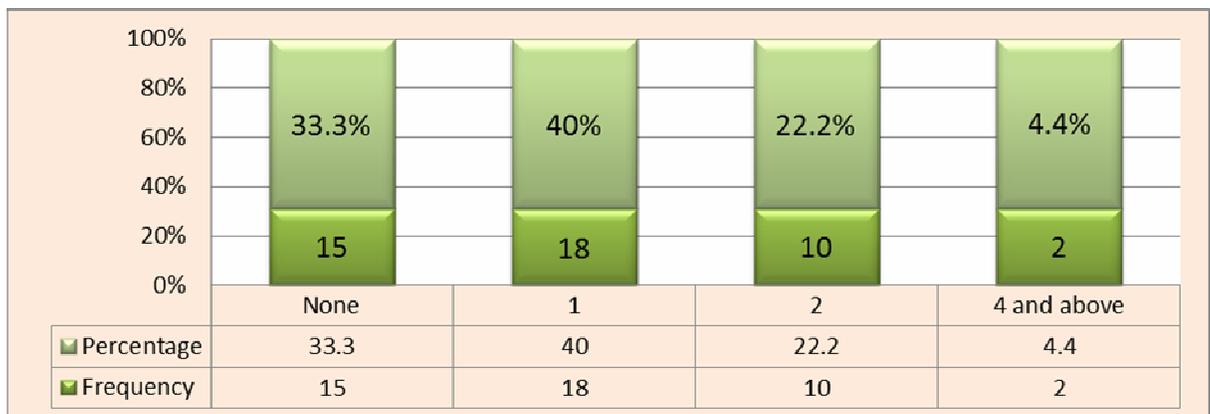
**Figure 4.9 Duration of Business Operation before receiving Loan from the Micro finance Institution financing.**



**Source: Research Findings**

The study further sought to determine the period business operated before receiving a loan from the Micro finance Institution financing. From the findings of the study majority (52.9%) indicated 1-3 years followed by 41.2% who said that they operated for 4 years above while the remaining 5.9% said that they operated for less than 1 year. The analysis of the findings is illustrated in figure 10.

**Figure 4.10 The Number of Microfinance Institutions the Enterprise has worked with**

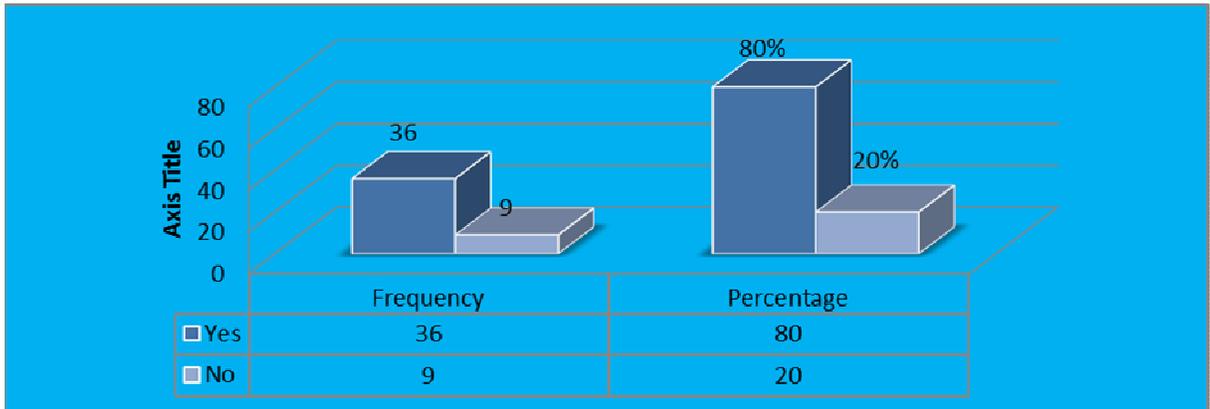


**Source: Research Findings**

The study also sought to determine the number of Microfinance Institutions the enterprise had worked with. According to the analysis of the findings majority (40%) indicated have worked with 1 MFI followed by 33.3% who said worked with none. The study further

revealed that 22.2% worked with 2 and the remaining 4.4% said worked with 4 and above. The findings are as shown in figure 10.

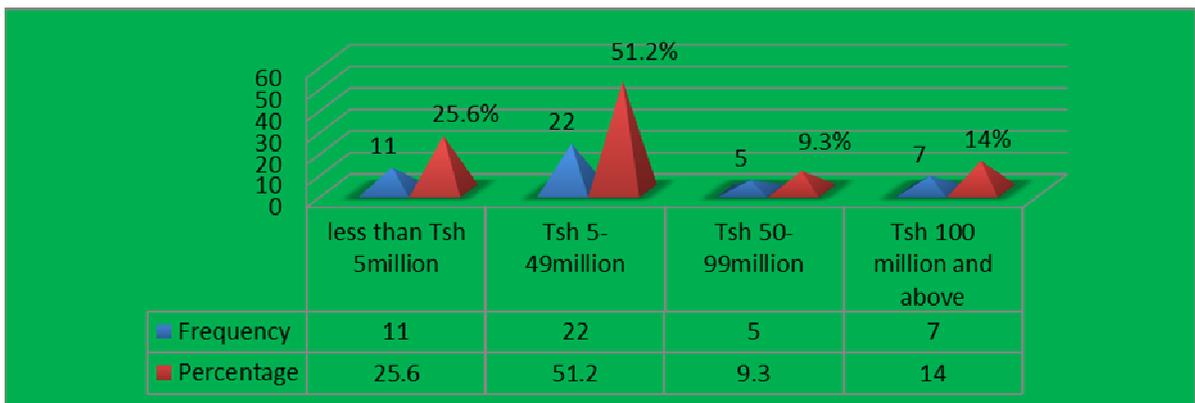
**Figure 4.11 Applying for Credit Facility in MFI**



**Source: Research Findings**

The study investigated from the respondents if whether they have ever applied for credit facility from any MFI. Based on the analysis of the results most respondents yes indeed they have applied by accounting 80% and only 20% said no. The result of the findings is illustrated in figure 11.

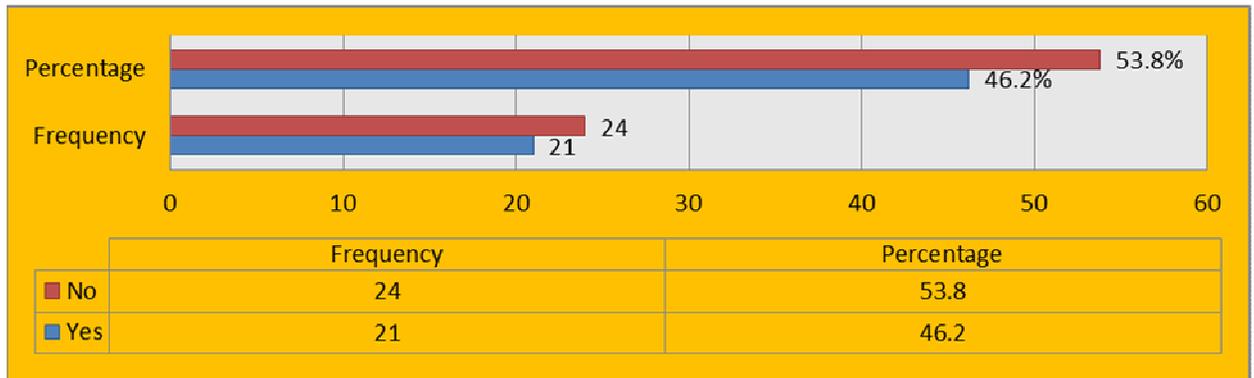
**Figure 4.12 Amount of Loan Applied**



**Source: Research Findings**

The study established the amount of loan applied which was granted to the respondents. Analysis of the findings revealed that 51% indicated Tsh5-49 million who accounted for the majority, 25.6% said less than Tsh 5 million, 14% indicated Tsh 100 million and above while the remaining 9.3% said Tsh 50-99 million. The result of the findings is illustrated in 12.

**Figure 4.13 Whether Loans Accessed from MFIs is Satisfactory for the Business need**



**Source: Research Findings**

The study inquired if whether loans accessed from MFIs is satisfactory for the business. It was evident that 53.8% said no who were the majority and the remaining 46.2% said that they are satisfactory. The results are illustrated in 13.

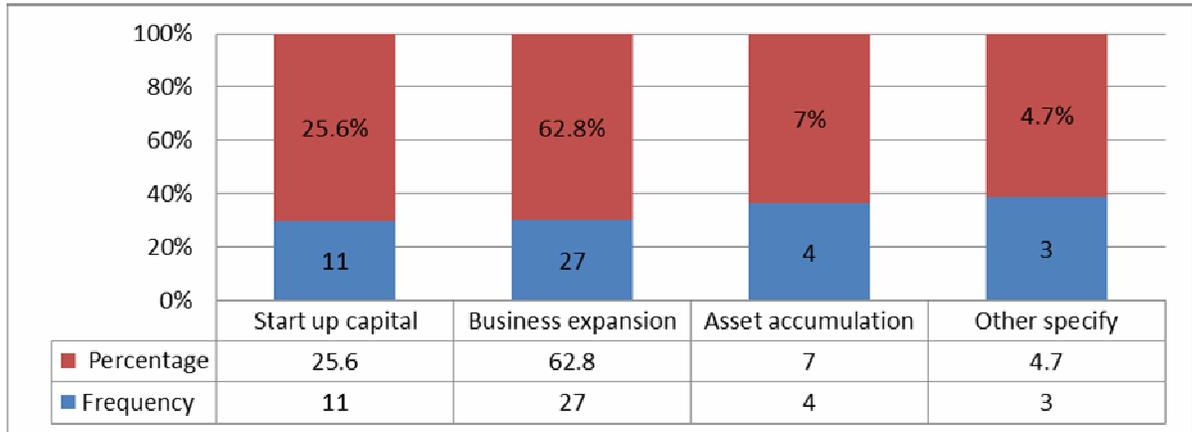
**Figure 4.14 If no do you access more credit from traditional banks than from MFIs**



**Source: Research Findings**

The respondents were further probed if whether they access more credit from traditional banks than from MFIs. Based on the findings of the study 54.5% said no while the remaining 45.5% yes. The findings are illustrated in figure 14.

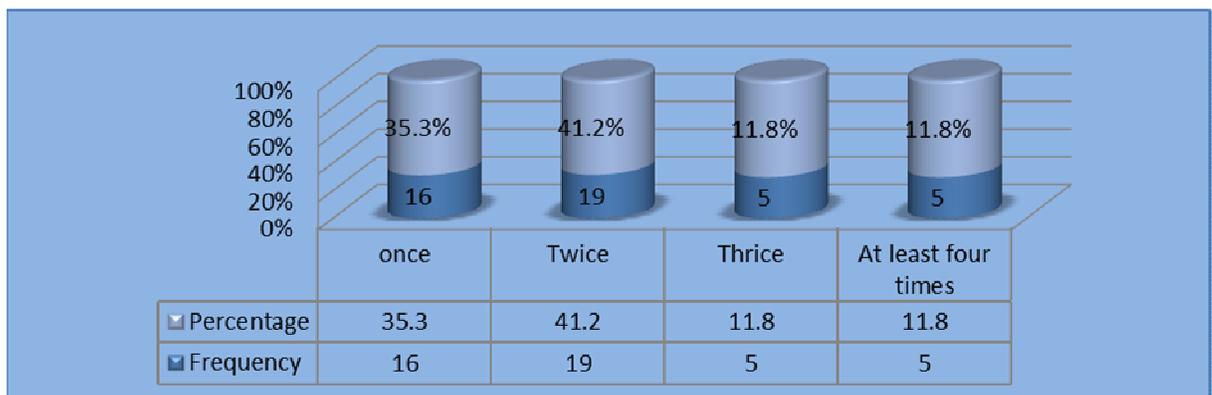
**Figure 4.15 The purpose for and size of loan accessed**



**Source: Research Findings**

The study further explored the purpose for and size of loan accessed by the respondents. Based on the findings of the study 62.8% said is for business expansion, 25.6% is for starting capital, 7% for asset accumulation and 4.7% indicated other purposes. The result is illustrated as in figure 15.

**Figure 4.16 Frequency of credit application**



**Source: Research Findings**

The researcher determined the frequency of credit application. The results revealed that 41.2% said twice who were the majority, 35.3% indicated once, 11.8% indicated thrice times and at least four respectively. The analysis of the findings is illustrated in figure 16.

The study investigated on how much the Net Income per year before accessing credit.

The respondents recorded 1,500,000, 2,550,000, 7,000,000, 8,100,000, 13.5 million, 15 million and 14 million. The study investigated on how much was the total asset per year before accessing credit. According to the analysis of the findings, some respondents indicated 700,000 thousand, 4.5 million, 7.5 million, 10 million, 13 million, 150 million, and 56 million respectively.

The researcher also required the respondent to provide details relating to the enterprise before accessing Credit from the Microfinance Institutions for past 2-3 years in operation. In investment turnover/ Sales in (Tshs), year 1 recorded 9,000,000, year 2 recorded 11,000,000 and 3 was 15,000,000. Total asset accumulation in (Tshs), year on recorded 7,000,000, year 2 recorded 7,500,000 and year 3 recorded 8,000,000. Net Income in (Tshs) year 1 recorded 7,500,000, year 2 recorded 9,500,000 and year recorded 12,500,000. Employment level year 1 recorded 1, year 2 recorded 1 and year 3 also recorded 1.

The researcher also required the respondent to provide details relating to the enterprise after accessing Credit from the Microfinance Institutions for past 2-3 years in operation. In investment turnover/ Sales in (Tshs), year 1 recorded 18M, year 2 recorded 19M and 3 was 21.5M. Total asset accumulation in (Tshs), year on recorded 15M, year 2 recorded 15M and year 3 recorded 15M. Net Income in (Tshs) year recorded 15M; year 2 recorded 16.7M and year recorded 19.5M. Employment level year 5 recorded 5, year 2 recorded and year 3 also recorded 5.

The study sought to investigate from the respondents on how they compare the difference between the change in Net Income level and asset accumulation before and after receiving microfinance credit. According to field responses, responses such as improvement in net income and asset accumulation, expansion of business and also an increment of the net income were obtained. The study also established the list of services of Micro Finance Institution apart from access to Microfinance credit and the growth of

the Enterprise. According to the results of the findings the respondents listed training of entrepreneurs, and business planning and operations were received.

The respondents were further required to give their own opinions on what should be done by MFIs and the stakeholders to eliminate the constraints. From the analysis of the findings some of the responses were that to reduce the credit terms required, reduce the interest rates, and eliminate corruption in loan processing. On the giving out the view on what should be done by MFIS to facilitate their role in serving the SMEs ,the respondents listed that, reduce interest rates charged on loans, provision of training, and reduce credit terms and condition. The respondents were required to write down their general comments with regard of the study. The results revealed that some of comment was to improve facility of services to customers, provide training on money management, procedures to get a loan is too bureaucratic, and also reduction of interest rates.

#### 4.2.4 Regression Analysis

The study sought to establish the effect of Microfinance credit on the growth of small and medium scale enterprises. The factors investigated were: access to microfinance credit, profit margin, asset accumulation and Number of employees. The regression model was:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Whereby Y represent the Enterprise Growth,  $X_1$  is access to microfinance credit,  $X_2$  is profit margin,  $X_3$  is Asset accumulation and  $X_4$  is Number of employees.  $B_0$  is the model's constant, and  $\beta_1 - \beta_4$  are the regression coefficients while  $\varepsilon$  is the model's significance from f-significance results obtained from analysis of variance (ANOVA).

**Table 4.2 Model's Goodness of Fit Statistics**

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>	<b>Durbin-Watson</b>
.745 <sup>a</sup>	.555	.509	.19610	1.874

a. Predictors: (Constant), Access to microfinance credit, Profit margin, Asset accumulation, Number of employees

**Source: Research Findings**

Table 4.2 shows that there is a good linear association between the dependent and independent variables used in the study. This is shown by a correlation (R) coefficient of 0.745. The determination coefficient as measured by the adjusted R-square presents a moderately strong relationship between dependent and independent variables given a value of 0.509. This depicts that the model accounts for 50.9% of the total observations while 49.1% remains unexplained by the regression model.

Durbin Watson test was used as one of the preliminary test for regression which to test whether there is any autocorrelation within the model's residuals. Given that the Durbin Watson value was close to 2 (1.874), there was no autocorrelation in the model's residuals.

**Table 4.3 Analysis of Variance (ANOVA)**

	<b>Model</b>	<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	1.389	4	.463	12.043	.043 <sup>a</sup>
	Residual	1.115	159	.038		
	Total	2.505	163			

a. Predictors: (Constant), Access to microfinance credit, Profit margin, Asset accumulation, Number of employees

b. Dependent Variable: Enterprise Growth

**Source: Research Findings**

The ANOVA statistics presented in Table 4.9 was used to present the regression model significance. An F-significance value of  $p = 0.043$  was established showing that there is a probability of 4.3% of the regression model presenting a false information. Thus, the model is significant.

**Table 4.4 Regression Coefficients Results**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.606	.433		8.336	.104
Access to microfinance credit	-.646	.126	-.967	-5.133	.002
Profit margin	.675	.378	.506	2.451	.027
Asset accumulation	.158	.078	.282	2.031	.032
Number of employees	.096	.075	.241	1.273	.013
Age of the Firm	.078	.282	2.031	.032	.078

a. Dependent Variable: Enterprise Growth

**Source: Research Findings**

The following regression result was obtained:

$$Y = 3.606 - 0.646X_1 + 0.675X_2 + 0.158X_3 + 0.096X_4 \quad P=0.043$$

From the model, when other factors (access to microfinance credit, profit margin, Asset accumulation, Number of employees) are at zero, the Enterprise Growth was 3.606. Holding other factors constant, a unit increase in access to microfinance credit would lead to 0.646 (p=.002) decrease in Enterprise Growth. Mas (2008) established that cost of operating an agent bank negatively influences Enterprise Growth. However, holding other factors constant, a unit increase in profit margin would lead to a 0.675 (p=0.027) increase in Enterprise Growth. This concurs with Kathambi (2009) who established that security concerns to large extent affect the Enterprise Growth.

Table 4.4 also shows that holding other factors constant, a unit increase in Asset accumulation would lead to a 0.158 (p=0.032) increase in Enterprise Growth. This is in line with Nsouli and Schaechter (2002) findings that Enterprise Growth' profitability is highly sensitive to service disruptions. They state that staff and space costs are incurred whether revenue is raised or not due to system failure. The findings, further, shows that

unit increase in Number of employees would lead to a 0.096 increase in their performance. Similarly, Whitefield and Boehme (2007) opined that lack of adequate capacity negatively affects the performance of the Enterprise Growth. These results show that when acting jointly, improvement in profit margin, Asset accumulation and Number of employees would improve Enterprise Growth. However, cost involved in setting up and operating agent banks negate performance of the same.

#### **4.3 Interpretation of the Findings**

The study sought to establish the effect of Microfinance credit on the growth of Small and Medium scale Enterprises. The factors investigated were: access to microfinance credit, profit margin, asset accumulation and Number of employees. The finding shows that there is a good linear association between the dependent and independent variables used in the study. R-square presents a moderately strong relationship between dependent and independent variables given a value of 0.509, this depicts that the model accounts for 50.9% of the total observations while 49.1% remains unexplained by the regression model. A Durbin Watson value was close to 2 (1.874), this implies that was no autocorrelation in the model's residuals.

The ANOVA statistics presented was used to present the regression model significance with an F-significance value of  $p = 0.043$ . Results shows a probability that was less than the conventional probability of 0.05 (5%) significance level, thus, the model is significant. Holding other factors constant, a unit increase in access to microfinance credit would lead to 0.646 ( $p=0.002$ ) decrease in Enterprise Growth. This implies that the use of Microfinance credit has negative relationship with the growth of enterprise growth and significant. The relationship is significant because the p value of 0.043 is less than the critical p value of 0.05. Holding other factors constant, a unit increase in profit margin would lead to a 0.675 ( $p=0.027$ ) increase in Enterprise Growth. The relationship is significant because the p value of 0.027 is less than the critical p value of 0.05.

Holding other factors constant, a unit increase in Asset accumulation would lead to a 0.158 ( $p=0.032$ ) increase in Enterprise Growth. The relationship is significant because the p value of 0.032 is less than the critical p value of 0.05.

The findings, further, shows that unit increase in Number of employees would lead to a 0.096 increase in enterprise performance. These results show that when acting jointly, improvement in profit margin, Asset accumulation and Number of employees would improve Enterprise Growth.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents summary of the study findings, conclusion and recommendations. The objective of the study was to determine the effect of Microfinance credit on the growth of Small and Medium scale Enterprises in Mwanza Region, Tanzania.

#### **5.2 Summary**

The study found of paramount importance to determine demographic information of the respondents. Based on the analysis of the findings majority are between 30-39 years and most of them are males. On the level of education of the participants secondary and university recorded 35.6% each respectively and most of the respondents engaged in trading. The study determined the period the respondents have done the business. According to the findings majority have engaged in business between 2-5 years and most enterprises have employed 5-49 people under sole proprietorship.

On the major reasons for establishing business, the findings listed that the participants said it is due of seeking additional income, increase asset base, provide services to the society, meeting daily consumption, lack of white collar jobs, Increase money for investment, accumulation of profit, Earning more money to establish a company, and also to support the family. On the sources of business capital majority indicated that it is loans from banks and on the proportion of funds the findings recorded down that year 1=Tsh 18,000,000, year 2=27,000,000, year 3=31,200,000. The analysis of the findings further reveals that some of the participants indicated year 1=16,000,000, year 2=12,000,000 and year 3=24,000,000.

The study inquired duration of business operated before receiving loan from the Micro finance Institution financing. The findings revealed that majority said 1-3 years and most respondents have worked with 1 Micro-finance Institution. On applying for credit facility in MFI most respondents said yes by recording 80% and most participants have applied

for credit ranging Tsh 5- 49 Million. On the whether the loan accessed from MFIs was satisfactory for the business need, most respondents said no by recording 53.8% and the question if whether the respondents access more credit from traditional banks than from MFIs also the participant said no by recording 54.5%. The study further sought to investigate the purpose for and size of loan accessed. Majority (62.8%) indicated for business expansion and many of them have applied for credit twice.

### **5.3 Conclusion**

The study investigated the effect of Microfinance credit on the growth of Small and Medium scale Enterprises in Mwanza Region, Tanzania and it can be concluded from the multiple regression analysis results showed that, holding other factors constant, a unit increase in access to microfinance credit would lead to 0.646 decrease in Enterprise Growth. Mas (2008) established that cost of operating an agent bank negatively influences Enterprise Growth. Regression result further indicated that holding other factors constant, a unit increase in profit margin would lead to a 0.675 increase in Enterprise Growth. A unit increase in Asset accumulation would lead to a 0.158 increase in Enterprise Growth. Finally findings revealed that unit increase in Number of employees would lead to a 0.096 increase in their performance.

In conclusion, these results show that when acting jointly, improvement in profit margin, Asset accumulation and Number of employees would improve Enterprise Growth. However, cost involved in setting up and operating agent banks negate performance of the same. Hence increase in profit margin, increase in total asset accumulation, and increase in number of employees have significantly promoted the growth of SMEs in Mwanza Region based on the research findings.

### **5.4 Recommendations for Policy**

The policy review should be followed by legislative review. As it has been shown, SMEs in Tanzania are operating in a very informal way. The level of investment in technical knowledge and research is very low. The link of the local research and development institutions with SMEs is very weak. This has resulted into ineffective use of the

Microfinance credit by SMEs. In this context, there is a need to review the existing laws in order to establish an enabling legal and regulatory environment responsive to the needs and contexts in which SMEs are operating.

The policy and legislative review should envisage introduction of the structures of the Microfinance credit regulatory institutions that have in mind the needs and expectations of the SMEs. In this sense, a recommendation to establish the Microfinance credit Support Desk should be institutionalized in the national policy as well as the governing legislation. This policy and legal approach is crucial as it will create permanence and sustainable system for microfinance credit support to SMEs. In order for the Microfinance credit to yield its idealized goals and promote SMEs in Tanzania, there must be a formalized quid pro quo research and expertise exchange relationship between locals and the present SMEs. Therefore, there must be the implementation framework through policy and legislative intervention that is specifically tailored to encourage partnership between locals and present SMEs in technology transfer and information sharing. The policy and legislation should provide certain statutory reliefs and recognition for research institutions which avail technologies, technical or any other useful information to SMEs.

### **5.5 Limitations of the Study**

The research met with various challenges when conducting the research that included the fact that most SMEs ordinarily do not want to give information due to client confidentiality. In addition, some of the respondents would not find the subject to be of interest. Additionally, some respondents would not want to give the information as they considered it of competitive importance.

Time limitation made it impractical to include more respondents in the study. This study was also limited by other factors in that some respondents may have been biased or dishonest in their answers. More respondents would have been essential to increase the representation of the Small and Medium scale Enterprises in Tanzania. However, the researcher did look for contradictions in the information given and no inconsistency were

found. Other challenges the researcher encountered in this study relates to access to and collection of hard data due to improper record keeping by SMEs owners. This was due to the fact that most of the SMEs operators did not keep proper records of their transactions, which made it difficult to get most of the relevant and accurate information needed for the study.

In spite of the above limitations the results of the study give credible information with respect to the effect of Microfinance credit on the growth of SMEs in Mwanza Region, Tanzania.

### **5.6 Suggestions for Further Study**

The study recommends that further research can be carried out on:

A broad study covering all SMEs countrywide should be done to find out the effect of Microfinance credit on the growth of SMEs.

Factors affecting financial innovations in Small and Medium scale Enterprises so as to establish a greater understanding by widening the research field.

Replication of the study in other regional capitals in Tanzania should be conducted among large Enterprises in order to find out the effect of Microfinance credit on the growth of SMEs.

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## APPENDICES

### Appendix 1- Letter of Introduction

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

**RE: REQUEST TO GRANT AUDIENCE/RESPONSE ON A POSTGRADUATE SCHOOL SURVEY QUESTIONNAIRE.**

The University of Nairobi School of business requires the post graduate students to carry out research project in partial fulfillment of the Masters of Science in Finance degree program.

The materials and /or information obtained during the survey was kept in utmost confidence and will only be used for the purposes of the stated academic exercise. The results of the detailed survey was in summary form and will not disclose any individual or company name or information in any way.

The questionnaire attached aims to collect data from SMEs. It would be appreciated if you could assist in the completion of the questionnaire within the shortest possible time but not later than two weeks.

Kindly find time and accord the necessary support.

Yours faithfully

-----

Penina Benjamin

**Appendix 2- Permission Letter for data collection**



**UNIVERSITY OF NAIROBI**  
**SCHOOL OF BUSINESS**

**MSC FINANCE PROGRAMME**

Telephone: 020-2059162  
Telegrams: "Varsity", Nairobi  
Telex: 22095 Varsity

P.O. Box 30197  
Nairobi, Kenya

DATE 20/09/2013

**TO WHOM IT MAY CONCERN**

The bearer of this letter PEOWA BENJAMIN

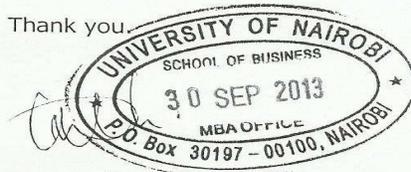
Registration No. DG3/79938/2012

is a bona fide continuing student in the Master of Science (Finance) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.



**PATRICK NYABUTO**  
**FOR: MSC FINANCE CO-ORDINATOR**  
**SCHOOL OF BUSINESS**

### Appendix 3 - Questionnaire to SMEs

**On the topic, “THE EFFECT OF MICROFINANCE CREDIT ON THE GROWTH OF SMALL AND MEDIUM SCALE IN MWANZA REGION TANZANIA”.**

I would be very grateful if you could spend some time to respond to these questions for me. You are assured that any information provided would be used for academic purposes only and was held strictly confidential.

Please, tick [] or fill in as appropriate.

#### SECTION A

#### RESPONDENT DEMOGRAPHICS

1. Kindly indicate your Age
  - a. 20 – 29 []
  - b. 30 – 39 []
  - c. 40 and above []
  
2. Kindly indicate Gender
  - a. Male []
  - b. Female
  
3. What is the highest level of education you have attained?
  - a. University degree []
  - b. High school or diploma []
  - c. Secondary education []
  - d. Primary education []
  
4. What is your line of business?
  - a. Manufacturing []
  - b. Trade []
  - c. Service []
  - d. food Processing
  - e. Other (Please specify).....
  
5. How long have you been in this business?
  - a. Below 1 year []
  - b. 2-5 []
  - c. 6-9 []
  - d. 10 and above []
  
6. Kindly indicate the number of employees in your Enterprise
  - a. Less than 5 people []
  - b. 5-49 people []
  - c. 50-99 people []
  - d. Above 100 []

7. Kindly indicate the form of ownership
  - a. sole proprietor [ ]
  - b. Partnership [ ]
  - c. Company [ ]
  - d. Other specify [ ]

**SECTION B**

**ACCESS TO MICROFINANCE CREDIT AND THE GROWTH OF SMEs**

1. What were your major reasons for establishing your business?  
 .....  
 .....
  
2. What is (are) the source(s) of your business capital?
  - a. Microfinance institutions [ ]
  - b. loans from banks [ ]
  - c. Own savings [ ]
  - d. Friends &Relatives
  - e. Self [ ]
  - f. Others (Please specify).....

Note main categories of Microfinance Institutions can be (i) NGOs example PRIDE (T), FINCA (T), Small Enterprise Development (SEDA), SIDO, (ii) Cooperative based institutions such as SACCOs and SACCAAs (iii) Banks that involve in microfinance credit delivery example NMB and CRDB

3. Indicate the Proportion of funds your business obtained from the following;
  - a. Microfinance institutions .....%
  - b. loans from banks ..... %
  - c. Own savings..... %
  - d. Friends &Relatives ..... %
  - e. Self .....%
  - f. Others (Please specify)..... %
  
4. For how long did your business operate before you received a loan from the Micro finance Institution financing your business?
  - a. less than a year [ ]
  - b. 1 – 3 years [ ]
  - c. 4 years and above [ ]
  - d. Other (specify) .....

5. Kindly provide the following details relating to your Enterprise before accessing Credit from the Microfinance Institutions at least for latest 2-3 years you have been in operation

	Year 1 (Tshs)	Year 2 (Tshs)	Year 3 (Tshs)
Investment turnover/ Sales			

6. How many Micro Finance Institutions do you work with?  
 a. None  b. 1  c. 2  d. 3  d. 4 and above
7. Have you ever applied for credit facility from any MFI?  
 a. Yes  b. No
8. If yes what amount of loan applied was granted?  
 a. less than Tsh 5million  b. Tsh 5-49million  c. Tsh 50- 99million %  
 d. Tsh 100 million and above
9. Is (are) the loans accessed from MFIs satisfactory for your business need?  
 a. Yes  b. No
10. If no do you access more credit from traditional banks than from MFIs?  
 a. Yes  b. No
11. If yes, what has been the purpose for and size of loan you have accessed?  
 a. Start up capital b. Business expansion c. Asset accumulation d. Other specify
12. How often have you applied for such credit?  
 a. once  b. Twice  c. Thrice  d. At least four times
13. How much was your Net Income per year before accessing credit?  
 Total Net Income Tshs.....
14. How much was your total asset per year before accessing credit?  
 Total asset (both current and non current asset) for the enterprise  
 Tshs.....

15. Kindly provide the following details relating to your Enterprise after accessing Credit from the Microfinance Institutions at least for latest 2-3 years you have been in operation;

	Year 1	Year 2	Year 3
Investment turnover/ Sales in (Tshs)			
Total asset accumulation in (Tshs)			
Net Income in (Tshs)			
Employment level			

16. How do you compare the difference between the change in Net Income level and asset accumulation before and after receiving microfinance credit?

.....  
 .....

17. Kindly list any other services of Micro Finance Institution(s) apart from access to Microfinance credit and the growth of your Enterprise.....

.....

18. In general, how has the existence of MFIs affected your business?

a. Don't know [ ] b. Positive [ ] c. Negative [ ] d. Unchanged [ ]

19. Please rank the following constraints basing on their affect on the access of credit from MFIs starting with most important as 1 and least important as 5

	1	2	3	4	5
Inadequate loan able to fund for SMEs					
Strengthen collateral requirement by MFIs					
Lack of incentive for banks to lend SMEs					
Negative perception of SMEs lending					
High interest rate					

Other (specify).....

20. Are you satisfied with the current effort being made by MFIs to address the above constraints? a. Yes [ ] b. No [ ]

21. If no, kindly give your opinion on what should be done by MFIs and the stakeholders to eliminate the above constraints .....

22. In your view what should be done by MFIS to facilitate their role in serving the SMEs .....

**SECTION C**  
**GENERAL COMMENTS**

1. What are your further comments you consider important regarding this study.....