# THE IMPACT OF MICROFINANCE ON SMALL AND MEDIUM ENTERPRISES GROWTH IN MOROGORO

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**A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF SCIENCE IN ECONOMICS OF THE OPEN UNIVERSITY OF TANZANIA**

**2013**

## CERTIFICATION

I, the undersigned, certify that I have read and hereby recommend for acceptance by Open University of Tanzania, a dissertation entitled; The Impact of Microfinance on Small and Medium Enterprises (SMEs) growth in Morogoro, in partial fulfillment of the requirements for award of the degree of Master of Science in Economics of Open University of Tanzania.

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Dr. Deus D. Ngaruko (PhD)

(Supervisor)

Date……

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## DECLARATION AND COPYRIGHT

I, **Moris Mhidini Momba**, do hereby declare that this Dissertation is my own work and has not been submitted for a Degree award in any other University or Higher Learning Institution.

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Date……

## DEDICATION

This dissertation is honestly dedicated to my dearly loved mother Modesta Nyanzobe Lubakiji who have been encouraging and supporting me in every step I made in my education and my lovely wife Carolar Noracy Chuma for being good image of my future.

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## ABSTRACT

This study examines the impact of the Microfinance on growth of the Small and Medium Entrepreneurs (SMEs) in Morogoro Municipality. The specific objectives of this study were as follows; to determine at what extent accessibility of microfinance lead to increase the volume of gross sales of participants and to understand other factors that enhancing SME's growth. The study used cross-sectional research design in which 150 SMEs were used as a sample size: 75 clients from BRAC and 75 clients from FINCA. Data were collected using questionnaires, direct observations and documentary reviews. Descriptive statistical procedures including descriptive and frequency distributions from the database template was used and then, running Linear Regression Model. The result findings revealed that most of the respondents who were engaged in micro enterprises were female. Indeed, they were also in the age of briskest and economical active individuals of mean age 31.2 years, and the majority of them had primary level of education. However, the statistical findings also revealed that the following null hypothesis are statistically significant under t-test at 0.05 level of significance; There is statistical significant on microfinance access on SMEs growth. While null hypothesis stated that there is statistical significant relationship between SMEs growth and start-up capital and the other which stated that there is no statistical significant that experience on SME activities improves SME's growth which reveals that it is not statistically significant at t-statistic 0.05 level of significance.

## TABLE OF CONTENTS

## LIST OF TABLES

## LIST OF FIGURES

## LIST OF ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| ACB | Akiba Commercial Bank |
| ADBI | Asian Development Bank Institute |
| BoT | Bank of Tanzania |
| BPR | Bank Perkreditan Rakyat |
| BRAC | Building Resources Across Communities |
| CBO | Community Based Organization |
| CRDB | Co-operative and Rural Development Bank |
| DCB | Dar es Salaam Community Bank |
| DFID | Department for International Development (United Kingdom) |
| FINCA | Foundation for International Community Assistance |
| GB | Grameen Bank |
| GDP | Gross Domestic Product |
| IDRC | International Development Research Centre |
| IFC | International Finance Corporation |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| LDC | Least Developing Country |
| MDG | Millennium Development Goal |
| MFI | Micro-finance Institution |
| MSME | Micro, Small and Medium Enterprises |

| | |
|---|---|
| NGO | Non Government Organization |
| NMB | National Microfinance Bank |
| ODA | Official Development Assistance |
| OECD | Organization for Economic Cooperation and Development |
| PTF | Presidential Trust for self-Reliance Fund |
| REPOA | Research on Poverty Alleviation |
| SACCOS | Saving and Credit Co-operation society |
| SEDA | Small Enterprises Development Agency |
| SIDO | Small Industries Development Organization |
| SME | Small and Medium Enterprise |
| SPSS | Social Package for Statistical Science |
| TAMFI | Tanzania Association of Microfinance Institutions |
| Tsh | Tanzanian Shilling |
| UN | United Nation |
| URT | United Republic of Tanzania |
| WB | World Bank |

# CHAPTER ONE

# 1.0 INTRODUCTION

## 1.1. Overview

This chapter gave attention to the background information to the problem, states the statement of the problem. It also stipulates research objectives and research questions. Finally, it provides the significance of the study. This chapter concentrates on the introduction which is categorized into the background information to the problem, statement of the problem, research objectives, and research questions. In the same vein, the chapter contains significance of the study.

## 1.2. Background of the Problem

Small and Medium Enterprises (SMEs) all over in the world are known to play a major role in social and economic development. This is apparently the case in Tanzania where SMEs contribute significantly to employment creation, income generation and stimulation of economic growth in both urban and rural areas. The SMEs nomenclature issued to mean small and medium-sized enterprises (ILO, 1998).

SMEs cover non-farm economic mainly manufacturing, mining, commerce and activities services. There is no universally accepted definition of SME. Different countries use various measures of size depending on their level of development. The commonly used yardsticks are total number of employees, total investment and sales turnover. In the context of Tanzania, SMEs are those engaging up to 4 people with

capital investment from Tshs.5 million to Tshs.200 million (URT, 2002). About a third of the Gross Domestic Product (GDP) of Tanzania originates from the SME sector.

### 1.2.1. Historical Background of SME in Tanzania

According to the informal Sector Survey of 1991, SMEs operating in the informal sector alone consisted of more than 1.7 million businesses engaging about 3 million persons, about 20% of the Tanzanian labour force. Though the data on SME sector are sketchy and unreliable, it is reflected already in the above data that SME sector plays a crucial role in the economy (URT, 2002). Since SMEs tend to be labour intensive, they create employment at relatively low levels of investment per job created. At present, unemployment is significant problem that Tanzania has to deal with. Estimates show that there are about 700 000 new entrants into the labour forces every year. About 500 000 of these are school leavers with few marketable skills. The public sector employs only about 40 000 of the new entrants into the labour market, leaving about 660 000 to join the unemployed or the underemployed reserve (URT, 2002). Most of these persons end up in the SME sector, and especially in the informal sector. Given that situation and the fact that Tanzania is characterized by low rate of capital formation, SMEs are the best option to address this problem. SMEs tend to be more effective in the utilization of local resources using simple and affordable technology. SMEs play a fundamental role in utilizing and adding value to local resources (URT, 2002).

In addition, development of SMEs facilitates distribution of economic activities within the economy and thus fosters equitable income distribution. Furthermore, SMEs

technologies are easier to acquire, transfer and adopt. Also, SMEs are better positioned to satisfy limited demands brought about by small and localized markets due to their lower overheads and fixed costs. Moreover, SME owners tend to show greater resilience in the face of recessions (URT, 2002). Through business linkages, partnerships and subcontracting relationships, SMEs have great potential to complement large industries requirements. A strong and productive industrial structure can only be achieved where SMEs and large enterprises not only coexist but also function in a symbiotic relationship. The SME sector in Tanzania is faced by many challenges such as limited access to finance and lack of enterprise culture. To address these challenges, that is where Microfinance Institutions (MFIs) come in. MFIs are the primary source of finance to SMEs and are also contributing towards promotion of the enterprise culture by offering various forms of training to SMEs. According to Chijoriga (2000), MFIs help to promote enterprise culture among SMEs by providing various financial services to SMEs. These services include; advancing loans and provision of credit management training to SMEs and holding their deposits. These services together help to promote enterprise culture which encompasses savings culture, investing culture and entrepreneurial skills.

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, and 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).

However, the generation of self-employment in the SMEs requires investment in working capital, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans can help the poor to accumulate capital and investment in employment generating activities (Hossain, 1988). According to Grade (1984), loans enable the individual's member or enterprises to enjoy the benefit of economies of scale and new technology. Availability of credit to small business and low income households could greatly enhance their economic strength and eventually break the vicious circle of low income – low saving – low investment – low income (Yunus 1984).

In a study conducted by Rweyemamu *et al.* (2005) 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.

Commercials 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. Stringent lending policies and collateral requirements, cumbersome procedures and their perception of small business and the rural poor as risky, often leads to exclusion. Most formal financial institutions regard low income households as too poor to save, and are not personally known to them, they do not keep written accounts or business plans, they usually borrow small sums, while administration and carrying costs are almost as high as for large loans (Kuzilwa and Mushi, 1997).

According to Wangwe and Semboja (1997), SMEs in Tanzania contribute 12% 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). Microfinance institutions (MFI's) provide a broad range of services including deposits, loans, payment services, money transfer and insurance to the poor/low-income households and their enterprises (Chijoriga, 2000).

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 institution 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). Micro finance enables clients to protect, diversify and increase their incomes, as well as to accumulate assets, reducing their vulnerability to income and consumption shocks (Robinson, 2002).

### 1.3. Problem Statement

Microfinance Institutions (MFIs) are set up to provide funding for the enterprising poor. Through cycles of loans and repayments it is expected that the SMEs are increasingly empowered and to grow. According to Mosley (2001), MFI are said to be a cheaper way of source of finance to SMEs. Despite of MFI service been cheaper way of source of finance to SMEs, very little is known on the actual cost for microfinance clients to access these services, except interest rates. The interest rate is not the only cost of credit incurred by SMEs, there are also other costs related to the process of obtaining information about the services and the whole process of applying for the loan, cost of getting transportation to make loan payments, time spent obtaining loan and tracking the debt all these are referred as transaction costs.

This study therefore seeks to investigate the impact of microfinance service on the growth of SMEs in Tanzania and to investigate the benefit received from microfinance loans if they outweigh the cost incurred by SME's when servicing the loan liability, and the contribution of MFI in Tanzania on improvement of household welfare of SME's.

Also there is no study that have been conducted in Tanzania which look on the cost and benefit of MFI loans to SMEs and weather the MFI loan have helped the SMEs to grow despite of the true cost incurred on the process, as a result industry never know if MFI loans have truly helped SMEs to grow.

Although people have received micro-loan, information documented in Robert (2009) indicates that most of SMEs whose secured loans have not yet managed to improve their enterprise's status. More specifically, the impact of micro-financing on SMEs growth through the efforts made by the several microfinance institutions for residents of Morogoro Municipality is still undetermined. Along with this, there is no statistical information attesting the extent to which micro-loan has been helpful to beneficiaries (Neeta and Diwan, 2010).

According to Sebstad *et al,* (1995) there is different range of indicators of growth of SMEs. This study will use volume of gross sales, income of the SMEs, and size of business production, business profit, and number of employee in the business and revenue as indicator of growth for the enterprises.

## 1.4. Research Objectives

### 1.4.1. Overall Objective

The overall objective of this study was to analyse the contribution of microfinance on the SME growth in Morogoro Municipality.

### 1.4.2. Specific Objectives

To achieve the overall objective the study pursued the following specific objectives:

i. To determine at what extent accessibility of microfinance lead to increase the volume of gross sales of a participant.

ii. To examine other factors enhancing SME growth.

### 1.5. Research Hypothesis

In order to meet the above objectives and get answers to the subject matter under investigation, this study will base on the following research hypothesis:

i. $H_0$: There is no statistical significant relationship between microfinance access and SMEs growth.

ii. $H_0$: There is no statistical significant relationship between SMEs growth and start-up capital.

iii. $H_0$: There is no statistical significant that experience on SME activities improves SME's growth.

### 1.6. Significance of the Study

First, this study was intended to shed light on the relationship between microfinance services and growth of SME 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 problems and challenges which small and medium enterprises face. Second, this

study will offer empirical evidence on the impact of microfinance services on the growth of small and medium enterprises for use in short term and long term interventions especially in the fight against poverty. A study of this nature is equally very important because it is going to enlighten the government and the public on the role of MFI in the SMEs sector. Finally, the study will facilitate the researcher to be awarded of a Master's of Science Degree in Economics in Open University of Tanzania.

### 1.7. Organisation of the Study

This study is organised into five chapters. Chapter one provides information on the background, statement, the general and specific objectives, the research questions, and the significance of the study, limitation as well as delimitation and the organisation of the study. Chapter two concentrates on issues related to micro finance institutions. The chapter continues to present the theoretical and empirical literature review. Additionally, the chapter three presents the description of the study area, research design, sample size and sampling procedures, data collection methods and tools. The chapter finally discloses data processing and analysis and conclusion. Chapter four presents an analysis and discussion of the research findings of the study. In this context the chapter analyzed data with reference to the research objectives, questions and hypothesis. Lastly is chapter five, this chapter describes conclusions and recommendations of the study with reference to the designed research objectives and analysis made. The conclusions that have been made hereunder are based on the research findings obtained from the field data.

# CHAPTER TWO

# 2.0 LITERATURE REVIEW

## 2.1. Overview

This chapter presents the review of related literature that has been summarized from different readings on the topic under study. It forms the literature of the study in two major parts; namely: theoretical literature which focuses on: Definitions of key concepts (microfinance and SME), relationship between microfinance and SMEs growth and the empirical literature review that focuses on giving a review of relevant literature on the following sub-sections: Role of microfinance in SME growth, Linkage between Microfinance and SME, Micro-finance Policy in Tanzania, Review of studies done outside of Tanzania.

## 2.2. Theoretical Literature Review

### 2.2.1. Conceptual Definitions

#### 2.2.1.1. Micro-finance

Microfinance refers to financial services provided to low-income people, usually to help support self-employment. Examples include: small loans, savings plans, insurance, payment transfers, and other services that are provided in small increments that low-income individuals can afford. These services help families to start and build "micro" enterprises, the very small businesses that are important sources of employment, income, and economic vitality in developing countries. As to REPOA (2006) Micro-finance does not only cover financial services but also non-financial assistance such as training and business advice.

According to MIFOS (2005) micro-finance is sometimes called “banking for the poor.” It is an amazingly simple, proven idea that empowers very poor people around the world to pull themselves out of poverty. Relying on their traditional skills and entrepreneurial instincts, very poor people, mostly women, obtain small-unsecured loans, usually less than $200, from local organizations called micro-finance institutions (MFIs).

Micro finance can be a critical element on effective poverty reduction strategy. Improved access and efficient provision of savings, credits and insurance facilities in particular can enable the poor to smooth their consumption, manage risk better; built assets gradually develop micro enterprises, enhance their income earning capacity and enjoy improved quality life (Rubambey, 2001). The main features of a microfinance institution which differentiate it from other commercial institutions, are such that, it is a substitute for formal credit**;** generally requires no collateral; have simple procedures and less documentation; easy and flexible repayment schemes; financial assistance of members of group in case of emergency; most deprived segments of population are efficiently targeted; and, last but not least, is groups interaction.

**2.2.1.2. Small and Medium Enterprises**

The SME 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 manufacturing, mining, commerce and services (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 in 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).

#### 2.2.1.3 Contribution of SMEs to the Economy

SMEs all over the world are known to play a major role in socio-economic development. URT (2003) estimates that about $1/3$ of the GDP originates from SME sector; they tend to be labor intensive thus creating jobs: the International Finance Company (IFC) of the World Bank estimates that there are approximately 2.7 million enterprises in the country. A large majority of these (98%) are micro enterprises (employing less than 5 people), effective in the utilization of local resources using simple and affordable technology; and complementing large industrial requirements through business linkages, partnerships and subcontracting relationships (Olomi, 2001; URT, 2003).

#### 2.2.1.4 Microfinance Market in Tanzania

Demand: 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. The SMEs are involved in a wide range of businesses

including trading, small 8 scale manufacturing, agriculture (crop farming and animal husbandry) and services (food vending, transport, barber shops etc).

Supply: 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 credit based institutions number between 80 and 100 out of which 42 are registered members of the Tanzania Association of Microfinance Institutions (TAMFI), the local microfinance network. The main microfinance institutions can be categorized as Non Governmental Organizations (NGOs), Cooperative based institutions namely SACCOs and SACCAs 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) and BRAC (Tanzania). 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 services 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, Kilimanjaro Cooperative Bank and Mkombozi Bank.

Urban versus Rural Distribution: The distribution with respect to the concentration of microfinance activities in Tanzania is skewed in favor of the urban areas leaving rural areas grossly under served. Most MFIs with an exception of tiny rural based SACCOs

are reluctant to extend their services to the rural areas due to poor infrastructure, high risk and high cost of operation. The latter is brought about by the fact that rural areas in Tanzania by nature are sparsely populated.

#### 2.2.1.5 Development in the Theory of SME

The last 50 years have witnessed important developments in the conceptualisation of the main issues relating to the SME sector and subsequent theoretical work. The main theory, which goes back to the seminal work by Lewis (1955), is the labour surplus theory. It is argued that the driving force behind SME development is excess labour supply, which cannot be absorbed in the public sector or large private enterprises and is forced into SMEs in spite of poor pay and low productivity. Arguably, the SME sector develops in response to the growth in unemployment, functioning as a place of last resort for people who are unable to find employment in the formal sector.

Various theoretical models have been developed which describe the growth of SMEs. One class of theoretical models focuses on the learning process, either active or passive, and the other models refer to the stochastic and deterministic approaches.

##### 2.2.1.5.1 Passive Learning Model

In the Passive Learning Model (PLM) (Jovanic 1982 cited in Agaje 2004), 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 (Stranova, 2001, Cunningham and Maloney 2001 and Goedhuys, 2002).

#### 2.2.1.5.2 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 (2002) 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, 2002 and Pier Giovanni *et al* 2002).

## 2.3. Empirical Literature Review

### 2.3.1. Role of Microfinance on SMEs Growth

Since the World Summit for Social Development the priority given to poverty eradication has grown. As stated in the previous report of the Secretary-General on the eradication of poverty, it is now broadly accepted that robust economic growth that is labour-intensive and equitable, combined with larger outlays of social expenditures, especially directed towards the poor (now estimated at 1.3 billion people), are a winning combination in the fight against poverty (Chaliand, 2003). Several factors have led to increased interest in micro-credit in promoting growth with greater equity. There has been a growth in the recognition of the importance of empowering all people by increasing their access to all the factors of production, including credit. In addition, the value of the role of Non-Governmental Organizations in development is receiving more attention.

It is in that context that micro credit has recently assumed a certain degree of prominence. It is based on the recognition that the latent capacity of the poor for entrepreneurship would be encouraged with the availability of small-scale loans and would introduce them to the small-enterprise sector. This could allow them to be more self-reliant, create employment opportunities, and, not least, engage women in economically productive activities. Currently, there are estimated to be about 3000 microfinance institutions in developing countries like in Kenya, Malawi, Nigeria, to mention just a few. These institutions also help create deeper and more widespread. They provide the rural population with access to savings within the local area and with a certain cushion against economic fluctuations, and they encourage a cooperative and community feeling (Department of Social Development, 2001). The groups formed

provide joint collateral and serve as instruments for spreading valuable information that is useful for economic and social progress.

In many developing countries, many loan takers have been proven to have much benefit as they get credits. Studies undertaken by Chaliand (2003) and Chijoriga (2000) on the impact of micro-credit programmes on household income show that participants of such programmes usually have higher and more stable incomes than they did before they joined the programmes. Some practitioners still have reservations about the findings of those studies. Moreover, not many micro credit programmes can afford to undertake impact assessments because they are generally expensive and time-consuming. There are serious disagreements among experts on the validity methodologies used in some of the published studies. In some cases, even the more rigorous studies have produced inconclusive results (Chaliand, 2003).

Chijoriga (2000) revealed that there are limits to the use of credit as an instrument for poverty eradication, including difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this is the fact that many people, especially the poorest of the poor, are usually not in a position to undertake an economic activity, partly because they lack business skills and even the motivation for business.

Furthermore, it is not clear if the extent to which micro credit has spread, or can potentially spread, can make a major dent in global poverty. The actual use of this kind of lending, so far at least, is rather modest: the overall portfolio of the World Bank, for example, is only $218 million. In recent international meetings, it has been stated that a

target to reach 100 million families by the year 2005 would require an additional annual outlay of about $2.5 billion. This should be compared to the total Gross Domestic Product (GDP) of all developing countries, which is now about $6 trillion. A certain sense of proportion regarding micro credit would seem to be in order.

In addition, the administrative structures governing these institutions are commonly either fragile or rudimentary, and often involve large transaction costs. A study by the Organization for Economic Cooperation and Development (OECD), for example, found that many specialized agricultural institutions were not designed to serve as financial intermediaries. The success of financial intermediation at any time depends significantly on how efficiently the transaction is completed. If the transaction costs, combined with high interest rates, require that the operation in question generate profit margins of the order of 30% to 50%, it is not clear that this would be economically beneficial (Chijoriga, 2000). It is not surprising that in many micro lending operations, trading activity – with quick turnover and large profit margins – dominates.

In many cases, micro-credit programmes have been stand-alone operations. There is now considerable consensus that lending to the poor can succeed provided it is accompanied by other services, especially training, information and access to land. According to the World Bank (2000) cited in Asian Development Bank Institute (2010) credit needs to be supplemented with access to land and appropriate technology. But such activities require strong support from the public sector. In some of the lowest-income countries, lack of access to land is the most critical single cause of rural poverty,

which dominates the poverty situation in those countries. Yet, few countries have substantial land reform programmes.

Moreover, in the proliferation of micro lending institutions, Non-Governmental Organizations and foreign donors have played an increasing role. Non-Governmental Organizations vary in quality and strength. The best results are produced, research shows, when developing country Governments and Non-Governmental Organizations work hand in hand. While donor participation can be positive, it should be noted that total Official Development Assistance (ODA) has declined in recent years.

### 2.3.2. Linkage Between Microfinance and SME

Several objectives so conceived by the government of Tanzania influenced the initiation of The IMFs schemes, among them, the most commonly mentioned ones include: poverty alleviation and improved living standards, offering financing to the poor Harper *et al* (1999), women's empowerment Rahmn (1999), and the development of the business sector as a means of achieving high standards and reducing market failure (Chijoriga and Cassimon, 1999).

Microfinance and its impact go beyond just business loans. The poor use financial services not only for business investment in the microenterprises but also to invest in health and education, to manage household emergencies and to meet the variety of other cash needs that they encounter.

In terms of understanding poverty Chaliand (2003) maintains that a simple distinction can be drawn within the group 'the poor' between the long-term or 'chronic poor' and those who temporarily fall into poverty as a result of adverse shocks, the 'transitory poor'. Within the chronic poor one can further distinguish between those who are either so physically or socially disadvantaged that without welfare support they will always remain in poverty (the 'destitute') and the larger group who are poor because of their lack of assets and opportunities. Furthermore within the non-destitute category one may distinguish by the depth of poverty (how far households are below the poverty line) with those significantly below it representing the 'core poor', who are sometimes categorized by the irregularity of their income (Chaliand, 2003).

In principle, micro finance can relate to the chronic (non-destitute) poor and to the transitory poor in different ways. According to WB (2000) cited in Asian Development Bank Institute (2010) the condition of poverty has been interpreted conventionally as a lack of access by poor households to the assets necessary for a higher standard of income or welfare, whether assets are thought of as human (access to education), natural (access to land), physical (access to infrastructure), social (access to networks of obligations) or financial (access to credit).

Lack of access to credit is readily understandable in terms of the absence of collateral that the poor can offer conventional financial institutions, in addition to the various complexities and high costs involved in dealing with large numbers of small, often illiterate borrowers (Chestnut, 2010). The poor thus have to rely on loans from either

moneylenders, at high interest rates, or friends and family, whose supply of funds will be limited. Microfinance institutions attempt to overcome these barriers through innovative measures such as group lending and regular savings schemes, as well as the establishment of close links between poor clients and staff of the institutions concerned.

Microfinance has consistently proven to be one of the most effective strategies in the Growth of SME in developing countries. Today, microfinance institutions around the world reach a little more than 100 million people (Asian Development Bank Institute, 2010). Thus most citizens earn their livings through self-employment, creating and operating their own tiny enterprises. Without financial services to fuel their productivity, the poor can never grow their micro enterprises into businesses that help them escape poverty.

Therefore by providing very poor families with small loans to invest in their micro enterprises, they become able to rescue themselves from poverty. They use these loans to start, establish, sustain, or expand very small, self-sustaining businesses (Begu, *et al* 2000). For example, a woman may borrow 150 000 Tsh ($100) to buy chickens, so she can sell eggs. As the chickens multiply, she will have more eggs to sell. Soon she can sell the chicks.

### 2.3.3. Microfinance Policy in Tanzania

Microfinance in Tanzania is one of the approaches that the Government has focused its attention in recent years in pursuit of its long term vision of providing sustainable financial services to majority of Tanzania population especially the most disadvantaged

groups such as the rural population, the disabled and the women (Rubambey, 2000). The government's choice of microfinance was influenced by the conviction that given adequate attention, microfinance has the potential to contribute considerably to the economic development.

### 2.3.4. Microfinance in the International Community

Studies on MFIs have been conducted in various countries all over the world. The findings from these studies are useful to new researches on microfinance. Some of the studies, which had a significant contribution, include the study by (Mosley, 2001). In his study on Microfinance and Poverty in Bolivia, Mosley assessed the impact of microfinance on poverty. The study was conducted through small sample surveys of four microfinance institutions, two urban and two rural, using a range of poverty concepts such as income, asset holdings and diversity, and various measures of vulnerability.

All the institutions studied had on balance, positive impacts on income and asset levels, with income impacts correlating negatively with income on account of poor households choosing to invest in low-risk and low-return assets. Mosley's study revealed also that in comparison with other anti-poverty measures, microfinance appears to be successful and relatively cheap at reducing the poverty of those close to the poverty line. However this was also revealed to be ineffective, by comparison with labour-market and infrastructural measures, in reducing extreme poverty. The study by Mosley (2001) further proposed actions that appear to be promising for the further reduction of poverty

in Bolivia which can also be useful for other developing countries. These actions include stronger efforts to mobilize rural savings, removal of lower limits on loan size, and the introduction of appropriate insurance mechanisms.

Hassan and Renteria-Guerrero (1997) made another empirical contribution in this area. In their work "The experience of the Grameen Bank (GB) of Bangladesh in community development", they examined the GB experience with a purpose of understanding the essential elements of its operations and the factors that enabled GB to reach the poor. This study revealed that the GB has established its credentials as an institution that aims at providing credit to the landless and asset less poor in rural areas. However, it was observed the credit by itself is an insufficient factor to improve poverty conditions, and thus the GB devotes a substantial amount of resources to the improvement of the social wellbeing of its members.

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). 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 labour amongst poor people.

Mosley and Hulme (1998) found evidence of a trade-off between reaching the very poor and having substantial impact on household income. They found that programmes that targeted higher-income households (those near the poverty level) had a greater impact on household income. Those below the poverty line were not helped much and the very poorest were somewhat negatively affected. The poorest tended to be more averse to risk-taking. They also used their loans for working capital or to maintain consumption levels rather than for fixed capital or improved technology. Since, microcredit programmes typically require loan repayment on a weekly basis; some critics argue that repayment comes from selling assets rather than from profits of micro-enterprises.

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 artisanal 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 labour 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 labour supply (income effect), it can negatively affect labour supply of particular type, for example male labour supply. As a result employment may decline, given the demand for labour. Therefore, the net impact cannot be determined a priori. 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.

### 2.3.5 Tanzania Microfinance Review

In Tanzania several studies has been done on microfinance institutions service, one of the researcher who have done research on MFI service is Kuzilwa and Mushi (1997) examined the role of credit in generating entrepreneurial activities. He used qualitative case studies with a sample survey of business that gained access to credit from a Tanzanian government financial source. The findings reveal that the output of

enterprises increased following the access to the credit. It was further observed that those enterprises, whose owners received business training and advice, performed better than those who did not receive training. He recommended that an environment should be created where informal and quasi-informal financial institutions can continue to be easily accessed by micro and small businesses.

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 28 MFIs and 194 MSEs 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 many is 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.

Another study on microfinance in Tanzania were carried out by 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 and 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 MSE'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.

Kuzilwa (2002) conducted a study to examine the role of credit in generating entrepreneurial activities. He used qualitative case studies with a sample survey of

businesses that gained access to credit from a Tanzanian government financial source. The findings revealed that the output of enterprises increased following the access to the credit. It was further observed that the enterprises whose owners received business training and advice, performed better than those who did not receive training. He recommended that an environment should be created where informal and quasi-informal financial institutions can continue to be easily accessed by micro and small businesses.

### 2.3.6. Microfinance and Income Generating Activities

Microfinance has been a key instrument in improving social status of the micro-credit members especially in developing countries. This can be seen in different domains such as running small business like "Mama Lishe", Retails shops, Grocery etc.

According to Chestnut (2010) borrowers use the loans to start businesses such as buying goods wholesale to sell in markets, making and selling crafts, farming and other similar activities. The profits they earn allow them to repay the loan, make a living, and generally improve their living conditions and the conditions of the community. As borrowers build credit, they qualify for larger loans. Most loans are made without collateral. However, to establish creditability with microfinance institutions, borrowers often form groups whose members guarantee one another's loan payments.

As microfinance focuses on providing poor people with access to credit so they can engage in income generating activities, there is cash flow which is used to increase assets, including permanent houses or savings accounts, offering recourse during hard times, and consumption, especially in food, nutrition, and education (Ohri 2004).

Sam (2002) in Vincent (2005) maintains that loans in less developed countries are made for a variety of purposes. Loans are made for housing and for "start up" loans so farmers can buy inputs to agricultural production: rice seeds, fertilizers and agricultural tools. But loans are also used for a variety of non-crop activities such as: dairy cow raising, cattle fattening, poultry farming, weaving, basket making, leasing farm and other capital machinery and woodworking. Of course, funds may be used for a number of other activities, such as crop and animal trading, cloth trading and pottery manufacture. Credit is also issued to groups consisting of a number of borrowers for collective enterprises, such as: irrigation pumps, building sanitary latrines, power looms, leasing markets or leasing land for cooperative farming.

The potential for loan uses are virtually endless, and differ between villages and countries. However, due to the fact that there is no such thing as a 'typical' developing country, loans provide a source of income for diverse activities chosen specifically by the borrower, to create their own life. Borrowers themselves make decisions on the uses of the benefits of the loans they get. The uses consist of solving their household problems such as children's education, health and nutrition. Christopher (2002) in Ohri (2004) noted that loans obtained from microfinance institutions play an instrumental role in bringing health services to their clients.

### 2.4 Research Gap

However, many studies on impact of microfinance on the SME's growth have been conducted in other parts of the world especially in Southeast Asia such as Malaysia,

Bangladesh as well as Africa in the countries like Nigeria, Ghana, Cameroon, Kenya etc. But rare studies have been conducted in the country to verify positive impact brought by micro-loan accessibility to SME practitioners. This situation may be associated with strangest of the sector in Tanzania. This study is in the right time to assess the impact of small loans on the improvement of Small and Medium Enterprises. Conventionally, economic indicators have been widely utilized in assessing the impact of micro finance where analyzers are particularly interested in measuring changes in income, sales, expenditure, consumption and assets.

An increase in net enterprise income of 93% was observed for borrowers of Indonesia's Bank of Rakyat was conducted to see the impact of the banks micro financing scheme (Fildler and Webster, 1996). In general, most impact assessment studies show improvements in quality of life and the positive impact of micro finances in poverty alleviation. However, even the famous Bank (the Grameen Bank) is currently facing an increase in the number of dropouts that affect its contribution to poverty reduction and the viability of the program and its borrowers in the future (Karim and Osada, 1998).

Furthermore, **e**mpirical literatures on impact analysis of micro credit in Tanzania remained to be scanty. One of these few literatures is the study done by Selejio (2002) who studied the impact of micro credit in Tanzania. The study revealed that micro credit has high possibility of increasing the borrower’s income and maintaining the living standards. Thus, it can turn back the future dream of the marginalized group of people who are seeking to be alleviated from poverty.

# CHAPTER THREE

# 3.0 RESEARCH METHODOLOGY

## 3.1. Overview

The arrangement of this Chapter gives various steps consisting of methods and techniques that will be adopted by the researcher in studying the research problem along with the logic behind them. Basically, the chapter discusses and presents the Research design, Description of the study area and population, Sampling frame, Sample size, Sampling techniques, Types and sources of data, Data collection methods, and Data presentation and analysis.

## 3.2. Study Location and Rationale

The study was conducted in Morogoro Municipality. It is one of the six administrative Districts in Morogoro region. The other districts are Morogoro rural, Kilosa, Mvomero, Kilombero and Ulanga. The Municipality is sub divided into 19 wards and 275 streets (URT, 2002). It was selected through simple random sampling. Also, it was selected from stand point that the area had considerably numbers of Microfinance Institutions such as FINCA, BRAC, PRIDE, SEDA, NMB, CRDB etc. It is the Regional Headquarter of Morogoro and it is about 195 kilometres to the west of Dar es Salaam. Morogoro region lies between latitudes $5^{o}$ 58" and 0" South of the equator and between longitudes $35^{o}$ 25" and $38^{o}$ 30" East of the Greenwich. Morogoro Municipality had a population of 294 467 of which 147 547 and 146 920 are male and women respectively (Morogoro Municipality report, 2009).

### 3.3. Research Design

According to Kothari (2004) a research design is "the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure". It is the conceptual structure within which research is conducted; it constitutes the blue print for collection, measurement and analysis of data. The function of a research design is to provide a plan of how important data can be amassed with smallest expenditure of time, efforts and money. The research design as a structure of an enquiry of data; therefore, this study used a cross-sectional design because it allows data and results to be obtained speedier. According to Babbie (1990); Bailey (1994), a cross sectional design allows data to be collected roughly at a single point in time without repetition from the representative population. The design was chosen because of economical point.

### 3.4. Sampling Techniques

#### 3.4.1. Cluster Sampling Technique

Cluster sampling technique involves the selection of an entire group from a list of groups (Adam and Kamuzora, 2008). The total population is divided into a number of relatively small subdivisions which themselves are clusters of small units. Some of these clusters are then randomly selected for inclusion in the overall sample. In this case, the researcher selected clusters/groups of respondents as sampling frame.

The researcher selected respondents from their clusters/groups receiving financial services from these micro credit programs. Under this sampling technique, one hundred

and fifty (150) respondents were selected from their groups to constitute the sample. This technique was very helpful in the sense that it helped to save time for data collection because the researcher tend to contact them in groups.

### 3.4.2. Data Collection Tools

In order to collect the data needed, the researcher used questionnaire, and interview for collecting primary data and documentary method for collecting secondary data. This study was involving the application of quantitative approach.

#### 3.4.2.1. Questionnaire

The researcher used this method to collect primary data from respondents. They were at first pre-tested by a small number of respondents and then after they distributed to clients of these micro-credit programs for collecting the data needed. Structured Questionnaires: This used to collect information from households. Questionnaires were developed to obtain survey data that allows an understanding of the impact of micro financing services on the growth of micro and small entrepreneurs. The question was formulated in English and translated into Swahili to make them understandable to respondents. They were distributed to collect quantitative data from one hundred and fifty (150) respondents receiving financial services.

#### 3.4.2.2. Interview

The researcher used this tool to supplement the questionnaire method of data collection to obtain the qualitative data. The interview was arranged to allow respondents to freely provide their views related to the problem that was being investigated. The interview

was semi-structured; i.e. some of the questions and topics were predetermined. Other questions were expected to arise during the interview and thus the method appeared to be informal and conversational, but carefully controlled and structured.

#### 3.4.2.3. Documentary Review

Under this method, the researcher tried to examine whether the data collected were reliable, suitable and adequate. This method helped the researcher to get supportive information that was being complemented data obtained through use of questionnaire and interview techniques. The method was therefore being helpful to understand the contribution made by these micro-credit programs in different areas and epochs, seeking to explore the magnitude of the problem as documented by other researchers. Different books, journals, newsletters, electronic information and other forms of documented materials will be perused.

### 3.5. Data Processing, Analysis and Presentation

Once the questionnaire or other measuring instruments have been administered, the mass of raw data collected must be systematically organized in a manner that facilitates analysis (Mugenda and Mugenda, 1999). In order to facilitate the analysis of data from questionnaires, interviews and documentary sources, findings was being extracted and presented to answer the research questions.

Statistical Package for Social Sciences (SPSS) computer software for storage, processing and analysis of data so as to obtain answers to the research questions. SPSS computer software was used for data processing before data analysis. The data analysis was

important since it distil crude data into clear and interpretable ones (Kerlinger, 1986). Descriptive statistical analysis procedures including cross-tabulations and frequency distributions from the database template was used to determine the relations between pairs of variables. The inferential statistical analysis, namely t-test was used. The t-test was employed to test the research hypothesis. Qualitative data (unstructured questions) were analysed through content analysis method. Content analysis is the systematic, quantitative analysis of communication content, including verbal, visual, print, and electronic communication. Under this method, a researcher applies objective and systematic counting and recording procedures to create a quantitative description of the symbolic content in a text (Neuman, 2003).

### 3.6 Empirical Framework of SME Growth

#### 3.6.1 Dependent Variable

There is little agreement in the existing literature on how to measure growth, and scholars have used a variety of different measures. These measures include, for example, growth of sales, employees, assets, profit, equity, and others (Davidsson, & Wiklund, 2000). The study used Small and Medium Enterprises Growth (SME_G) as a dependant variable; in this study a researcher uses volume of gross sales (in Tsh) per annual as a measure of SME growth. In this phenomenon, a researcher takes unit price of the commodity multiplied by the total quantity sold of each individual respondent.

$$GS = P \times \sum QS \qquad (1)$$

Where; GS denotes Volume of gross sales (in Tsh) per annual, P denotes unit price of a commodity and QS denotes Quantity of goods and services sold per annual.

### 3.6.2 Independent Variables

#### 3.6.2.1 Amount of Loan (AMOL)

Amount of loan in Tsh, the researcher used this variable as an independent variable to measure the access of fund on SME. Here, the study used to measure the total amount of loan that SME practitioners acquired from MFI in a given period of time.

$$AMOL=\sum Lo + R \qquad (2)$$

Where; AMOL denotes total amount of loan in Tsh. acquired by SME participant, Lo denotes micro-loan in Tsh. and R denotes Rate of interest in Tsh. for such micro-loan.

#### 3.6.2.2 Experience of SME Members (EXPp)

The study also used Experience of SME participants in particular business; here a researcher measures the experience of SME member by taking the total number of years in business since its operation to the time when this research conducted.

$$EXPp=T_{t-1} - T_t \qquad (3)$$

Where; EXPp denotes experience of SME members, $T_{t-1}$ denotes initial year of business operation while $T_t$ denotes present year when research conducted.

#### 3.6.2.3 SME Member's Start-up Capital

Star-up capital in Tsh. was another independent variable that used by a researcher in its model to analyse the growth of SME. Star-up capital was measured through summing up all sources of capital that SME member accumulated for the purpose of initiating the firm.

$$STCA = OS + FC + GR + Lo \quad (4)$$

Where; STCA denotes Star-up capital in Tsh, OS denotes own saving, FC denotes funds from family, friends, relatives and spouse, GR denotes funds from donors and Lo denotes loan from commercial and non-commercial banks.

#### 3.6.2.4 Education Level

Education level is another independent variable that measured the SMEs growth, a researcher takes the general level of education that a member completed in term of Tanzania education system. Level of education included are, primary education, secondary education, and higher education. A value of 1 was given to entrepreneur whose completed primary education and value 0 to those who have other level of education.

#### 3.6.2.5 Number of Employees

Number of employees (EMPLY) – is another independent variable in order to test for scale effects in the relation to growth SME.

### 3.7. Empirical Model

This study used cross-sectional data regression model in empirical test, and tests whether MFI improves SME growth. In empirical test, individuals of cross-sectional data are SME practitioners from BRAC and FINCA in Morogoro Municipality. The researcher used the following econometric model to estimate through single equation linear regression model. This is the multiple regression model of the form

$$SME\_G_i = \beta_0 + \beta_1 AMOL_{1i} + \beta_2 EDU_{2i} + \beta_3 EXPp_{3i} + \beta_4 STCA_{4i} + \beta_5 EMPLY_{5i} + e_i \qquad (5)$$

Where,

*SME_G* = SMEs growth,

*AMOL* = the total amount of micro-loan to the participant,

*EXPp* = Number of years being in the business (Age of the business),

*EDUC* = Level of education of the SME's member

*STCA* = Start-up capital in Tsh,

*EMPLY* = Number of employee

*β's* = are multiple regression coefficients estimated

*e* = the error term.

*i = 1..... n*, where n is the number of SME

The Ordinary Least Squares (OLS) technique was used in estimating the specified econometric model. Apart from its simplicity, it gives reliable estimates. The estimation software was SPSS version 16

# CHAPTER FOUR

# 4.0 DATA ANALYSIS AND DISCUSSION

## 4.1 Overview

This chapter presents an analysis and discussion of the research findings of the study. In this context the chapter analyzed data with reference to the research objectives, questions and hypothesis. The study provides description of the socio-economic and demographic characteristics of the respondents namely age, sex, and education level. Also the main occupation and years in business (experience) were discussed.

## 4.2. Socio-economic and Demographic Characteristics of the Respondents

For that matter, socio-economic and demographic characteristics provide a foundation for understanding the differences and similarities in the human resource base at the household levels. Also, they acts as factors that may influence participation in micro credit's program that again leads to huge impacts to the credit users. On the other hand, the physical resource base of a household indicates its stock of wealth, life standards and wealth or poverty level (Barnes and Keogh, 1999).

The primary research data from SME's practitioners in BRAC and FINCA were by the use of structured questionnaires which in turn get analyzed for different significance levels after being employed in the regression model. A total of 150 questionnaires were randomly distributed to SMEs taking loan from BRAC and FINCA as shown on table 4.1, therefore considered as adequate to the subsequent data analysis. The demographic

profile of respondents was summarized with age, gender and education. The validity and reliability tests of research were conducted prior carrying out the statistical techniques.

**Table 4.1: Number of Respondents Covered on the Study**

| Name of MFI | Frequency | Percent |
|---|---|---|
| **BRAC** | 75 | 50 |
| **FINCA** | 75 | 50 |
| **Total** | 150 | 100 |

**Source: Field Data, 2013**

### 4.2.1 Gender of Respondents

The characteristics of the respondents according to sex showed that there were more female 77.3% among the SMEs members and 22.7% were found to be male as per figure 4.1. These results imply that female were dominant in MFIs involved in this study. This situation attributed by the policy of these MFI for empowering women economically, however, most of women engaging on SME get loan from these Micro finances by forming groups of 20 – 30 members. This makes micro credit institutions to build up capacities for income generation activities among the micro entrepreneurs and to provide sustainable sources of livelihood to SMEs household members.

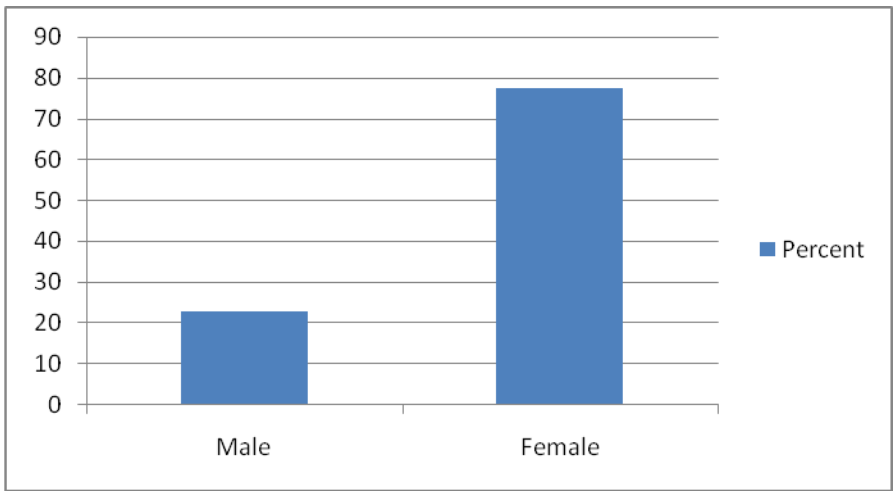


**Figure 4.1: Sex of Respondents**

**Source: Field data, 2013**

### 4.2.2 Mean Age of Respondents

Age is an important factor which can influence economic activities to be performed by a healthy individual. In this case, age indicates the capability of an individual to produce economic material wealth for humankind consumption. The research findings in Table 4.2 shows that minimum age of respondents was 18 years old and maximum age was 45 years old, mean age of respondents was 31.24 years old. This result suggests, therefore, that a large number of respondents were in their economically active age; which may imply high level of productivity, ceteris paribus. Moreover, this is also an indication that a high proportion of the active and healthy labour force still needs more and access to micro credit institutions so as pull them out of poverty in the study area.

**Table 4.2: Mean Age of Respondents**

| N | Minimum | Maximum | Mean | Std Deviation |
|---|---|---|---|---|
| **150** | 18 | 45 | 31.24 | 5.880 |

**Source: Field data, 2013: Note N=Number of respondents**

### 4.2.3 Education Level of Respondents

Education is a process to attain acculturation through which the individual is helped to attain the development of his potentialities and their maximum activation when necessary, according to right reason and to achieve thereby his perfect self-fulfillment (Okafor, 1984). In its strictly sagacity, this implies that education is an important agent of change as it equipped a person with the necessary knowledge and skills so as to increase their productivity and income earning ability.

The study revealed that; 64.6% were primary education, 19.3% have secondary school education, and those with degree accounted for 0.7% of the respondents, while those who have other education accounted for 8.0%. The distribution of the educations levels among respondents is summarized in figure 4.2. These results suggest that most of the micro entrepreneurs consulted by the researcher were found to have primary level of education. This result agrees with the study done in Tanzania by Kristiansen, *et al.*, (2003) who revealed that majority of the micro entrepreneurs had primary education level as a result most of their micro enterprises fails to expand their earning capacity.

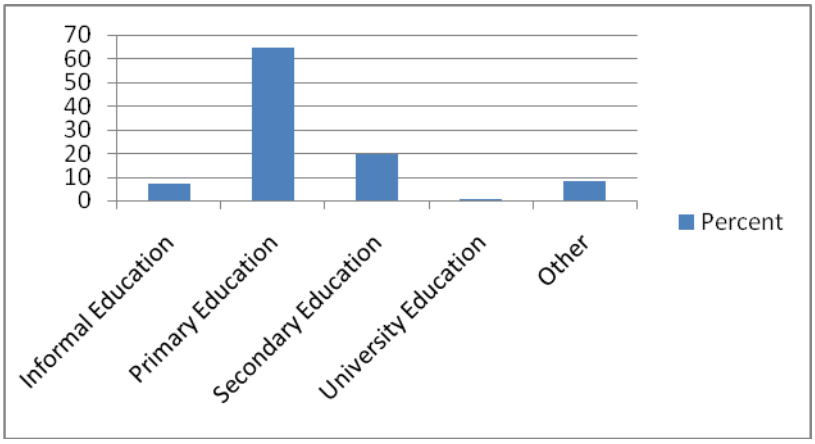


**Figure 4.2: Respondent's Education Level**

**Source: Field data, 2013**

### 4.2.4 Source of Initial Capital of the SME

Business capital is seen as peculiar important and challenge as a start-up businesses in the developing world including Tanzania although their policies encourages development of entrepreneurship because most jobs are reported to be created by small and micro-enterprises (IDRC, 1999). From the study it was realized that 110 clients representing 73.3% had established their enterprises with their own funds. This was through personal savings, only 29 client representing 19.3% admitted that their businesses were established by funds from spouse and relatives. Only 6 client representing 4.0% confirmed that he established his business through grants while the remaining 5 representing 3.3% had their businesses established through borrowing from non-banks. This shows that most people set up their businesses from their own funds through personal savings which were either saved in banks or through some collectors.

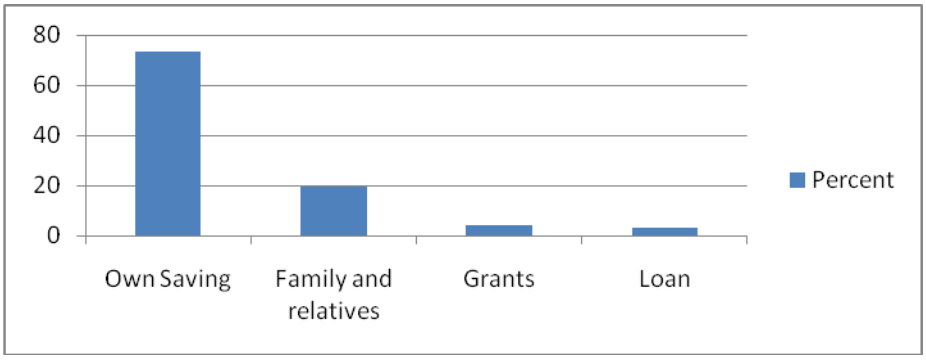


**Figure 4.3: Distribution for Source Capital (in Tsh)**

**Source: Field data, 2013**

### 4.2.5 Client's Start-up Capital

The study revealed that the minimum start-up capital of the entrepreneurs was Tsh. 30 000 and the maximum was Tshs. 8 000 000. However, table 4.3 depict that, the mean of start-up capital was Tsh. 623 500. The most usual source of finance came from individual saving. Corporate profits are cited by almost all businesses as a means of financing growth, although this did not exclude other sources. Self-generated funding plays a vital role but it is not enough. The high-growth SME must appeal to outside funding to pursue or consolidate its development. In some countries, this function is exercised by large industrial or financial groups; the large corporation acquires the SME. Another possibility is the funding of growth by the financial system.

**Table 4.3: Mean Start – up Capital of Respondents in Tsh**

| N | Minimum | Maximum | Mean | Std Deviation |
|---|---|---|---|---|
| **150** | 30 000 | 8 000 000 | 623 500 | 9.157 |

**Source: Field data, 2013**

### 4.2.6 Amount of Loan Accessed

The researcher examined the impact of the microfinance accessibility on the SMEs growth. However, for the sake of analysis the researcher categorized two groups that represented members who accessed and those who did not have accessed. The figure shows those members who get loan amounted less than Tsh. 500 000 represented those who are not accessed and members who get loan amounted Tsh. 500 000 and above represented accessibility of MFI services.

A result in figure 4.4 presents a summary of loan access of respondents with reference to amount of Tanzania shillings accessed from MFIs involved in this study. The results showed 82.7% of the respondents had acquired loan and 17.3% of respondents did not accessed the loan facilities.

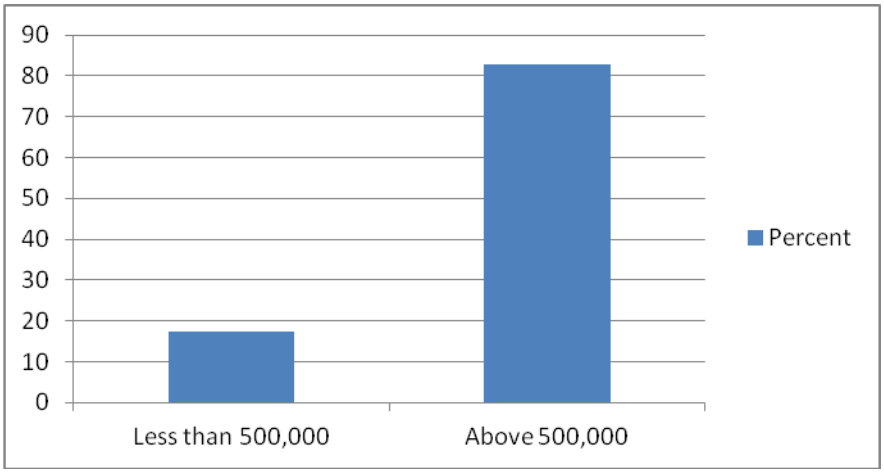


**Figure 4.4: Amount of Loan Accessed by Respondents**

**Source: Field data, 2013**

### 4.2.7 Number of Years in Business

The findings in Table 4.4 indicate that minimum age of business was 1 year and maximum age in business was 13 years from its establishment. The results suggest that most of the entrepreneur who engaging on small business tend to run their business activity for average of 5 years and then quit to another business. It is estimated that the life period of surviving for small business is at least one to three years and afterward, these types of small business start to contract quickly toward decease (Selejio and Mduma, 2005).

**Table 4.4: Mean Year of Respondent in SME**

| N | Minimum | Maximum | Mean | Std Deviation |
|---|---|---|---|---|
| **150** | 1 | 13 | 5.00 | 2.783 |

**Source: Field data, 2013**

### 4.2.8 The Business Type Operated by Respondents

This study wanted to understand the types of business that are engaged by the respondents in order to support their family economy, and then a question was posed to collect information on the matter. The statistical results in Table 5 show the distribution of respondents with respect to their types of economic activities they are engaged in. Food vending was the main specified activity at the rate of 26.7%, followed by retail shops at the rate of 10%. However, 36.7% of the business type falls under other type of business which involves different businesses apart from listed in figure 4.5.

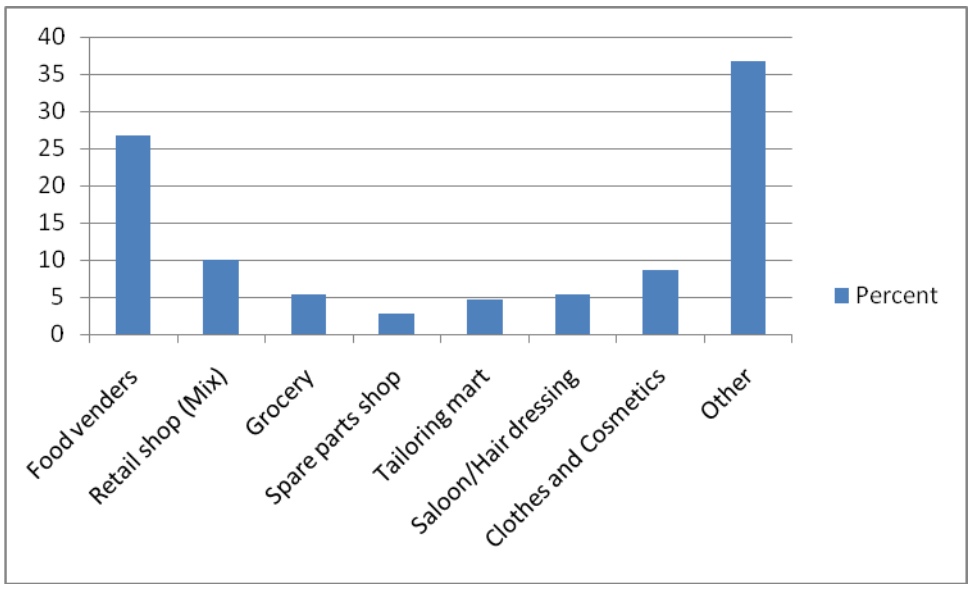


**Figure 4.5: Distribution for Business Operated by Respondents**

**Source: Field data, 2013**

### 4.3 Model Estimation

The researcher used correlation analysis to reduce multicollinearity on the econometric model for processing and analyzing research data. The study used this method since collinearity of the explanatory variables is just degree of correlation, so, the matrix measures the relationships of individual explanatory variables against another individual explanatory variable within regression.

The correlation matrix of dependent and explanatory variables is presented in table 5 and is used to examine the possible degree of collinearity among variables. The table shows that the two most highly correlated variables are total current investment and amount of loan (a coefficient of 0.905). As we observe in table 5, the correlation coefficients are not large enough to cause collinearity problems in the regressions and are statistically

significant at the usual levels of significance. To mitigate the problem with possible multicollinearity we gradually exclude the variables that are expected to be highly correlated with the rest (in this case, STCA and Tci).

**Table 4.5: Correlation Matrix for Model Estimation**

| Variables | Sales | Busty | EMPLY | STCA | AGE | EXPPp | AMOL | EDUC | Tci |
|---|---|---|---|---|---|---|---|---|---|
| Sales | 1 | | | | | | | | |
| Sig | | | | | | | | | |
| Busty | -.224** | 1 | | | | | | | |
| Sig | .006 | | | | | | | | |
| EMPLY | .100 | .411** | 1 | | | | | | |
| Sig | .225 | .000 | | | | | | | |
| STCA | .356** | -.305** | .114 | 1 | | | | | |
| Sig | .000 | .000 | .164 | | | | | | |
| AGE | .089 | -.035 | .119 | .167* | 1 | | | | |
| Sig | .278 | .671 | .146 | .041 | | | | | |
| EXPPp | .107 | -.163* | -.133 | .031 | .422** | 1 | | | |
| Sig | .194 | .046 | .106 | .709 | .000 | | | | |
| AMOL | .434** | -.351** | .080 | .597** | .125 | .097 | 1 | | |
| Sig | .000 | .000 | .333 | .000 | .126 | .239 | | | |
| EDUC | -.100 | .130 | -.055 | -.317** | .056 | -.015 | -.232** | 1 | |
| Sig | .225 | .112 | .500 | .000 | .493 | .855 | .004 | | |
| Tci | .444** | -.368** | .107 | .882** | .162* | .073 | .905** | -.304** | 1 |
| Sig | .000 | .000 | .190 | .000 | .047 | .374 | .000 | .000 | |

"Correlation at the 0.01 level (two tails)

'Correlation at the 0.05 level (Two tails)

**Source: Field data, 2013**

### 4.4 Multiple Regression Analysis Results

The complete data set based on 150 observations on the chosen variables. Table 4.6 reports the multiple regression analysis on selected variables. The amount of loan (in Tsh) was 0.371 with p - value of 0.002 for the study sample. On number of years in business (Firm's age) was 0.083 with p - value of 0.328, level of education represented 0.040 with p - value of 0.613. Similarly other variables like, respondent's age representing -0.009, types of business operated by respondents represented -0.142 and Number of employee represented 0.140 with their p - values 0.912, 0.119 and 0.108 respectively.

The estimated result showed R- Squared of 0.223. This indicates that 22% of the variations in the growth of SMEs are explained by the independent variables. The F-Statistic which is a key statistic in this cross-section study is 5.810 (0.000) and is significant at 95% confident level. This implies that almost all the independent variables in the model have jointly contributed to the growth of the SMEs in the Morogoro Municipality.

Durbin Watson (DW) – Statistics is 2.008. This figure indicates that successive error terms are not correlated.

**Table 4.6: Variables of the Research Model**

| Variables | Coefficients | T | Sig |
|---|---|---|---|
| (Constant) | | 1.876 | .063 |
| AMOL | .304 | 3.174 | .002 |
| EXPp | .083 | .981 | .328 |
| Age | -.028 | -.332 | .741 |
| STCA | .138 | 1.413 | .160 |
| EMPLY | .125 | 1.443 | .151 |
| Busty | -.119 | -1.299 | .196 |
| EDUC | .040 | .506 | .613 |

Dependent variable: Gross sales in Tsh

$R^2 = 0.223$ F- Statistics = 5.810 (0.000) DW = 2.008

**Source: Field data, 2013**

### 4.4.1 To Determine at What Extent Accessibility of Microfinance Lead to Increase the Volume of Gross Sales of Participant

To determine the extent of accessibility of microfinance on increasing the volume of gross sales of participants, the study findings shows that accessibility of microfinance has positive influence on volume of gross sales of SME's participant. Similarly, this objective was supported by other studies, for instance Timmons and Spinelli, (2004) states that lack of access to finance is one of the main constraints to the growth and expansion of small businesses.

#### 4.4.1.1 Amount of Loan Accessed

The additional Tsh 1 000 amount of loan on average, then SME growth increase by 304 units per annum ceteris paribus. The higher the access the amount of loan the higher the volume of gross sales per annum. The main interest is in the signs and magnitudes of the variables measuring the impact of accessibility of microloan (amount of loan) because they represent the sensitivity of SME growth to amount of loan in Tsh. Theoretically, microfinance accessibility enables poor to smooth their consumption, gradually develop micro enterprises and enhance income capacity (Rubambey, 2001). Similarly, lack of broad access to financial services limits opportunities for agribusiness enterprises and small holders to adopt efficient technologies and efficient resource allocation (Peer, 2010). In fact the entrepreneur who accessed high loan is able to improve his/her business environment which can attract and monopolize the market through improving the quality and increase quantity of product, setting competitive price, increasing advertising budget and to improve business premise. The coefficients on amount of loans in Tsh are statistically significant under t-test at 5% level of significance. The magnitude of these coefficients is consistent with the hypothesis stated that; there is no statistical significant relationship between microfinance access and SMEs growth. The study suggest that, the null hypothesis was rejected hence there is statistical significant relationship.

### 4.4.2 To Examine Other Factors Enhancing SME's Growth

The study aimed to understand other factors rather than loan accessibility that enhancing SME's growth, in this point of view the researcher analysed variables of start-up capital

in Tsh and experience of SME practitioners to measure the SME's growth. The study reveals that these variables were not statistically significant at t statistic 0.05 level of significance.

#### 4.4.2.1 Number of Employees

The additional 1 worker on average, then SME growth goes up about by 125 units per annum ceteris paribus. The main interest is in the signs and magnitudes of the variables measuring the impact of number of employee on SMEs growth, because they represent the sensitivity of SME growth to number of employee. Ceteris paribus the higher the number of employees the higher the volume of gross sales per annum, on the study shows that firms have 1 to 5 employees, this due to the nature of their business as well as small capital they have. The empirical evidence shows that the larger the firm (in terms of assets or number of employees) the greater its potential to grow (Wiklund and Shepherd, 2005). The coefficients on number of employees are statistically insignificant under t-test at 5% level of significance.

#### 4.4.2.2 Experience in Business

The experience of an entrepreneur in his/her business increases by a year on average, then SME growth increase by 0.083 units per annum. The main interest is in the signs and magnitudes of the variables measuring the impact of experience of years in business on SMEs growth, because they represent the sensitivity of SME growth to experience of years in business. Ceteris paribus, the more experience within the business the higher the SME growth. Theory states that SME practitioners with more managerial, sector

experience or prior SME experience as owner/manager tend to correlate with greater growth (Storey *et al,* 1989). On the study shows that the mean years experience of entrepreneurs was 5 years while the maximum experience years was 13 and minimum experience years was 1 year. The study reveals that there is no necessity for being in business for long term to influence enterprise's growth; the reason could be low demand on the product or low production on the product with high competition. On the other hand, most of the entrepreneurs quit from one business to another after five years for searching more profitable business with high volume of gross sales. The coefficients on experience of years in business are statistically insignificant under t-test at 5% level of significance. The magnitude of these coefficients are inconsistent with the hypothesis that; There is no statistical significant that experience on SME activities improves SME's growth. The study result suggests that the null hypothesis was accepted hence there is no statistical significant relationship.

#### 4.4.2.3 Education of the SME Member

The education level of an entrepreneur possessed increases by a stage on average, and then SME growth goes up about by 0.040 units per annum. The main interest is in the signs and magnitudes of the variables measuring the impact of education on SMEs growth, because they represent sensitivity of SME growth to education. Ceteris paribus, the fact that basic education enhances the overall quality of the owner/manager by providing him/her with basic numeric and literacy skills thus increases the chance of survival. Theory states that the fact that a manager has a higher education degree or even a postgraduate degree seems to stimulate the growth of the firm, thus having an impact

on both survival and growth. On the study shows the majority of the respondents were in primary education level fall under 64.6% while owners who undergone university degree were 0.7%. The study shows those owners who having primary education level have average volume of gross sales per annum, the reason could be they have small initial capital hence they get little amount of loan from MFIs. The coefficients on education of respondents are statistically insignificant under t-test at 5% level of significance.

#### 4.4.2.4 Age of Respondents

An extra age of an entrepreneur in a year on average, then SME growth goes down about by 0.028 units per annum. The main interest is in the signs and magnitudes of the variables measuring the impact of age of respondent on SMEs growth, because they represent less sensitivity of SME growth to age of respondents. Theory states that age is an important factor which can influence economic activities to be performed by a healthy and energetic individual. In this case, age indicates the capability of an individual to produce economic material wealth for humankind consumption. Available discussion explaining the influence of the age of the owner/manager advocates for the younger owner/manager; the argument here rests on the fact that the younger owner/manager has the necessary motivation, energy and commitment to work and is more inclined to take risks (Storey, 1994). The logic is that the older owner/manager is likely to have reached his/her initial aspiration. On the study shows that mean age of entrepreneurs was 31.24 years while the maximum age was 45 years and minimum age was 18 years, in the study area most of the people belonging to this age are running

businesses which have low returns. This could be because of lack of enough capital, low level of business skills and unfavourable business location. The coefficients on age of respondents are statistically insignificant under t-test at 5% level of significance.

#### 4.4.2.5 Start-up Capital

The additional Tsh 1 000 start-up capitals on average, then SME growth goes up about by 138 units per annum ceteris paribus. The main interest is in the signs and magnitudes of the variables measuring the impact of start-up capital in Tsh on SMEs growth, because they represent the sensitivity of SME growth to start-up capital. Ceteris paribus the higher the start-up capital the higher the volume of gross sales per month, on the study shows that those people having enough capital during their venture experienced higher volume of gross sales per month. In fact the entrepreneur who have large initial capital may improve his/her business environment which can attract and monopolize the market through improving the product, setting competitive price, advertising as well as good location for the business. The coefficients on start-up capital are statistically insignificant under t-test at 5% level of significance. The magnitude of these coefficients is inconsistent with the hypothesis that; there is no statistical significant relationship between SMEs growth and start-up capital. The study suggests that the null hypothesis was accepted hence there is no statistical significant relationship.

#### 4.4.2.6 Business Type Operated by Entrepreneurs

Moving to food vending decreases by a unit on average, then SME growth goes down about by 0.119 units per annum. The main interest is in the signs and magnitudes of the

variables measuring the impact of food vending on SMEs growth, because they represent less sensitivity of SME growth to business type operated by entrepreneur. Available theories explaining the sector in which a firm operates is considered an influential factor on the growth processes in small firms but the extent to which it is a significant factor is less clear-cut. Although the level of industrial disaggregation can be expected to influence the results of sector analysis, empirical studies Smallbone *et al* (1995) usually find that there are significant differences amongst sectors in terms of the typical firm growth rates. On the study shows that most of the people were operating food vending, this business operated mostly by female and these are the majority of respondents in this study. Similarly this type of business taking large part of SME, this could be because the business need small amount of capital to operate the sector. The coefficients on business type are statistically insignificant under t-test at 5% level of significance.

**4.5 Summary of Chapter Four**

The data analysis in this chapter used descriptive analysis in terms of frequency and descriptive as well as regression analysis. The study findings reveal that all three specific objectives were captured under the field data gathered by a researcher. The three research hypothesis were tested at sig 0.05 level of significance, one research hypothesis out of three was revealed that null hypothesis has statistically significant; which are (1) $H_0$: There is no significant statistical relationship between microfinance access and SME growth. While the rest research hypothesis tested and the study findings reveal that the null hypothesis was not statistically significant, which are; $H_0$: There is no statistical

significant that experience on SME activities improves SME's growth and $H_0$: There is no statistical significant relationship between SME growth and start-up capital.

# CHAPTER FIVE

# 5.0 CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Overview

This chapter describes conclusions and recommendations of the study with reference to the designed research objectives and analysis made. The conclusions that have been made hereunder are based on the research findings obtained from the field data. Consequently, the opinions suggested were compared with the previous results done by other academicians/intellectuals and key informants. With this respect, this chapter concentrates on conclusions, policy implications and finally, proposes the area for further studies.

## 5.2 Conclusion

This study uses the financial accessibility approach to study the impact of microfinance on SMEs growth in Morogoro Municipality. It uses data collected from a field survey from two MFIs located on Morogoro municipality. Linear regression was used to assess the impact of microfinance on SMEs growth on the likelihood that respondents would increase the volume of gross sales, to assess the respondents' sensitivity to accessibility. The model contained seven independent variables (amount of loan, years in business, start-up capital, number of employees, age of respondents, education level and business type). The data and method employed here produce results consistent with more traditional impact study in Tanzania for the same period.

The study findings reveal that MFIs played its role of providing funds for the SME, the total number of 150 SMEs involved in this study achieved to secure loan from two MFIs in the study area which were BRAC and FINCA branches in Morogoro Municipality. These MFIs provided different amount of loans to the SMEs with the lowest amount of Tsh 200 000 and the highest amount of Tsh 7 000 000 during this period of the study. It also aimed to investigate the impact of microfinance services on the growth of SMEs in Morogoro Municipality. The study used the volume of gross sales in Tsh per annum to measure the SME's growth. The study findings demonstrated that MFIs has positive impact on SMEs growth in the study area, since the variable amount of loan to the client presenting microfinance accessibility to SME has positive relation with volume of gross sales in Tsh per annum. Its coefficient was 0.304 and its p-value 0.002 sig two sided tail which is statistically significant at 5% level of significance.

The research findings are in conformity with the reviewed literature under chapter two whereby studies done in other parts of the world including developed, and Least Developing Countries (LDCs) indicated that; access to loan, start-up capital, number of employees and experience of SME in years has positive influence to their growth. The contribution of SMEs to economic growth and creation of employment is very evident worldwide.

### 5.3. Policy Implications

The main policy implication of the study is that the government of Tanzania should try hard to meet the credit needs of the SMEs in the country for an immediate economic growth of the nation. This the government may achieve through the following ways:

i. Easy accessibility to credit through specialized or development oriented banking or financial institutions should be encouraged. This fund should be made available to the SMEs at reduced interest rate.

ii. Establishment of a well funded National Credit Guarantee fund that will assist for micro-loan facilities from the banks and other financial institutions. This will help reduce the excessive demand for collateral security.

### 5.4. Area for Further Studies

i. Many scholars concentrated their studies on micro credit impact on abled individuals and fewer studies have been directed to analyze on the same aspect to the disabled individuals.

ii. An analytical and detailed study is required to determine the real causes for the failure of many entrepreneurs in Tanzania, despite the legal regulatory and policy reforms that are being undertaken since 1980s.

iii. The study to investigate the contribution of cultural and gender aspects to SME growth. The study should attempt to establish linkage with enterprise growth with culture and gender of the entrepreneur.

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# APPENDICES

## Appendix I: Questionnaire Respondents

Dear respondents,

I am sending this questionnaire to you in order that I may request for your collaboration in my academic research project through answering to questions herein. The purpose is to collect data on "**Research Proposal on the Impact of microfinance on the SME's Growth in Morogoro Municipality.**" Any information you provide in this sheet is for academic purposes and will be treated just between you and me.

Thanks in advance.

---

**A. Personal particulars**

1. Age: [ ] Years

2. Gender (*Please indicate by check mark*)

a. Male[ ], b. Female [ ]

3. Highest Level of education (i) Informal Education (ii) Primary school (iii) Secondary school (iv) University (v) others …( )

4. Where did you get your initial capital for starting business? Please specify……

5. Where do you get the money to run your business?

| **MFI** | **Amount of loan –Tsh per year** | | | **Total amount – Tsh** |
|---|---|---|---|---|
| | 2011 | 2010 | 2009 | |
| FINCA | | | | |
| BRAC | | | | |

6. When did you start business? (Please specify a year).....

7. What forms of business do you do? (Please specify).....

8. How much was your start-up capital?.....

9. What is your production yield/revenue earned?

| **Before loan facilities** | | | **After loan facilities** | | |
|---|---|---|---|---|---|
| Little | Moderate | High | Little | Moderate | High |
| | | | | | |

10. Before getting loan facilities how much were getting as your average net profit?.....

11. After getting loan facility how much are you now getting as your average net profit?.....

12. Please state your gross sales volume per month at present …… Tshs.

13. How many employees do you have? Before loan facility [ ], at present [ ]