IMPACT OF MICROFINANCE INSTITUTIONS IN DEVELOPMENT OF TEXTILE INDUSTRIES IN TANZANIA: THE CASE OF PRIDE TANZANIA

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A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION OF THE OPEN UNIVERSITY OF TANZANIA

2013

CERTIFICATION

The undersigned certify that they have read and hereby recommend for acceptance a dissertation entitled: ***Impact of Microfinance Institutions in Development of Textile Industries in Tanzania: The Case of PRIDE Tanzania*** in a partial fulfilment of the requirements for the degree of Master of Business Administration

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Dr. G.S. Mwaluko

(Supervisor)

Date: ………………………………..

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DECLARATION

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

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Date: ………………………………….

DEDICATION

To my family; my beloved husband Gerald Manongi and my children, the boys; Herald and Harold, and their precious sister Harmony, who have motivated me to undertake this study.

To my parents who have supported my education throughout to this level and my colleagues and friends for their remarkable encouragement and care during the entire period of my study.

ACKNOWLEDGEMENTS

I express my sincere surrender and honour to Almighty God for granting me the opportunity and strength to go through this work up to the completion.

I would like to acknowledge the dedication and perseverance of Dr. G. S. Mwaluko in supervising the entire work that has been archived in this dissertation, which included his constructive criticism while going through my draft manuscripts.

I also wish to express my sincere gratitude to all respondents who agreed to talk to me and filled the questionnaires honestly as I delivered to them; these include PRIDE Tanzania staff who provided me with insightful information.

Furthermore, I would like to convey my sincere thanks to all my fellow MBA students at The Open University of Tanzania, Dar es Salaam Campus, for being cooperative and also helpful to me whenever I was in need.

Finally, I am grateful to God and my family for their unceasing intercessory prayers throughout my academic career. May God the Almighty bless them abundantly.

ABSTRACT

The main objective of this study was to assess the role of financial institutions in the development of Small and Medium Enterprises (SMEs) in the garment sector and propose strategies for enhancing accessibility of micro financing to SMEs in the textile industry. The target population for the study consisted the garment sector SMEs particularly women in the Batik business within the study area. The sampling procedure utilised was the purposive sampling based on one stage where respondents were chosen through a random sampling technique. The sample comprised of 85 SMEs in the garment sector and Managers from PRIDE Tanzania. Qualitative and quantitative primary data were obtained through questionnaires and interviews. Quantitative data analysis used descriptive statistical procedures using frequency distribution. Secondary information was also used as received from various microfinance internet-based databases and available literature sources. Findings depict that the MFI plays a major role in development of SMEs in the Textile Industry with notable accessibility by the youth and women entrepreneurs. Also the researcher concludes that, PRIDE is generally fair when providing funding, however the interest rates charged by the institution was found to be a deterrent to potential SME clients and a significant factor in credit repayment defaults by subscribing low-income earners and micro-business owners in the garment sub-industry. In view of the observation made during the study, the researcher recommends that PRIDE TANZANIA should review its interest rate policy and propose for more affordable and sustainable rates for small scale business owners.

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LIST OF ABBREVIATION AND ACRONYMS

ADAT	Artisans Development Agency of Tanzania
AGOA	African Growth and Opportunity Act
BEST	Business Environment Strengthening in Tanzania
DANIDA	Danish International Development Agency
DSM	Dar es Salaam
GDP	Gross Domestic Product
ILO	International Labour Organisation
IMF	International Monetary Fund
MF	Microfinance
MFI	Microfinance Institution
MSE	Micro and Small Enterprise
MSF	Micro and Small Farm
MSME	Micro, Small, and Medium Enterprise
MIT	Ministry of Trade and Industry
NGO	Non-Governmental Organisation
PRIDE	Promotion of Rural Initiative and Development
PRIDE TANZANIA	(Tanzania) Enterprise Limited
PTF	Presidential Trust Fund
RPED	Rural Programme on Enterprise Development
SADC	Southern African Development Community
SAP	Structural Adjustment Program
SELF	Small Enterprise Loan Facility
SHG	Self-Help Group

SIDA	Swedish International Development Agency
SIDO	Small Industries Development Organization
SME	Small and Medium Enterprise
SMEDP	Small and Medium Enterprises Development Policy
TAMFI	Tanzania Association of Micro-Finance Institutions
TCB	Tanzania Cotton Board
TCLSB	Tanzania Cotton Lint and Seed Board
TCMB	Tanzania Cotton Marketing Board
TZS	Tanzania Shilling
TIB	Tanzania Investment Bank
UDEC	University of Dar es Salaam Entrepreneurship Centre
UN	United Nations
UNIDO	United Nations Industrial Development Organisation
UNDP	United Nations Development Programme
UNCDF	United Nations Capital Development Fund
URT	United Republic of Tanzania
USAID	United States of America International Aid Agency
USD	United States Dollar
SACCOS	Savings and Credit Cooperative Organisation Society
SPSS	Statistical Package for Social Sciences
ROSCA	Rotating Savings Cooperative Association
VICOBA	Village Community Bank
MDG	Millennium Development Goal
WTO	World Trade Organization

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background

Microfinance is generally regarded as a form of financing that can contribute to alleviate poverty in developing and emerging countries. Fundamentally, microfinance programs provide opportunities for poor entrepreneurs, who are generally excluded from the formal banking sector, to establish themselves and expand their businesses through provision of small unsecured minor scale loans, which may be cross-collateralised or completely non-collateralised (McGuire and Conroy, 1999).

However, microfinance is not a new concept. It can be traced back to the 19th century when money lenders were informally performing the role of now formal financial institutions. The informal financial institutions constitute: village banks, cooperative credit unions, state-owned banks, and social venture capital funds to help the poor. These institutions are those that provide savings and credit services for small and medium-size enterprises (SMEs). They mobilise rural savings and have simple and straight forward procedures that originate from local cultures and are easily understood by the local communities (Germidis et al., 1991).

The creation of SMEs generates employment but these enterprises are short-lived and consequently are bound to die after a short while causing those who gained job positions to lose them and even become poorer than they were previously. It is not until recent that microfinance has gained recognition thanks to the Nobel Prize winner Yunus Muhammad of the Grameen Bank. It should be noted that microfinance is not a panacea but a main tool that can foster economic growth in developing countries. It is known worldwide that the poor cannot easily borrow from the banks. Banks do not lend to them because they do not have what is required to be granted loans or be provided with appropriate bank services.

The lack of financial power is a contributing factor to most of societal problems. These problems emanate from poverty and it is known that with poverty one is bound to suffer so many consequences ranging from lack of good health care system, education, and poor nutrition. Microfinance has proved this commercial banking concept wrong. They target the poor, who are considered risky by conventional commercial banks. Indeed, the repayment rate in microfinance institutions has been demonstrated to be rather positive (Zeller and Sharma, 1998).

Researchers have viewed microfinance in different dimensions. Microfinance gives people new opportunities by helping them secure finances that cannot easily be accessed through conventional financing arrangements such as loan facilities from commercial banks. It broadens the horizons and thus plays both economic and social roles by improving the living conditions of the people. In a nutshell, these improvements contribute to alleviation of poverty as can mostly be appreciated in overall development of SMEs in the informal sector.

The UN Millennium Development Goal (MDG) to alleviate poverty by the year 2015 is far-fetched from being achieved despite the enormous works that microfinance institutions are doing to contribute in this domain (Hiderink and Kok, 2009). The main challenge facing the poor is to gain financial power to enable them boost their income generating activities (Hiderink and Kok, 2009).

Since independence, the Government of Tanzania has embarked on several attempts aimed at reducing poverty in the country. In spite of all these attempts, much is still needed to tackle this problem, which is considered very vital in the economic life wire of the state. A recent development has been the increasing involvement of NGOs and the microfinance institutions in the process of enhancing the development of SMEs particularly to informal sector. The question now is; why microfinance at this point in time? This was as a result of complaints that were coming up from informal sector that they have a great contribution to poverty alleviation if they are properly considered.

Among the difficulties or complaints faced by informal sector was the issue that most of them often save their money by hiding in some parts of the house, not recognized by banks, fear to transact with banks etc. How then are these microfinance institutions of significance to the sustainable development of the country? Further still, why are informal sector not in large scale to increase their wealth and improve on their living standard? It was important to look at this because even though the government promotes SMEs in both urban and rural areas through different institutions, microfinance institutions are not leaving any stone unturned to make sure that the acute poverty striking the population is redressed.

1.2 Economic Overview of Tanzania

With a population of about 40 million, Tanzania had in 2010 a Gross Domestic Product (GDP) of USD 23, 120.346.7 million and GDP per capita of USD 574. GDP growth averaged 7.1% between 2001 and 2008. It declined to 6% in 2009 due to the global economic slowdown but was expected to exceed 7% in 2010. With about 58% of the population living below the one-dollar-a-day international poverty line and 90% below the two-dollars-a-day threshold, Tanzania remains one of the low-income developing countries (Tanzania Paris Survey, 2010). Eighty percent of the country's poor population lives in rural areas, depending on subsistence agriculture and unable to participate in broader markets. Poor roads, exorbitantly expensive utilities and prohibitive policies have compounded this problem, significantly impeding the growth of the economy. Agriculture, the mainstay of the economy, is almost 50 percent of GDP, and small-scale peasant farmers, who make up 70 percent of the population, carry out over 80 percent of agricultural activities. About 30 percent of the population over 15 years of age is illiterate (UDEC, 2002).

Economic growth has been between five and six percent during 2001 and 2002, most of it has been due to capital intensity (e.g., productivity improvements in mining) and has not resulted in employment creation. While the majority of Tanzania's formal economic activities take place in major cities, in most districts most private sector activities are micro-level informal activities involving the local peasant population. An estimated 700,000 Tanzanians enter the labour force every year and only 40,000 or so can expect to find paid employment – the remainder will have to turn to some form of self-employment if they are to generate a livelihood. Thus, the micro and small business sector is seen as very important in the next stage of the country's economic growth. The SME sector contributes 30 percent of GDP and is responsible for more than 50 percent of private sector job creation.

1.3 The Private Sector in Tanzania

At this point in Tanzania's history, the culture of entrepreneurship is in need of revitalization. During the years of colonial rule in the country, the development of indigenous entrepreneurship was hampered. Tanzanians of African origin were mainly employed as labourers in cash crop farming, with limited access to business. After independence in 1961, enterprises remained under the control of expatriates and immigrant entrepreneurs, mainly of Asian origin. The Declaration of Arusha in 1967 served as a landmark in the history of Tanzania. It set out a policy focusing on socialism, self-reliance and rural development.

The result of this declaration was the across-the-board nationalization of industrial activities and a substantial increase in direct state ownership and intervention of the economy. However, the "Africanization" of the economy did not take place through the transfer of ownership to the indigenous entrepreneurial class. Within the framework of socialism and self-reliance, which was linked to a strategy of import substitution, the government opted for the development of large-scale, monopolistic, mostly state-owned enterprises. At the time, leaders were of the view that rapid development was only possible if key enterprises were owned by nationals (the indigenous business class being too small to take on this mission).

The government took control of the production of many goods, import and export marketing tasks, the allocation of resources and foreign exchange, and the determination of prices. These control mechanisms were used to stimulate the development of the public sector; the policy environment was strongly biased against small private enterprises. This economic adjustment programme had both positive and negative impacts on small enterprises, depending on their characteristics, but tended to dramatically suppress “entrepreneurial impetus”. In fact, during the socialist era of 1967-1976, a campaign was launched to discourage private entrepreneurship, projected in the popular press and among politicians as evil and something to be tolerated only during the transition to full socialism (Olomi and Nchimbi, 2002).

By the end of the 1970s, the stimulation of large-scale state enterprises, capital and import intensive, was proving ineffective due to the lack of technology and management know-how. Due to the extent of the economic crisis of the 1970s and early 1980s, and pressure from the World Bank and IMF, the government was forced to change its economic policies from 1986.

The government adopted the Economic Recovery Programme, designed to put an end to the economic deterioration and to transform the state-led economy into a market-driven economy. Final reforms took place in 1991, and the regulatory environment partially adjusted accordingly. Due to privatization activity and the retrenchment of workers from public institutions, coupled with the state of the economy, many people were driven into micro-enterprises in order to make ends meet.

These “first generation entrepreneurs” found – and in many cases still find – themselves operating in an underdeveloped “enterprise culture”. Development partners are now clearly focused on working with the government to strengthen the Tanzanian economy. Several new policies have been put into place over the past three years, including the National Micro Finance Policy (2000), the Strategic Trade

Policy (2002), the Business Environment Strengthening in Tanzania (BEST) Programme (2001), the Poverty Reduction Strategy Paper (2001), an Agricultural Sector Development Strategy (2000), a Rural Development Strategy, and a Sustainable Industrial Development Policy (1996-2020). To these can be added the National SME Development Policy (2003) and the National Trade Policy (2003). In addition, several donors are implementing major development strategies – the UNIDO Integrated Country Programme (2002-2005), USAID Private Enterprise Support Activities (2002), DANIDA Business Sector Programme Support (2003-2008), and the UNDP Private Sector Development Programme.

In 2003, the government took the lead on such a growth strategy and is working on a number of key issues:

i) strategy for pro-poor economic growth;
ii) implementation framework for strengthening the business environment (BEST Programme);
iii) revision of local revenue systems;
iv) clarification of the Lands Act in order to secure the use of land as collateral;
v) improved access to essential agriculture and rural financial services;
vi) improved international trade arrangements for Tanzania.

In February 2003, the government approved a new Small and Medium Enterprise Development Policy (SMEDP) and is in the process of designing its implementation framework.

1.4 Perspectives on the Textile Industry in Tanzania

Cotton production and related downstream manufacturing industry plays a crucial role in Tanzania's economy. Nearly 500,000 Tanzanian smallholder farmers are involved in the production of cotton1, and it is estimated that the crop contributes to the livelihoods of up to 40% of the population, or 16 million people. Yields, at 562 kg per hectare, are very low by international standards and the seed cotton bought by the ginners is often of poor quality and/or badly contaminated. As with most countries in Africa, the bulk of Tanzania's cotton production (in excess of 70%) is exported as lint; a key concern of the government at present. Indeed, textile and garment manufacturing is one of the key sectors outlined in the national government's Integrated Industrial Development Strategy; testament to its status as a highly labour-intensive industry, which can incorporate value added yields of between 500% and 600% in its value chain. Tanzania's textile and garment sector wasn't always characterised by such challenges. Prior to the reforms of the 1990s, the sector was thriving, but faced with the withdrawal of government support, removal of trade barriers and the full rigours of international competition, it soon collapsed (MIT, 2010).

Manufacturing plants were sold off by the government to private investors, who have rebuilt the industry since the early 2000s. Much of the equipment bought at this stage was antiquated and inefficient, making it difficult for these companies to be internationally competitive; a major constraint they now face. Indeed, where companies have upgraded or replaced their equipment, it has inevitably been second- or third-hand, and for the most part globally uncompetitive; leaving the industry under great pressure and at considerable risk. The majority of the mills in Tanzania are involved in the production of Kitenge and Kanga cloth, which is sold to wholesalers on the local market (Salm et al., 2011).

The cloth is then sold on by wholesalers to outlets and traders, who distribute the products throughout the region, with Mozambique, Malawi, Rwanda, Burundi and Uganda all being important markets. The production of mosquito nets in Tanzania has also been an enormous success, in that the nets are now exported throughout Africa. That said, there is concern that some countries, including Tanzania, are approaching saturation point with regard to the distribution of these nets, and so the development of additional products using similar production technology is being contemplated by factory management (Salm et al., 2011).

Tanzania's garment industry is currently very limited in terms of size and products offered. Most of the industry is oriented towards export markets, and principally shipped to the US, taking advantage of the trade preferences offered by African Growth and Opportunity Act (AGOA). There is currently a small local and regional market for Tanzania's garments, which is limited to promotional clothing and caps. Given the massive quantities of cotton lint produced locally, the ready availability of cheap labour throughout the country, and the current trade preferences the country enjoys, at first glance there would appear to be enormous potential to grow the textile and garment industry in Tanzania. On further analysis, however, there are significant restraints on the sustainability and development of the industry that, if not adequately addressed, will stifle growth and place the entire value chain at risk (Salm et al., 2011).

1.5 The Research Problem and its Setting

Since its formal adoption in many developing nations in recent times, microfinance (MF) is being applied in poverty eradication strategies (UNCDF, 2005). It has been used to provide low-income people with small grants, microcredit and other services. Microfinance service providers and policy makers alike regard it as an impetus to enhance productivity in the informal sector and private sectors, especially in the development of SMEs in poverty-stricken populations across the world. In particular, MF is regarded as an important mechanism in achieving the Millennium Development Goals that were set to reduce extreme poverty in the world in the second decade of the twenty-first century (UNCDF, 2005). Various dynamics are at play in the interface between microfinance service provision and targeted beneficiaries. To this end, targeted research, evaluation and monitoring are requisites towards a consolidated understanding of any impact this mode of financing has to the general society in the developing countries.

Tanzania is amongst the low-income countries implementing various strategies to graduate to a middle-income country in the foreseeable future. The country has valuable natural resources with potential development in many of its economic sectors. In particular, MSMEs are crucial in harnessing the resource base, which includes natural fibres such as cotton. It is estimated that 70 percent of the cotton produced in Tanzania is exported in raw form as lint (Integrated Industrial Policy 2025, MIT, 2010). This statistic is indicative that 30 percent of cotton produced in Tanzania finds its way in the local textile and garment sectors. Thus, development of the textile industrial sector, with increased capacity for value addition of locallysourced raw materials, is important to transform Tanzania’s economy. Moreover, the importation of textile and apparel products for consumption in Tanzania is widespread as a result of free-trade and multilateral treaties in which Tanzania is an active participant; a reality of the globalization phenomenon. This means that there are substantial trading activities of locally-produced as well as imported textile and garment related materials, from formal sector wholesalers to retailers in the informal sector.

At the heart of this mixed value chain are the micro and small entrepreneurs, particularly in urban areas. To this end, various critical questions from the socio-economic perspective arise. Do the various small businesses involved in the textile and garment sector in Tanzania have access to sound financing to run sustainable businesses? In respect of efforts to eliminate poverty-income and general improvement in livelihoods, what kind of impact is experienced by the SMEs involved in the entire value chain of the textile and garment industry?

The private sector as a whole in Tanzania is still very young when benchmarked globally. For many years since independence in 1960s the economy was state-controlled and the textile industry in particular was state-owned and run by parastatal corporations. The transformation to a fully-fledged liberalised economy began in late 1980s and various reforms were implemented in the late 1990s where privatisation of state-owned firms proceeded at significant rate. Liberalisation of the financial and banking subsectors also took place during the 1990s. Proliferation of the micro, small, and medium entrepreneurs also occurred as the state-ownership and control of the economy progressively faded.

Due to the decline of the public sector, the role of MSMEs in promoting economic growth and development, offering alternative employment and reducing income disparities has been generally recognised. In Tanzania, Micro and Small Enterprises contribute 12% and 34% of rural and urban employment respectively as well as up to 32% of the GDP (Kessy and Urio, 2006). Economic and business dynamics at play during economic transformation are still not fully understood and naturally subjected to various targeted researches to grasp what is working and what needs adjustment in the entire spectrum of the Tanzania's economy.

A critical issue in any enterprise development is access to finance. To contribute to the knowledge-base of the MSME development in the textile and garment subsector in Tanzania, this study embarked on researching underlying issues small firms in the sector are facing in business development, from start-up to expansion. Particular attention was given to the issue of financing through the sprawling framework of microfinance. A case study approach was adopted and one of the major microfinance institutions in Tanzania, Promotion of Rural Initiative and Development Enterprises Limited (PRIDE Tanzania), which plays an active role in the microfinance arena for many years in Tanzania, was chosen for the study.

PRIDE's inception of operations in Tanzania in the 1990s coincided with the economic structural adjustment programmes; hence, its selection for the case study was biased in that regard. Thus, using PRIDE and its client base for this research many unclear issues of existing administrative practices, business environment experience by the targeted beneficiaries, and existing regulatory framework as a whole, in relation to the desired outcomes of microfinance initiative, could be probed in a meaningful way. Moreover, the study focused on small and medium traders in the sprawling textile and garment industry where there is interplay between on-going efforts by the Government of Tanzania to implement liberal policies and overall enhancement of the local productive capacity in the industry (MIT, 2010).

Conceivably, many aspects are at play in the entire process of microfinancing small firms and the impact produced at the end of the spectrum where the funds are utilised by the firms in either establishing new business ventures or expansion of existing businesses. Such aspects require targeted research in various sub-industries where microfinance services are provided. This particular research was guided by the following general questions:

i. What kind of socio-economic factors exist in small and medium scale business operations in the textile and garment industry in urban Tanzania?
ii. Do SMEs in the textile and garment industry have reasonable access to reasonable financial resources needed for sustainable business development?
iii. Do microfinance institutions provide impact-oriented funding to develop small businesses in Tanzania in an acceptable way and on reasonable terms?
iv. What challenges are SMEs facing with regards to access and utilization of funds from microfinance institutions?
v. What should be done to improve microfinance service delivery?

1.6 Research Objectives

The research study was set to investigate the problems and opportunities that small businesses in garment sub-industry face in their development efforts, with a particular interest in the role of micro-finance institutions in the industry. In addition to gaining a more general understanding of the challenges facing development of small garment firms, the study was also aimed to identify how microfinance institutions are contributing to the development of small businesses and why such businesses succeed or fail in their efforts to acquire financing for their development. Furthermore, the study focused on the resource needs of developing small and medium size firms, and how microfinance in general contribute to these firms' development the overall sustainable development of small and medium level entrepreneurship.

1.6.1General Objective

The study aims at assessing the extent to which microfinance institutions contribute in the development of small and medium businesses in the textile and garment sector in urban areas and whether implementation of existing policies and strategic framework of the microfinance service providers impacts entrepreneurship in the textile and garment sub-industry.

1.6.2 Specific Objectives

The research centred on the following key aspects:

i. To assess services (particularly conditions and procedures for credit) as offered by the microfinance institution PRIDE Tanzania in relation to business development by small and medium-sized textile enterprises in urban Tanzania.

ii. To evaluate performance of small and medium traders in the textile and garment sector in urban Tanzania in terms of growth, employment creation, income levels, and overall socio-economic impact after reception of microfinancing incentives.

iii. To establish recommendations on policy adjustments and strategic alignments for optimization of microfinance service delivery to small and medium entrepreneurs.

1.7 Justification of the Research Study

In trying to justify why this study was important, it was vital to mention that researchers had found this area of study very important to the development of the socio-economic activities in developing countries and their contributions to the development of small and medium size businesses in Tanzania in textile with particular focus on batik subsector. Extensive research has been carried out on the role of the financial management aspects. This research focused on PRIDE TANZANIA, an MFI which has not been exploited much in terms of its contributions to the development of small and medium size businesses and particularly in the textile industry. A study of this nature was equally very important because it aimed to enlighten policy makers and the public in general on the role PRIDE is playing in the SMEs sector since it is in partnership with some international NGOs and with the government.

Microfinance as a whole provides the population especially informal sector a means to have access to financial services in their localities to boost their living standards in a sustainable manner in line with the millennium development goals of alleviating poverty in developing countries. They can contribute in the fight against poverty by improving the informal sector which is the main source of living to the inhabitants of such developing nations. Thus it will pave a way forward for potential NGOs wishing to help in the sustainable development of SMEs to understand the difficulties they may come across and how they can succeed in their endeavours to push the development agenda.

1.8 Scope and Delimitation of the Research

PRIDE has branches scattered in the entire geographical landscape of Tanzania with its main objective of providing financial services to the poor which cannot be done by formal financial institutions (banks) and as such helping in poverty alleviation and alleviating poverty. To cover all the regions in the entire country was not possible because of the limited time frame for data collection required for this level of research study programme. The research was limited to a survey of batik textile SMEs in the City of Dar es Salaam. The impact of microfinance to the development of SMEs in this area has been analyzed, looking at its contributions, and in what form, and of course the response of entrepreneurs to the contributions of MFIs to them, with specific focus on PRIDE Tanzania.

CHAPTER TWO

2.0 LITERATURE REVIEW AND THEORETICAL PERSPECTIVES

2.1 Introduction

This chapter documents aspects and concepts related to microfinance and development of SMEs as analysed from secondary sources through reviews of relevant literature. The aspects and concepts chosen are those that were found to be closely linked with the focus of this research. The role played by microfinance in the development of SMEs is reviewed. Moreover, SME involvement in the textile industry, in particular, is also outlined. The status of microfinance industry is also reviewed with particular focus on microfinance institutions in Tanzania.

The chapter opens with an overview of microfinance. This shows the various products and services that MFIs have and explain how they are of importance to the development of SMEs, and also the extent to which transaction costs affects the delivery of these products and services. The next centre of attention is SME growth and development providing an idea on how firms are considered by financial institutions before they are presented with financing services. Since the type of microfinance is of significant importance in getting such services, the chapter further reviews factors that determine the capital structure of a business. The latter will explain why some firms prefer to borrow over equity capital. The next concern is to investigate how some firms face problems to access loans. Furthermore, the existing framework of MFIs in Tanzania is presented and illustration and in-depth analysis of the MF triangle is presented. Lastly, we delve to show some theoretical links between microfinance and SME development in Tanzania.

2.2 The Concept of Microfinance

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses; it is mostly used in developing economies by SMEs who do not have access to conventional sources of financial assistance (Robinson, 1998). Microfinance services are provided by three types of sources:

i) Formal institutions such as rural banks and co-operatives;

ii) Semi-formal institutions such as non-governmental organisations; and

iii) Informal sources such as money lenders and shopkeepers.

In addition to financial intermediation, some MFIs provide social intermediation services such as formation of group membership, development of self confidence and provision of training services on financial literacy and business management (Ledgerwood, 1999). There are different providers of microfinance (MF) services and some of them are; nongovernmental organisations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non bank financial institutions. The target group of MFIs are self-employed low-income entrepreneurs who are typically traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisan blacksmith, etc (Ledgerwood, 1999).

2.3 Microfinance Products and Services for Development of SMEs

According to Bennett (1994) and Ledgerwood (1999) MFIs can offer their clients who are mostly the men and women who could be below or slightly above the poverty line a variety of products and services. The most prominent of their services is financing, that they often render to their clients without tangible assets and these clients mostly live in rural areas, a majority of whom are illiterate or have only accessed some form of basic education.

Formal financial institutions do not often provide these services to small informal businesses run by the poor as profitable investments. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral (farms) due to distance. It is because of this that the cost to lend a dollar will be very high and also there is no tangible security for the loan.

The high lending cost is explained by the ‘transaction cost theory’. The transaction cost can be conceptualized as a non financial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan. The cost incurred by the lender include; cost of searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinising loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts.

On the other hand, the borrowers may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings, etc (Bhatt and Shui-Yan, 1998). The parties involved in a project will determine the transaction cost rate. They have the sole responsibility to reduce the risk they may come across (Stiglitz, 1990).

Microfinance triangle comprise of financial sustainability, outreach to the poor, and institutional impact. There are costs to be incurred when reaching out to the poor and most especially with small loans (Christabell, 2009). The financial institutions always try to keep this cost as minimum as possible and when the poor are in a dispersed and vast geographical area, the cost of outreach increases. The provision of financial services to the poor is expensive and to make the financial institutions sustainable requires patience and attention to avoid excessive cost and risks (Adam and Von Piscke, 1992).

The deliveries of MF products and services have transaction cost consequences in order to have greater outreach. Some microfinance institutions visit their clients instead of them to come to the institution thereby reducing the cost that clients may suffer from (FAO, 2005). For MFIs to be sustainable, it is important for them to have break-even interest rates. This interest rates need to be much higher so that the financial institution‟s revenue can cover the total expenditure (Hulme and Mosley, 1996). The break-even rate which is higher than the market rate is defined as the difference between the cost of supply and the cost of demand of the products and services. The loan interest rates are often subsidised (Robinson, 2003).

The loans demanded by smaller enterprises are smaller than those requested by larger onse but the interest rates remain the same. This indicates that, per unit cost is high for MFIs targeting customers with very small loans and possessing small savings accounts (Robinson, 2003). Even though the interest rate is high for applicants requesting very small loans, they are able to repay and even seek repeatedly for new loans. The social benefits that are gained by clients of MFIs superceeds the high interest charged (Rosenberg, 1996). The high interst rate is also as a means to tackle the problem of adverse selection where a chioce is made between risky and non risky projects. The good clients suffer at the expense of the bad ones (Graham Bannok and partners, 1997). Microfinance clients admit that convenience is more important to them than return (Schmidt and Zeitinger, 1994).

Low-income men and women have a serious hindrance in gaining access to finance from formal financial institutions. Ordinary financial intermediation is not more often than not enough to help them participate, and therefore MFIs have to adopt tools to bridge the gaps created by poverty, gender, illiteracy and remoteness. The clients also need to be trained so as to have the skills for specific production and business management as well as better access to markets so as to make profitable use of the financial resource they receive (Bennett, 1994).

In providing effective financial services to the poor requires social intermediation. This is “the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals” (Bennett, 1997). Some microfinance institutions provide services such as skills training, marketing, bookkeeping, and production to develop enterprises. Social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly (Legerwood, 1999).

2.3.1 Microfinance Services

According to Bennett (1997) and Legerwwod (1999), the services provided to microfinance clients can be categorized into four broad different categories:

i) Financial intermediation or the provision of financial products and services such as savings, credit, insurance, credit cards, and payment systems should not require ongoing subsidies.

ii) Social intermediation is the process of building human and social capital needed by sustainable financial intermediation for the poor. Subsidies should be eliminated but social intermediation may require subsidies for a longer period than financial intermediation.

iii) Enterprise development services or non financial services that assist micro entrepreneurs include skills development, business training, marketing and technology services, and subsector analysis. This may or may not require subsidies and this depends on the ability and willingness of the clients to pay for these services.

iv) Social services or non financial services that focus on advancing the welfare of micro entrepreneurs and this include education, health, nutrition, and literacy training. These social services are like to require ongoing subsidies and are always provided by donor supporting NGOs or the state.

2.4 Growth and Development of SMEs

The purpose or goal of any firm is to make profit and growth. A firm is defined as an administrative organisation whose legal entity or framework may expand in time with the collection of either physical and tangible resources or resources that are of human nature (Penrose, 1995). The term growth in this context can be defined as an increase in size, or other parameters that can be quantified, or a process of change or improvement (Penrose, 1995). The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state (Penrose, 1995). The growth of a firm can be determined by supply of capital, labour and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of resources to the firm (Ghoshal, Halm and Moran, 2002).

Enterprise development services - also referred as business development services or nonfinancial services - are provided by some MFIs adopting the integrated approach. The services provided by nonfinancial MFI services are; marketing and technology services, business training, production training and subsector analysis and interventions (Ledgerwood, 1999). Enterprise development services can be sorted out into two categories. The first is enterprise formation which is the offering of training to persons to acquire skills in a specific sector such as weaving and as well as persons who want to start up their own business.

The second category of enterprise development service rendered to its clients is the enterprise transformation program which is the provision of technical assistance, training and technology in order to enable existing SMEs to advance in terms of production and marketing. Enterprise development services are not a prerequisite for obtaining financial services and they are not offered free of charge. These charges are subsidized by the government or an external party since to recover the full cost in providing the services will be impossible by the MFI. The enterprise development services may be very meaningful to businesses but the impact and knowledge that is gained cannot be measured since it does not usually involve any quantifiable commodity. It has been observed that there is little or no difference between enterprises that receive credit alone and those that receive both credit packages and integrated enterprise development services (Ledgerwood, 1999).

2.4.1 Minimal Equity Requirement

Firms rely mostly on informal sources of finance for start-up capital for their businesses since credit markets are limited. A majority of the start-up capital is from personal savings and borrowed money from friends and relatives. Minimal amount of funds as start-up is borrowed from the formal institutions such as banks. The granting of loans is much easier to large firms than small ones (Gary and Guy, 2003). MFIs consider clien’s ability to repay debt and assess the minimal sum small scale businesses can contribute as equity before offering a loan. This is to say a business should not be financed entirely with borrowed money. When a business is in the start-up phase, it requires at least a certain amount resources for the MFI to consider the application for a loan.

In a situation where the firm is unable to provide the said equity capital, some MFIs require household items to be pledge as a security before the loan can be granted.

These MFIs also apply some sort of financial and psychological measurements and when they consider that correct to any prospective borrower it is then that the loan can be granted. It is generally said that people care more on things that they have worked for or items that they own (Zeller, 2003). This and other reasons explain why MFIs deem it necessary for borrowers to have minimal equity contribution before applying for a loan. The source of the minimal equity capital is known by the MFIs because the client may be at high risk of non respecting the terms of repayment had it been the funds were borrowed from somewhere. This means that a business with little borrowed capital with good market standing will have an upper hand in getting financial assistance from the MFIs (Ledgerwood, 1999).

2.4.2 Market Size

The size of the microenterprise market is estimated by the MFIs to know if it can be benefited from financial services, in case self reported credit need be confused with the repayment capacity and effective demand. The market for MFIs takes into consideration the type of microenterprise being financed and the characteristics of the population group.

2.4.3 Characteristics of Microfinance Target Population

i) Female Clients

The main focus in many MFIs is to empower the women by increasing their financial power and position in the society so as to have equal opportunity as men (Moyoux, 2001). The poorest people in the society are known to be women and they also are responsible for the child up bringing including education, health, and nutrition. There are cultural barriers that exist between the women that make them to stay at home making them to have the constraint to have access to financial services. Some banks are unwilling to lend to the women because their access to property is limited and they also have fewer sources of collateral security. Based on experience, women generally are very responsible and are affected by social forces. When the income of a woman is increased, the effect is noticed throughout the household and to the community than when that same amount is increased to a man. They also have a high repayment loan and savings rate than their male counterparts (Ledgerwood, 1999). A study carried out by the World Bank on sustainable banking for the poor, with the title of the project "Worldwide Inventory of Microfinance Institutions", found that female programs are group-based with the characteristic of having small loan size and short loan term (Paxton, 1996).

ii) The level of poverty

Poverty alleviation is the focal point of microfinance institutions and the poorest form a majority of the population. The outreach of MF services to the poor is measured in terms of scale, the number of clients that is reached and the depth of the clients they reach (Ledgerwood, 1999). Institutions that are contributing in the fight against poverty are very effective in the improvement of the welfare of those under and those just above the poverty line (Hulme and Mosley, 1996).

iii) Geographic focus

MFIs serve both urban and rural areas but their focus is more in the rural areas. Products and services offered by the MFIs are aimed towards meeting the expectations of the target location or area. Those in the rural areas are different from those in the urban areas and the infrastructural development in these areas also matters. Markets are very important for microenterprises irrespective of the area where the firm is located. The difficulty to produce and distribute or deliver the goods because of lack of infrastructure will hinder or retard the growth of businesses thus limiting the financial services that will be demanded. An example of a reduce transaction cost will be the availability of good road network. Grameen Banks is a typical MFI that is successful and it has branches in the same geographical areas where their clients live (Ledgerwood, 1999).

2.5 Types of Microenterprises

The type of population to be serve and the activities that the target market is active in and also the level or stage in development of the business to be financed is determined by the MFIs. SMEs differ in the level in which they are and the products and services offered to them by the MFIs are towards meeting the demands of the market. SMEs are financed differently and the financing is determined by whether the firm is in the start-up phase or existing one and also whether it is stable, unstable, or growing. The type of activities that the business is involve in is also determined and this can be; production, commercial or services activities (Ledgerwood, 1999).

2.5.1 Existing or Start-up Microenterprises

In identifying the market, MFIs consider whether to focus on already existing entrepreneurs or on potential entrepreneurs seeking for funds to start up a business venture. Working capital is the main hindrance in the development of already existing SMEs and to meet up, the borrow finance mostly from informal financial services such as; families, friends, suppliers or moneylenders. The finances got from these informal financial services have high interest rates and services offered by the formal sector or not offered by these informal financial services.

MFIs see it less risky to work with existing microenterprises because they have a history of success (Ledgerwood, 1999). Businesses that are financed by MF from scratch consider that they will create an impact in society by alleviating poverty through utilisation of funds provided towards growth of their business, and in turn their net income, for use in their daily livelihoods. An integrated approach lays down the foundation for start-up businesses to grow since financial services alone will not help them. They need other services such as skills training to equip them with all the necessary tools that can hinder them from obtaining loans. Existing businesses with part of their capital being equity is preferred by most MFIs to work with as the level of involvement is high and consequently lower risk (Ledgerwood, 1999).

2.5.2 Level of Business Development

MFIs provide their products and services based on the level of development of the targeted businesses. SMEs can be grouped into three main levels of business development that profit from access to financial services.

i) Unstable survivors are groups that are considered not credit worthy for financial services to be provided in a sustainable way. Their enterprise are unstable and it is believe they will survive only for a limited time and when MFIs focus on time to revert the situation by providing them other extra services, it is noticed that costs increases and time is also wasted.

ii) Stable survivors are those who benefit in having access to the financial services provided by MFIs to meet up with their production and consumption needs. Stable survivors are mainly women who engage in some sort of business activities to provide basic needs such as food, child health, water, cooking for the household, etc. These types of microenterprises rarely grow due to low profit margins which inhibit them to reinvest and an unstable environment due to seasonal changes which makes them to consume rather than to invest in the business.

i) Growth enterprises are SMEs with high possibility to grow. MFIs focusing on these types of microenterprise are those that aim to create jobs, and to move micro entrepreneurs from an informal sector to a formal sector. MFIs prefer to provide products and services to meet the needs of this group since they are more reliable and posing them the least risk (Ledgerwood, 1999).

2.5.3 Financial Intermediation

MFIs have as main objective to provide financial intermediation which involves the transfer of capital or liquidity from those who have excess to those who are in need both at the same time. “Finance in the form of savings and credit arises to permit coordination. Savings and credit are made more efficient when intermediaries begin to transfer funds from firms and individuals that have accumulated funds and are willing to shed liquidity, to those that desire to acquire liquidity” (Von Pischke, 1991).

It is visually known that almost all MFIs provide credit services. Other MFIs also provide some financial products such as; savings, insurance, and payment services. Each MFI has its objectives and the choice of the financial service to provide depends on the demands of its target market and its institutional structure. Two important considerations when providing financial services are; to respond effectively to the demand and preference of clients and to design products that are simple and easy to understand by the clients and easily managed by the MFI. The common products that MFIs provide include; credit, savings, insurance, credit cards, and payment services. These points are briefly described and also show how financial services are provided to SMEs.

i) Credit

These are borrowed funds with specified terms for repayment. People borrow when there are insufficient accumulated savings to finance a business. They also take into consideration if the return on borrowed funds exceeds the interest rate charged on the loan and if it is advantageous to borrow rather than to postpone the business operations until when it is possible to accumulate sufficient savings, assuming the capacity to service the debt is certain (Waterfield and Duval, 1996). Loans are usually acquired for productivity reasons; that is to generate revenue within a business.

ii) Savings

Savings mobilisation in microfinance is a very controversial issue. They have been increase awareness among policy makers and practitioners on the vast number of informal savings schemes. MFIs such as credit union organisations around the world have been very successful in rallying clients to save (Paxton, 1996).

iii) Insurance

This is one of the services and products that are experimented by MFIs. Many group lending programs offer insurance or guarantee scheme as collateral and the Grameen bank is a typical example of MFI in this scheme. One percent of the loan is required to be presented by the group member as their contribution for the insurance for the loan (Ledgerwood, 1999).

iv) Credit cards

These are cards that allow borrowers to have access to a line of credit if and when they need it. This card is also use to make purchase assuming the supplier of the goods will accept the credit card or when there is a need for cash. The card is also called a debit card when the client is accessing his or her own savings (Ledgerwood, 1999).

v) Payment Services

Payment services include cheque cashing and cheque writing opportunities for clients who retain deposits (Caskey, 1994). In addition to cheque cashing and cheque writing privileges, payment services comprise the transfer and remittance of funds from one area to another (Ledgerwood, 1999).

2.6 Capital Structure of SMEs

SMEs have some important aspects that are considered when taking decisions on their financial structure. A firm's history is a more important factor in determining the capital structure than its characteristics. The cost of debt to equity is compared; the increase in risk and the cost of equity as debt increases is also compared before taking the decision. The advantage of debt by SMEs due to tax reduction is also considered. The costs of capital remain unchanged when there is a deduction in taxes and interest charges. This indicates that using cheaper debt will be favourable to the business than using equity capital due to increase risk (Modigliani and Miller, 1958 and 1963). Firms would seek a good portion of their capital structure as debt to a certain level so as to take these tax advantages. An over reliance on debt as capital by SMEs will have a negative effect in the business activity in that it will increase the probability of the firm to go bankrupt (Myers, 1984).

Myers (1977) determines the capital structure of SMEs. The pecking order theory (POT) was used to explain why firms will choose a particular capital structure than the other. The POT stipulates that SMEs average debt ratio will vary from industry to industry because these industries have varied asset risks, asset type and the requirements for external capital (Myers, 1984). Firms in one industry will have certain aspects that are common to most than to firms in a different industry (Harris and Raviv, 1991). The decisions are made taking into consideration information asymmetry, agency theory, and the signalling theory. The signaling theory describes signs and the effectiveness or how a venture will progress in an uncertain environment (Busenitz et al., 2005).

The main idea behind this theory is that there is an information signal that alerts the stakeholders of what is happening in the business (Deeds et al., 1997). The success of a business in the future is determined by the availability of information to the firm.

The stakeholders of a business require signals to find the way of the asymmetry of information between what is known and what is unknown (Janney and Folta, 2003). The outsiders get to know about a particular venture based on the signals it sends out. These signals need to be favourable because it is from it that potential investors will be informed and thus show the intention to invest in the venture. The cost of equity will be high when poor signals are noticed by outsiders and this will restrain potential investors (Busenitz et al., 2005). Firms get access to venture capital when they have a good goodwill (Prasad, Bruton and Vozikis, 2000). Good signals to the outsiders of a firm can be described as equal to due diligence with reduced time and input (Harvey and Lusch, 1995).

New businesses have problems in getting a favourable position in the market. Their existence is determined by their size and age. If it continues to exist, it means it is capable of maintaining its size or it is expanding. This of course goes with time and when they continue to exist, it means resources are acquired or unlimited (Freeman, 1982). This process of gaining stability and to survive makes the firm to gain legitimacy and thus can be trusted as a successful business since it emits positive signals (Singh, Tucker and House, 1986). Firms with unlimited resources at the infancy stage are easy to go bankrupt and die in this early stage (Aldrich and Auster, 1986). Firms that are young and small are incapable of getting the available resources for the proper functioning of its business activities and they are always associated with external organisations in a vertical manner for support (Stinchcomb, 1965). The integration of the young firm with a well established one gains ground for available resources such as funding and legitimacy (Singh et al., 1986).

Businesses employing this approach to gain legitimacy are at risk since they are not independent. The other activities will have an influence in the outcome of the other. Its competitors along with others get to know the inner dependent firm which the competitor will use it as its strength. They get to know the weaknesses of the opposing firm but at the same time they will enjoy the benefit of transaction cost. The reduction of costs is due to the fact that they integrate with others to realise their objectives. This is done by gaining the inside of the quality of work, production and ideas within its top level.

It is realised that there is no target equity mix and this is due to the fact that they exist two different kinds of equity. The two are at extremes meaning one at the top and the other at the bottom of the pecking order. These differences are caused by the costs of information asymmetry. External sources of funding have more moral hazard problems and consequently the demand for own or internal finances are of paramount to the firm (Myers, 1984). This moral hazard is explained by the fact that SMEs are very close entities; that is owned and or controlled by one person or few people (Watson and Wilson, 2002).

World Bank (2000) reiterates the fact that SMEs are more likely to be denied new loans for their businesses than larger firms when in need. They consider SMEs to lack the skills to manage risk and the high transaction costs in lending to them compared to the amount that is borrowed (Hallberg, 1994).SME lack managerial skills, resources and experience to motivate the potential investors to invest on them. They view them as high risk business concerns and some well to do SMEs may be hindered critical financing (Kanichiro and Lacktorin, 2000). SMEs and providers of debt and equity need to have a cordial relationship to avoid the problem of information asymmetry and conflicts of interests. All SMEs require financing to grow and the source may be internal or external.

The external sources constitute loans, equity infusions, subsidies, or government grants. The internal source is income generated from cash flows that are reinvested. Many SMEs are self –financing by friends and family members at the beginning stage of development but when it gets to a later stage in development, external financing become necessary. Banks find it hard to grant loans to SMEs until when they find it have a stable growth. More so they need to have a track record of their activities, sufficient collateral or adequate guarantees. Businesses that are viable and have good market positions during periods of recession will have difficulties in obtaining bank financing.

Credit availability to SMEs depends on the financial structures in place, legal systems, and the information environment. SMEs in countries with more effective legal system have less financing obstacles since the laws protect property rights and their enforcement are implemented to financial transactions (Beck et al., 2005).

2.7 Access to Capital for Development of SMEs

Formal financial institutions have failed to provide credit to the poor and most of whom are found in developing countries and to be more specific in the rural areas. The reason given by Von Pischke (1991) is that their policies are not meant to favour the poor. The poor are mostly illiterate and banks lack those skills to target these rural customers. In these areas, the population density is very low causing high transaction cost by the financial institutions since they need to move for long distances and also takes time to meet the customers (Devereux et al 1990).

SMEs in developing countries are considered to be too unstable by banks to invest in. Due to this instability, the banks consider SMEs to have high risk and the costs these banks suffer to monitor the activities of the SMEs are high. Hossain (1998), Bhattacharya, et al. (2000) and Sia (2003) identify that formal financial institutions (banks) are reluctant to lend to SMEs since investing in SME activities is considered by banks to be very risky. They find it risky in the sense that if invested in, and in an event of unfavourable business conditions, they have low financial power, assets, and easily go bankrupt (Sia, 2003). The cost of borrowing from banks is very high and this prevents SMEs to borrow from this institution but these costs to borrow are sometimes subsidised by the government (Meagher, 1998).

The application process for a loan is long and difficult for SMEs to meet up with the demands (Hossain, 1998). The collateral demanded by banks for a loan is based on fixed assets and which are very high in other to hinder these businesses to acquire loans. They cannot afford these collaterals which include; estates, and other fixed assets valued usually at 200% of the loan (Meagher, 1998). The major setback that prevents SMEs to get funding from external sources is the problem of information asymmetry. That is the magnitude of the deviation of the correct information that is needed by the lending institution (Bakker, Udell, and Klapper, 2004).

Banks use cash flows and profitability to measure or to assess the worthiness of a business. This is a very expensive and, not a good method to measure the credit strength of rural SME. Production and distribution in the rural areas is influenced by social factors that are often neglected by enterprises in developing countries (Otero et al 1994). Agriculture dominates rural activities in developing countries and is dependent on the weather conditions for its output. An enterprise in this sector is considered risky because its outcome is undetermined.

2.8 Organization of Microfinance Institutions

2.8.1 Cooperative Financial Institution

This is a financial institution that can be termed semiformal. It constitutes credit unions, savings and loan cooperatives and other financial cooperatives. They are generally identified as credit unions or savings and loan cooperatives and provide savings and credit services to its members. There are no external shareholders and run the same as a cooperative and implementing all its principles. Members who are at the same time customers make the policy of the cooperative. They are either elected or work on voluntary bases. They are not often subjected to banking regulations but have their own regulations and are under the supervision of the ministry of finance of the country.

Individual financial cooperatives in a country are often govern by a league that coordinate activities of these credit unions, trains and assist its affiliates, act as a place where the deposit and provide inter lending facilities and act as a link between external donors and the cooperative system (Schmidt, 1997).They raise capital through savings but to receive loans is not easy. Loans are delivered following the minimalist approach where the requirements for loans are not often difficult to meet by customers; little collateral, character and co-signing for loans between members. These loans are usually loans within the savings of the member (Schmidt, 1997).

2.8.2 Group Lending

This method of providing small credits to the poor is most use by microfinance that provides loans without collateral. The interest charge is around not much different from that of commercial banks but far lower than interest charge by individual by money lenders (Natarajan, 2004). The Grameen bank is a typical example of microfinance institution using this method. The repayment rate is very high since each member is liable for the debt of a group member (Stiglitz, 1990). Group formation is made by members who know themselves very well or have some social ties. Loans are not granted to individuals on their own but to individuals belonging to a group; and the group acts as a collateral which is term social collateral. This is to avoid the problems of adverse selection and also to reduce costs of monitoring loans to the members who must make sure the loan is paid or they become liable for it (Armendariz, 1994).

2.8.3 Individual Lending

This is the lending of loans to individuals with collateral. Besley and Coate (1995) argue that despite the advantages of lending to groups, some members of the group may fail to repay their loan. Montgomery (1996) stresses that this method of lending avoids the social costs of repayment pressure that is exerted to some group members.

Stiglitz (1990) highlights that members in group lending bear high risk because they are not only liable for their loans but to that of group members. Navajas et al. (2003) and Zeitingner (1996) recommend the importance of routine visits to the clients to make sure the loan is use for the project intended for. These monitoring is vital but at the same time increases the cost of the microfinance institution.

2.8.4 Self-Help Groups (SHG)

This is common among women in the rural areas who are involved in one income generating activity or another (Ajai 2005). Making credit available to women through SHGs is a means to empower them. This group is an institution that helps its members sustainably with the necessary inputs to foster their lives.SHG provides its members with not only the financial intermediation services like the creating of awareness of health hazards, environmental problems, educating them etc. These SHGs are provided with support both financial, technical and other wise to enable them engage in income generating activities such as; tailoring, bee keeping, hairdressing, weaving etc. It has a bureaucratic approach of management and are unregistered group of about 10 – 20 members who have as main priority savings and credit in mind (Ajai, 2005). The members in the SHG have set dates where they contribute a constant and equal sum as savings. These savings are then given out as loans to members in need for a fixed interest rate (Bowman, 1995).

2.8.5 Village Banking

This is a method of lending to individual members to have constant access to money for their Micro-enterprise daily transactions (Mc Nelly and Stock, 1998). Borrowers are uplifted using this method because they own SME that earn money sustainably. This enables them to acquire a larger loan sum which gives them higher profit when introduced into the business and of course the interest with this high sum is high making the bank financial sustainable. Village banking as of the 90s has gained grounds and certain adjustments are made to suit partner institutions (Nelson et al; 1996). Hatch and Hatch (1998) Village banking loan and savings growth rate increases as the bank continue to exist.

2.9 The Triangle of Microfinance

The performance of the financial sector in providing financial intermediation for small and medium size enterprises can be evaluated in three vital dimensions: financial sustainability, outreach, and welfare impact (Zeller and Mayer, 2002). They went further to say that this microfinance triangle is the main policy objective of these microfinance institutions which are aimed towards development. The internationally agreed objectives of development are the Millennium development Goals (MDGs). These MDGs are to alleviate poverty and this is done in many dimensions of welfare such as increasing access to education, health, nutrition, women's empowerment and of course basic needs (Morduch et al, 2003).

Donor organisations and governments differ in the microfinance objective which is of prominence to them; i.e. financial sustainability, depth of outreach, and welfare impact. This influences their perceptions on the relative efficiency on the different microfinance institutions and how financial policies are designed and evolve (Stiglitz, 1992; Krahnen and Schmidt, 1994). The financial sector can contribute to the development of SMEs either directly or indirectly. The direct influence is by increasing the access to financial services to the poor. There are three distinguished ways to how access to financial services can influence income generation activities and consumption stabilization of the poor (Zeller et al, 1997). The indirect method is by supporting a sustainable financial system as a prerequisite for social and economic growth.

There has been a paradigm shift in thinking about relevant policies for the development of the financial sector and precisely in the field of microfinance in the 1990s. This shift is as a consequence of the failures of small farmer credit and successes of some few MFI. The financial policy has changed due to this shift and it is based on the assumed lapses between the demand for credit and savings services, and how these services can be access by a specific target group. It was before now more emphases were laid on improving the outreach to small farmers in the 1960s and 1970s, and in the 1980s and 1990s to the poor. This was focused on serving more of the poor (breadth of outreach) and the poorest of the poor (depth of outreach) (Zeller and Mayer, 2002). MFIs were focusing on the poor and in order to have access to or supply of MF services with demand has been constant for MFIs trying to serve clientele outside the border line of formal financial institutions (Von Pischke, 1991).

The main objectives of microfinance institutions are prioritised differently by different authors. Researchers like Otero and Rhyne, (1994); Christen et al., (1995) argues that increasing access to reach the poorest of the poor (depth of outreach) and sustainability are compatible objectives. Although Hulme and Mosley (1996), Lapenu and Zeller (2002), with others argue that they may be a trade-off between augmenting outreach to the poorest and attaining financial sustainability. This trade-off is as a result from the fact that MFI transaction costs have a high fixed cost element which makes unit cost for smaller savings and smaller loans high as compared to larger financial transactions. This rule of reducing unit transaction costs with larger transaction size generates the trade-off between better outreach to the poor and financial sustainability, regardless of the borrowing technology used (Zeller and Mayer, 2002).

The financial sustainability of the financial institutions and outreach to the poor is two of the three policy objectives of the contemporary developments in the field of microfinance. Welfare impact is the third policy objective that relates to the development of the financial system and precisely on economic growth and poverty alleviation and food insecurity.

Innovation in the institutional domain and the expansion of microfinance institutions rely on public intervention and financial support. The state and donor transfers such as international NGOs subsidises the costs of most microfinance institutions reaching a greater number of clients below the poverty line. These costs include the opportunity costs of forgoing other assistance to public investments such as in primary education when limited funds are used for microfinance (Zeller et al.1997).

The subsidy dependent index Yaron (1992) has become the universally accepted measure to quantify the amount of social costs involved in running the activities of a financial institution. Zeller and Sharma (1997) argue whether public sector development are economically or financially sustainable and to find out that they compared social costs with social benefits to know which one will have a greater impact on the society.

The crucial triangle of microfinance is a triangle that reflects the three policy objectives of MF of outreach, financial sustainability and impact. Some of these objectives contribute more impact and at the same time inadequate outreach. The other objectives may produce limited impacts but are very much financially sustainable (Zeller and Mayer, 2002). The impact of finance can be increased through complementing non financial services such as SMEs or marketing services, or training of borrowers that raise the profitability of loan financed projects (Sharma and Buchenrieder, 2002). The MF impact assessment studies reviewed suggested that the poorest amongst the poor can gain from microfinance by having a constant consumption through the management of their savings and borrowing habits.

It is noted that the management of loans for productive purposes with the aim to raise income and assets is effectively done by those just below or just above the poverty line. An increase in financial services will have a positive outcome in the welfare of the poorest but not necessarily to lift them from poverty because of the lack of access to market, technology, and other factors that raise production.

2.10 Theoretical Links between Microfinance and SME Development

Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that credit augment income levels, increases employment and thereby alleviate poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995). The main objective of microcredit according to Navajas et al, (2000) is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions.

Diagne and Zeller (2001) argue that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME"s risk-bearing abilities; improve risk-copying strategies and enables consumption smoothing overtime. With these arguments, microfinance is assumed to improve the welfare of the poor. It is argued that MFIs that are financially sustainable with high outreach have a greater livelihood and also have a positive impact on SME development because they guarantee sustainable access to credit by the poor (Rhyne and Otero, 1992).

Buckley (1997) argue that, the indicators of success of microcredit programs namely high repayment rate, outreach and financial sustainability does not take into consideration what impact it has on micro enterprise operations and only focusing on “microfinance evangelism”. Carrying out research in three countries; Kenya, Malawi and Ghana, Buckle (1997) came to the conclusion that there was little evidence to suggest that any significant and sustained impact of microfinance services on clients in terms of SME development, increased income flows or level of employment. The focus in this augment is that improvement to access to microfinance and market for the poor people was not sufficient unless the change or improvement is accompanied by changes in technology and or technique.

Zeller and Sharma (1998) argue that microfinance can aid in the improvement or establishment of family enterprise, potentially making the difference between alleviating poverty and economically secure life. On the other hand, Burger (1989) indicates that microfinance tends to stabilise rather than increase income and tends to preserve rather than to create jobs. Facts by Coleman (1999) suggest that the village bank credit did not have any significant and physical asset accumulation.

The women ended up in a vicious cycle of debt as they use the money from the village banks for consumption purposes and were forced to borrow from money lenders at high interest rate to repay the village bank loans so as to qualify for more loans. The main observation from this study was that credit was not an effective tool to help the poor out of poverty or enhance their economic condition. It also concluded that the poor are too poor because of some other hindering factors such as lack of access to markets, price stocks, unequal land distribution but not lack of access to credit. This view was also shared by Adams and Von Pischke (1992).

A study of thirteen MFIs in seven countries carried out by (Mosley and Hulme (1998) concludes that household income tends to increase at a decreasing rate as the income and asset position of the debtors is improve. Diagne and Zeller (2001) in their study in Malawi suggest that microfinance do not have any significant effect in household income meaning no effect on SME development. Investing in SME activities will have no effect in raising household income because the infrastructure and market is not developed.

Some studies have also argued that using gender empowerment as an impact indicator; microcredit has a negative impact (Goetz and Gupta, 1994). Using a "managerial control" index as an indicator of women empowerment, it came to conclusion that the majority of women did not have control over loans taken by them when married. Meanwhile, it was the women who were the main target of the credit program. The management of the loans were made by the men hence not making the development objective of lending to the women to be met (Goetz and Gupta, 1994). Evidence from an accounting knowledge as an indicator of women empowerment concluded that women are marginalised when it comes to access to credit (Ackerly, 1995).

2.11 Micro-Finance Institutions (MFIs) in Tanzania

Micro-finance operators in Tanzania function within the framework of the Government's National Micro Finance Policy of 2000. The objectives of this policy are to provide the basis for the evolution of an efficient and effective micro-finance system to serve the low segment of society and contribute to economic growth and poverty reduction. The policy establishes a framework within which micro-finance operators will develop, lays out the principles to guide operations of the system, defines roles and responsibilities of actors, and provides guidelines for coordinating mechanisms. The Central Bank was given the mandate to coordinate implementation of the policy. It is interesting to note that the Micro Finance Policy includes "gender equity" as a best practice.

Access to financial services should be available to both men and women. In order to achieve gender equity in the delivery of services, it may be necessary to make special efforts to incorporate features that make the services accessible to all (National Micro Finance Policy, 2000).

Table 2.1: Strengths and Weaknesses of MFIs in Tanzania

Institution	Strengths	Weaknesses
CRDB Bank	A wide branch network (in most regional headquarters). A number of micro-finance products.	Stringent lending requirements for large loans. Still learning to deal with small loans.
National Micro-Finance Bank (NMB)	A large branch network (95 branches countrywide).	Still piloting its lending programme. Upper lending limit is low (TZS 500,000).
PRIDE – Tanzania	Branches in several urban areas. Has a big loan fund. High recovery rate (over 90 percent).	Uses the group-lending model, which requires weekly repayments and meetings, hence high transaction costs for borrowers. Graduated loans (one has to start with TZS 50,000)
Akiba Commercial Bank	Targets small borrowers.	Branches in Dar es Salaam only.
	Started a micro-finance window.	Others weaknesses – same as PRIDE-
	Offers flexible lending arrangements. High recovery rate (over 90 percent).	Tanzania.
Presidential Trust Fund (PTF)	High recovery rate (over 95 percent). Borrowers get training.	Limited branch coverage (in just three regions). Limited loan fund. Same weaknesses as PRIDE-Tanzania.
Small Enterprise Loan Facility (SELF/VPO)	Targets the poorest regions. Offers wholesale loans to MFIs. Builds capacity of client (MFIs).	May be unsustainable due to focusing on low-income regions.
Other NGOs (AFREDA, BEST)	Localized services, tailored to circumstances of target groups.	Limited outreach. Same weaknesses as PRIDE- Tanzania.

Source: UDEC, 2002

There are a number of micro-finance operators in the country (the major ones are highlighted in Table 2.1) and, although a number of key informants stated the view that micro-financing is plentiful, most MFIs operate in urban areas with relatively well developed infrastructure, thereby denying access to rural MSEs and those in backward regions (UDEC, 2002). Key informants reported that micro-credit operators had recently formed the Tanzania Association of Micro-Finance Institutions (TAMFI), with support from the Swedish International Development Agency (SIDA). At this point, however, there is no collective data on micro-finance clients, no evidence of systemic performance evaluations of the micro-finance industry, and a great need for sharing of good practices in managing micro loan funds.

2.12 The SME Sector in Tanzania

2.12.1 Definitions

The Tanzanian government defines SMEs according to sector, employment size, and capital investment in machinery. Accordingly, SMEs are defined as micro, small, and medium-size enterprises in non-farm activities, including manufacturing, mining, commerce and services. 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 (Table 2.2). Capital investments range from less than TZS 5 million to over TZS 800 million. This definition would exclude a number of informal economy enterprises, peasant farmers, and Tanzanians engaged in lower-level income-generating activities.

Table 2.2: MSME Definition in Tanzania

Category	Employees	Capital investment in machinery (TZS)
Micro-enterprise	1-4 employees	Up to 5 million
Small enterprise	5-49 employees	5-200 million
Medium enterprise	50-99 employees	200-800 million
Large enterprise	100+	Over 800 million

Source: SME Development Policy, 2003

2.12.2 Characteristics of the SME Sector in Tanzania

There is a shortage of comprehensive data on the state of the SME sector in Tanzania. Most reports on the sector rely on data from the 1991 National Informal Sector Survey (NISS), which is outdated. Although other studies have been done (the 1992 Rural Informal Sector Survey (RISS), the 1995 Dar es Salaam Informal Sector Survey), the NISS (1991) remains the only nationwide study of the informal sector. The current number of enterprises by size, sector, geographical location, age and sex of owner remains unknown.

The 1991 NISS survey reported a total of 1,801,543 informal sector enterprises employing 2,369,380 people (an average of 1.3 persons per enterprise). Sixty percent of the enterprises were located in rural areas and 40 percent in urban areas. Informal sector employment amounted to about 22 percent of the total labour force, 15 percent in the rural areas and 56 percent in the urban areas. About 74 percent of people employed in the sector were sole operators. Women made up about 36 percent of the sector. Over 75 percent of female employment in the sector was in the trade/restaurant/hotel category.

According to Mlingi (2000) “recent estimates indicate the number of establishments and the number of employees in the sector has been growing at a rate of 10 percent a year since 1991 mostly taking place in urban areas. She cites evidence from Wangwe (1999) that most of the growth is accounted for by an increasing number of female operators in the informal sector. Mjema (1998) estimated that the proportion of males in the informal sector declined from 64 percent in 1991 to 30 percent in 1995, implying that the percentage of women operators in the sector increased from 36 percent in 1991 to 70 percent by 1995.

Table 2.3: Distribution of MSEs and MSFs by Size: Five Regions of Tanzania, May 2003

Total No. of households	2,021,553
Avg. household size	5.33 people
Estimated population	10,770,228
Number of MSEs	781,687
Number of MSFs	365,102
Percentage of households with MSE	38.8%
Percentage of households with MSF	18.1%
Percentage of households with MSEs or MSFs	56.9%

Source: Swisscontact, 2003

The latest survey of SMEs in Tanzania was carried out by Swisscontact (2003). The researchers conducted a survey of 4,050 households in the Uruhu Corridor, which includes five regions of the country. The number of households in these regions totals about 2 million and represents about a third of the country's population. The purpose of the survey was to estimate the number of micro and small enterprises (MSE) and micro and small farms (MSFs), and to explore their challenges and use of financial and nonfinancial business services. Fifty-seven percent of the households had a member who was operating an MSE or an MSF; for the MSE portion, it was over 38 percent (see Table 2.3).

Almost 43 percent of the MSEs were owned by women, 48 percent by men; 8.6 percent by families (husband and wife), and 0.5 percent by multiple owners. The 781,687 MSEs employed 1,260,520 persons, including the working owners, an average of 1.6 per enterprise.

The population of Tanzania is approximately 37 million. Extrapolating from the Swiss contact household survey in five regions, assuming it is representative of the country as a whole, suggests that there are as many as 2,685,404 MSEs and 1,254,270 MSFs in the country. If women own 43 percent of MSEs (in the five regions), then there could be as many as 1,154,724 women-owned MSEs in the country. However, there is no way to fully substantiate these estimates.

Over 85 percent of MSEs in the Swisscontact survey were not registered; just over 50 percent had a daily trade, local authority or other licence. Over two-thirds of the MSEs operated their enterprises from home (43 percent) or from the roadside (20.9

percent (see Table 2.4). Only 31 percent operated in a market, commercial or industrial centre. Ninety-three point five (93.5) percent marketed their products and services to the final consumer (mostly in the same town or region), reflecting the large number of traders and service providers in the total MSE population.

Table 2.4: MSE Operating Locations

Operating Locations	Percentage
Homestead	43.0
Roadside	20.9
Traditional markets	15.6
Commercial/industrial centres	14.8
Unknown	5.7
Total	**100.0**

Source: Swisscontact (2003)

Table 2.5: Distribution of MSEs by Gross Annual Sales

Range of gross annual sales	Number	Percent
Up to TZS 100,000	47,014	6.0
TZS 100,001 – 200,000	56,007	7.2
TZS 200,001 – 500,000	126,824	16.2
TZS 500,001 – 1 M	137,250	17.6
TZS 1,000,001 – 2M	163,627	20.9
TZS 2,000,001 – 5M	162,822	20.8
TZS 5,000,001 – 10M	57,901	7.4
Over TZS 10M	30,242	3.9
Total	**781,687**	**100.0**

Source: Swisscontact (2003)

Just less than half of MSEs had gross annual sales of under TZS 1 million (about USD 1,000) and only 4 percent had sales of over TZS 10 million (about USD 10,000) (see Table 2.5). In lieu of recent data on the employment size of Tanzanian MSEs, this provides evidence of their micro scale.

2.13 Major Constraints Facing the MSME Sector

There are two levels of constraints facing MSMEs in Tanzania, those acting as barriers to general operations and those impeding growth. The UNDP, ILO and UNIDO (2002) report concluded with a list of factors impeding the development of informal MSEs

i) the low level of education of the entrepreneurs;
ii) the lack of managerial, marketing and production skills;
iii) the use of rudimentary technology;
iv) the low-skilled work base;
v) lack of access to credit;
vi) the tiny purchasing power of their consumers/clients; and
vii) Regulatory constraints stemming from the difficulties of obtaining legal status.

In determining barriers to MSME growth, Rural Programme on Enterprise Development (RPED) surveys completed over the 1993-95 period, revealed that the most serious constraint was related to credit access, followed by market-related problems (demand and competition), problems with inputs, and lack of infrastructure (Verspreet and Berlange, 1998. See table 2.6). The ranking and intensity of constraints varied by size of the enterprise. Problems related to infrastructure, inputs, taxation, regulation, and skilled labour became more serious for medium-size enterprises.

Table 2.6: Main Constraints as Perceived by Firms (by Firm Size)

Constraint	Micro (%)	Small (%)	Medium (%)
Credit-related problems	85.6	75.0	63.3
Demand or competition related problems	49.3	42.3	36.6
Regulations related problems	7.7	2.3	13.0
Tax burden	9.7	10.3	14.0
Lack of infrastructure	12.0	9.7	38.7
Lack of support services	9.0	11.7	12.0
Lack of skilled labour	7.7	7.0	11.0
Investment capital related problems	11.3	10.0	4.0
Problems with inputs	16.7	17.3	24.7
Macroeconomic problems	3.7	4.3	7.7

Source: Verspreet and Berlange, 1998

2.14 The Situation of MSMEs in Tanzania

Key informants confirmed findings from the literature that entrepreneurs are predominantly found in informal, micro level, and low-growth sectors, and encounter high competition while earning subsistence incomes. Seriously encumbered by their low levels of education, entrepreneurs are unable to find employment in the formal, private sector, and are the first to lose their jobs in retrenchment exercises. Of necessity, they are driven into entrepreneurial activities. Their business opportunity identification tends to reflect their traditional roles in food production, textile (batik), crafts, small-scale farming, and small scale cooperative production. These activities are “somewhat” culturally acceptable.

Several key informants stated that many entrepreneurs lack exposure and socialization, which restrict their ability to identify higher growth potential business ventures. They are likely to be operating in groups from home, and often lack social, cultural and business support for their role as entrepreneurs.

Entrepreneurs operating in the informal economy lack the ability to accumulate the savings required for the start-up process – entrepreneurs with poor levels of education are less likely to have accumulated savings from previous employment. They additionally lack access to working capital and credit and, as a result, have low profits to reinvest in their firms. Tanzanian entrepreneurs, as is the case with entrepreneurs in many countries throughout the world, are reported to be "risk adverse", with limited capacity to absorb the cost of failure. Micro credit key informants reported that micro-financing is readily available and that high percentages of their clients are entrepreneurs. However, their assessment is that entrepreneurs need to be better informed about financial services, the correlation between debt and growth, and how to deal with lending institutions.

Tanzania's entrepreneurs are quite often lack technical and business management skills, including the sophistication needed to negotiate with financial institutions. The exception to this is entrepreneurs in large urban centres, or those in the textile and food industry, who have substantial support from organizations such as the Small Industries Development Organization (SIDO). These entrepreneurs do have some potential for growth, subject to market identification and adequate capital for processing equipment.

2.15 The Challenges and Barriers of Growth

Entrepreneurs in growth modes who require financing “beyond the low cap micro-finance levels” are seriously restricted by their inability to successfully obtain loans from financial institutions, even if they are referred to them, because they are unable to meet the loan conditions pertaining to security. Limited access to support services is another constraint for these entrepreneurs. Key informants advised that entrepreneurs lack access to advice, counselling and encouragement. This is largely attributed to a lack of donor-supported services. Entrepreneurs, in most cases, do not have the funds to pay for these services, and those that can afford user-pay programming do not prioritize funds to pay for these services.

Many of the laws and regulations affecting businesses (including licensing procedures) were designed for relatively large enterprises and are therefore beyond the reach of most MSEs, particularly the micro-enterprises. Corruption and bureaucracy make matters worse especially for those who do not have the same opportunities to meet and negotiate (bribe) with predominantly public officials. The UDEC (2002) report expressed amazement that any entrepreneurs in the informal economy managed to achieve the transition to a formal enterprise in such a difficult environment.

In summary, all entrepreneurs operating in the MSME sector are subject to a number of cultural, socio-economic and operational barriers that limit their ability and capacity to take their enterprises to the next stage of development. In addition, entrepreneurs in different stages of transition from the informal economy to the SME sector face other unique challenges. For those who run informal micro-enterprises, the main challenges are: dealing with costly and complicated formalization procedures (if they wish to formalize); harassment due to operating in locations and premises that are not meant for business; and finding the time required to attend training supported by donors and NGOs.

For those who run formal micro-enterprises, the unique critical challenges are in dealing with high and multiple taxes, complex tax compliance procedures, and access to finance. For entrepreneurs who are already running small enterprises, the main challenges are: limited access to quality and affordable business development services; access to term finance and sufficient working capital to meet their needs; multiple taxes, and compliance with labour laws.22

2.16 The Textile Industry in Tanzania

Since its independence, 1961 Tanzania invested heavily in textile industry so that it could satisfy the demand of the market in terms of clothes and the cotton growing in Tanzania. The textile industry in Tanzania has locations nationwide with hubs in Arusha, Mwanza and Dar es Salaam. The textile manufacturing has employed large amounts of labour. For instance cotton only has been one of the main cash crops for more than 400,000 small-scale farmers, most of whom live in the most populous regions of Mwanza, Singida, Kagera, Kigoma and Shinyanga (USAID, 2004).

Textile is grown in 42 districts of 13 regions, respectively out of 127 districts and 21 regions of Mainland Tanzania. More than 99 percent of the crop is produced in western cotton growing area, around Lake Victoria, covering Shinyanga Mwanza, Mara, Tabora, Kigoma, Kagera and Singida regions. The rest is grown in eastern cotton growing area. The eastern cotton growing area comprises of Iringa, Kilimanjaro, Morogoro, Tanga, Manyara and Coast regions. Though this area currently produces less than 1 percent of the entire crop, it has greater potential for increased cotton production than western cotton growing area which, due to continued cultivation, coupled with inadequate use of fertilizers, has generally become exhausted to support a more productive crop.

Current domestic cotton production averages 700,000 bales per annum, equivalent to 126,000 MT of cotton lint; with yields at around 760kg/ha of seed cotton, or 260 kg/ha of lint cotton.

Table 2.7: Shows the Cotton Production and Yield Trends between 2001/02 and 2008/09

Period	Acreage ('000 Hectares)	Yield Kg/ Ha	Production ('000 MT)
2001/02	392	161	63
2002/03	291	172	50
2003/04	459	257	117
2004/05	471	212	100
2005/06	450	214	96
2006/07	459	215	99
2007/08	410	163	67
2008/09	485	256	124

Source: Tanzania Cotton Board; **Cotton World Statistics** in: Bulletin of the International Cotton Advisory Committee; September, 2009.

During the 1980s, the textile sub-sector was the largest employer in the country, employing about 37,000 people. The textile sub-sector is currently at the revival stage after commendable efforts by the government to revive the sub-sector partly through the privatization and investment policies. Most of the new industries are engaged in the production of printed fabrics for the local and regional market, although there are some which have succeeded in exporting yarn and finished garments to Europe (Ladha, 2000). It is reported that over 80 percent of Tanzanian lint is exported directly to regional and international market with less than 20 percent being utilized by the local textile mills a long way from the national target of utilization of up to 60 percent. Many textile manufacturers are planning to absorb the targeted extra volume of cotton exported by ginneries through increasing production, installing quality machines and looking for bigger markets.

The performance of textile sub-sector has significant implications on poverty reduction. Cotton for example, which was introduced by the German Settlers around 1904, contributes about 15 percent of foreign exchange earnings and it is the second largest export crop after coffee. About 40 percent of the country’s population depends on cotton for their livelihood. The textile sub-sector on the other hand, was deliberately established in early 1970s by the government as part of the industrialization efforts.

Through the textile sub-sector the government intended to generate more employment, add value to the cotton based exports, and develop products that could be substituted for textile imports (Ladha, 2000). The textile sector grew from 4 textile mills between 1961 and 1968 to 35 mills by 1980s. The total investment in the sector exceeded USD 500 million during the 1980s and consequently, the textile sector became the largest employer in the country employing about 37,000 people; the third contributor to the government revenue through various taxes; and the largest exporter of manufactured goods.

Table 2.8: Contribution of Cotton and Textile Sector to the Tanzanian Economy (in Percent)

Year	**GDP**		**International Trade (Trade in Goods)**				**Employment (Industry)**	
			Cotton		**Textile**			
	Cotton	**Textile**	**Export**	**Import**	**Export**	**Import**	**Cotton**	**Textile**
2000	1.8		5.92	0.72	2.55	4.32		13.56
2001	1.8		4.79	0.81	2.64	4.52		12.69
2002	1.8		3.76	0.96	2.33	4.72		12.95
2003	…		4.33	0.43	2.57	4.45		13.20
2004	…		5.98	0.30	2.81	3.30		13.44
Average	**1.8**		**5.41**	**0.67**	**2.71**	**4.28**		**13.17**

Source: ESRF (2006)

Tanzania embarked on major reforms towards market oriented economy since mid 1980s as a result of the Structural Adjustment Programs (SAPs) supported by the World Bank and IMF. As part of these reforms, the country adopted a liberal trade regime. Measures to liberalize trade included, among others, withdrawing the role of the government in production and commercial activities in favour of the private sector, rationalizing import tariffs, dismantling import restrictions, introducing a foreign-exchange market, and improving incentives for export performance. Currently, Tanzania’s trade liberalization is shaped by several multilateral and regional trade agreements associated with bodies such as the World Trade Organization (WTO), the Southern African Development Community (SADC), and the East African Community (EAC).

Trade liberalization and reforms in the textile sub-sector involved three steps. First, cooperative movement reform: This began in 1991 when the government crafted a new Cooperative Society Act (Kahkonen and Leathers, 1997). With this Act the cooperative unions had to conform to the international cooperative principles. That is, primary societies were to be formed by farmers, who would then control the cooperative unions through their elected representatives.

Second, the gradual relaxation of price controls by the government starting from 1991/92. That is, in 1991/92 the government announced only indicative price for textile products such as cotton, and during 1992/93, cooperative unions were given the freedom to determine their own producer prices. Third, before 1994, the textile sub- sector was highly monopolized. Two institutions, the cooperative unions and the Tanzania Cotton Marketing Board (TCMB) handled all the marketing and processing of cotton. From 1994 this monopoly was abolished and TCMB, which was renamed the Tanzania Cotton Lint and Seed Board (TCLSB), had a new role of enforcing marketing regulations. In addition, all price controls were removed and private traders were allowed to set their own producer prices. Note that, the Cotton Industry Act of 2001 provided for the formation of the new Board called the Tanzania Cotton

Board (TCB), which replaced the TCLSB.

Table 2.9: Trend and Pattern of Employment in the Textile Sector between 1991/4 and 2001/04

Year	Permanent Employment		Temporary Employment		Employment		
	Number	%	Number	%	Total Textile	Total Mfg.	Share of Textile Employment in Mfg.
1991	30624	98.5	461	1.5	31085	124002	25.1
1992	34322	98.3	581	1.7	34903	128967	27.1
1993	34358	97.9	644	1.8	35085	129456	27.1
1994	34394	98.0	713	2.0	35107	129984	27.0
Avg.	**33425**	**98.2**	**600**	**1.8**	**34045**	**128102**	**26.6**
2001	930	10.7	7769	89.3	8699	68570	12.7
2002	911	10.3	7932	89.7	8843	68296	12.9
2003	892	9.9	8098	90.1	8990	68120	13.2
2004	874	9.6	8268	90.4	9142	68045	13.4
Avg.	**902**	**10.1**	**8017**	**89.9**	**8919**	**68258**	**13.1**

Avg = Average; Mfg. = Manufacturing
Source: ESRF (2006)

In the textile sub-sector, as the pre-liberalization government protection and subsidies came to an end because of trade liberalization and reforms, the textile sub-sector inevitably collapsed, leading to massive labour redundancies and unprecedented idle capacities. The textile sub-sector could not survive international competition in the new market oriented economy because of poor management; high operating costs such as high power tariff as well as unfavourable taxation policies; high level of foreign debts and currency devaluation; poor and outdated technology; unfair competition from substandard imports as well as high degree of tax evasion by importers; and negative export incentives (RATES, 2003). Consequently, in 1996, for example, only two industries were operating out of 35 textile mills.

According to the Ministry of Industry and Trade 2004 report on Status of Textile Industries in Tanzania, 50 textile industries were established by the year 2002 by the government and private companies. However, only 23 (or 46%) of the established industries are operating. The industries are involved in dyeing, spinning, wearing, printing Khanga and Kitenge, bed sheets, garments, knitting, woven blankets and socks. In the 1960s and 1970s, Tanzania was able to meet the demand of the market in terms of clothes. The industries produce adequate clothes and materials for making clothes. Furthermore the industries were of the major employers and contributor to GDP. It employed about 25% of the working force and contributed 25% of GDP in manufacturing sector (SAILIN LTD (TIB, 1996). According to Zuku A (2002), the development of the textile industry was attributed to the demand and deliberate government policies.

Though the textile industries were able to satisfy the market but it could not meet the demand of some types of clothes i.e. suits and suiting materials and other specific dress materials. This was due to the lack of technology of producing them. From 1980, the economy of the country started to decline. This also affected the textile industry. The capacity of the sector to produce adequate with good quality garments decline. At the same time the government continued to restrict the importation of goods including clothes. This limited the availability of the clothes. As a result individuals started to print batik and tie and dye. They were commonly known in Kiswahili as "MAWINGU" because most of them were in sky colour.

The final nail of the coffin of the textile industry was hammered in 1994/95. The sector collapsed due to poor economy and government policies emanating from the liberalization policy.

According to Zuku, A, (2002) the collapse of the textile industry was due to inadequate supply of cotton lint, lack of power/power interruptions, high power tariffs, unfair competition from imports and devaluation of Tanzania shilling hence difficult to buy spare parts for the machines. From 1980-1985, Tanzanian's experienced a shortage of goods including clothes. As it has already being mentioned that local initiatives of producing clothes emerged (batik and tie and dye) but with a poor quality and also expensive to the extent that not everybody could afford.

This was a period whereby small-scale enterprise in textile industry started to appear in the economy. Thus, with a population of more than 30 million people in Tanzania, it may be concluded that the garment manufacturing handled by small-garment manufacturers (tailors) is quite significant. Despite their status, they are viewed as offering a critical contribution to the policy goals of employment creation, promotion of economic growth and poverty alleviation (Rogerson, 2000). Tailoring and dressmaking have been operating even before independence. By 1958, there were 860 establishments in tailoring and dressmaking in Tanganyika employing up to

1,954 people (International Bank for Reconstruction and Development Report, 1961).

After 1967, laws, rules and regulations did not favour the development of SME's. It is argued for example, that while private SME's were tolerated in the urban areas, in the villages they were effectively outlawed, with the 1975 Ujamaa Villages Act decreeing that all village-based enterprises should be communally owned (Bagachwa, 1993). Also the government regulatory environment has been inimical to the development of such entities.

Apart from the mainstream dressmaking, there has emerged a strong desire towards garment SME's in Afrocentrics (tie and dye dresses, skirts, blouses shirts traditional dresses) which are high quality dresses with international status. These are doing better especially in export compared to mainstream dressmakers. On an average, they employ two to ten qualified tailors and quite a few a have up to or more than twenty employees (Mbwambo, 2000). Women are quite active especially in Afrocentrics and special occasion wears. Also, they feature well in specialised high quality wears for the affluent.

Batik uses the wax technology where candles are used. Tie and dye is a technique where the material is tied well and dipped in chemical liquids of different colours. These colours contain caustic, sodium and soda ash. Different kinds of material are used to make batik and tie and dye, for example viscose, bazee and cotton. In Tanzania tie and dye viscose material is sold at around fifteen US dollars, bazee at around twenty US dollars while cotton costs about fifteen US dollars. Batik materials are more expensive than tie and dye. Most customers of batik and tie and dye in Tanzania are tourists, CCM followers and church choir members. Most materials for production of batik are bought in Dar es Salaam where they are cheap, but they are also found in textiles mills located in Kagera, Musoma and Mwanza.

It is strongly argued by Biggs et al (1994) that there is an increasing demand for Afrocentric garments in the USA. But the market is by no means uniform. Consumer preferences and purchasing criteria differ by demographics and market segment.

Tanzania leads the East African countries in the export of textiles and apparel to the European Union, with annual average exports worth €14m over the nine year period, 2000- 08. However, the leading Eastern and Southern African country exporters of textiles and apparel to the EU market are respectively Mauritius, Madagascar and South Africa, with such exports worth respectively €456m., 229m., and 170m. in 2008. On the other hand Tanzania's textiles and apparel exports to the USA market amounted to a paltry USA$ 2m; compared with USA$ 340m for Lesotho, USD 279m for Madagascar, and USA$ 247m for Kenya.

2.17 The SMEs Garment Sub-Sector and Batik and Tie and Dye in Tanzania

In the wake of reforms, most of the garment firms, both private and parastatal, were experiencing operational problems. The problems include outdated machinery, fast liberalisation, rising prices for cotton lint, high electricity rates, shortages of inputs and spare parts and the heavy depreciation of the shilling. Consequently, most of the garment/textile mills have closed or lack working capital. Further, low managerial skills and lack of motivation result in a stunted pace of operation (Kweka, Semboja and Wangwe, 1997).

Despite the stated problems, a recent study by UNIDO and MIT (2001) found that in 2000, garment/textiles were second in the recovering manufacturing sector after food processing. While in 1997 just one garment/textile firm (Sun Flag of Arusha) was active, by 2001 there were ten active mills/factories. These were Urafiki Textile Mills, Namera Group Textiles (the former Sungura Textiles), Blanket and Textile Manufacturers Ltd., Morogoro Canvas, Ubungo Spinning, Mbeya Textiles, Musoma Textiles, Karibu Textile Mills, Lakhan Textile Mills, Affrights Ltd. (former CIC), Kiltex Arusha, A to Z and Sun Flag.

In addition to the formal, big and medium size firms, small-scale enterprise is also featuring in the economy. With a population of about 30 million people in Tanzania, it may be concluded that the garment manufacturing handled by small-garment manufacturers (tailors) is quite significant. Despite their status, they are viewed as offering a critical contribution to the policy goals of employment creation, promotion of economic growth and poverty alleviation (Rogerson, 2000). Tailoring and dressmaking have been operating even before independence. By 1958, there were 860 establishments in tailoring and dressmaking in Tanganyika employing up to 1,954 people (International Bank for Reconstruction and Development Report, 1961).

After 1967, laws, rules and regulations did not favour the development of SME's, it is argued for example, that while private SME's were tolerated in the urban areas, in the villages they were effectively outlawed, with the 1975 Ujamaa Villages Act decreeing that all village-based enterprises should be communally owned (Bagachwa, 1993). Also the government regulatory environment has been inimical to the development of such entities.

Apart from the mainstream dressmaking, there has emerged a strong desire towards garment SME's in Afrocentrics (tie and dye dresses, skirts, blouses shirts traditional dresses) which are high quality dresses with international status. These are doing better especially in export compared to mainstream dressmakers. On an average, they employ two to ten qualified tailors and quite a few a have up to or more than twenty employees (Mbwambo, 2000). Women are quite active especially in Afrocentrics and special occasion wears. Also, they feature well in specialised high quality wears for the affluent.

Batik uses the wax technology where candles are used. Tie and dye is a technique where the material is tied well and dipped in chemical liquids of different colours. These colours contain caustic, sodium and soda ash. Different kinds of material are used to make batik and tie and dye, for example viscose, bazee and cotton. In Tanzania tie and dye viscose material is sold at around six US dollars, bazee at around eight US dollars while cotton costs about five US dollars. Batik materials are more expensive than tie and dye. Most customers of batik and tie and dye in Tanzania are tourists, CCM followers and church choir members. Most materials for production of batik are bought in Dar es Salaam where they are cheap, but they are also found in textiles mills located in Kagera, Musoma and Mwanza. It is strongly argued by Biggs *et al* (1994) that there is an increasing demand for Afrocentric garments in the USA. But the market is by no means uniform. Consumer preferences and purchasing criteria differ by demographics and market segment.

2.18 Support Services and Challenges to SMEs in Textile Sub-Sector

At the institutional level there are a number of public and private sector institutions such as Artisans Development Agency of Tanzania (ADAT), UNIDO, Pride Tanzania, Equal Opportunity for All and Small Scale Industry Organisation (SIDO) that support industrial development. They provide various support services including finance, advisory services, information, training on entrepreneurship, research and development, investment promotion and technology development. These institutions however face capacity constraints, lack of exposure to best practices developed globally and lack of coordination. The challenge is how these institutions can be mobilised so that they apply best practices in supporting industrial development and in addressing key constraints faced by manufacturers.

Global commodity chains are instrumental to international competitiveness. The usefulness of value chain analysis has been demonstrated in studies of industries as varied as fresh fruits and vegetables, garments, footwear and automobiles. The concept of global value chain recognises that the design, production/processing and marketing of many products involve a chain of activities divided among enterprises located in different countries/places.

Value chain analysis is thus helpful in identifying those areas of production which are subject to intensifying competition and hence declining terms of trade, while exposing the processes which allow poor countries and poor producers to upgrade their activities so as to provide for sustained income growth (Gereffi and Kaplinsky 2001).

Amongst the problems pointed out in recent studies, which hinder Tanzanian small scale enterprises from being internally competitive, include lack of market and technological information; poor attitude on quality or poor support services to facilitate production; low and unexploited linkages that can add value to Tanzania exports; inability to enter international supply chains with high value added, low entrepreneurship development and outdated technology (UNDP, 2001). At the same time, the international market for the products from these sub-sectors has over the last ten years been much influenced by liberalisation and globalisation. Industrialisation today is the result of an integrated system of global trade and production.

In this emerging global system, production capacity is distributed among an unprecedented number of developing as well as developed countries (Korzeniewicz *et al,* 1992). Full commodity network includes: the agro-extractive sector (cotton), the industrial sector (textile and clothing manufacturing) and the service sector (activities associated with export, marketing and retailing of textiles/garments). The extent to which a country can gain from trade depends on how it gets access to, and gainfully participates in the global chains.

The current industrial development context in Tanzania is characterised by a series of opportunities and challenges operating at the national, institutional and enterprise levels. At the policy level, the government has committed itself to a profound process of restructuring, promotion of foreign direct investment, capacity building and policy reform geared towards increasing the contribution of manufacturing sector in poverty reduction, equitable access to basic services and economic recovery. Sustainable Industrial Development Policy (SIDP) and Small and Medium Enterprises (SME) Policy are some of the direct testimony to this. Implementation of these policies by various stakeholders is one of the key challenges.

The country is endowed with a rich agricultural resource base, which has been instrumental in the industrialisation of Tanzania. The agricultural sector provides supplies to more than ten industry groups which together account for more than half of the manufacturing GDP and over sixty percent of manufacturing employment. However, the potential from this sector is far from being fully exploited. More than ninety percent of agricultural products, including cotton, are still exported in raw form denying the country and individuals benefits originating from value added. Agro-industries, therefore, provide a base for some other sectors.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This particular chapter introduces the research approach that was employed in this study. It contains descriptions of the research purpose, area of study, population, research sample and sampling techniques, data collection methods, data collection instruments and data analysis methods.

3.2 The Research Phenomenon

Saunders et al. (2009) define research as something that people undertake in order to find out things in a systematic way, thereby increasing their knowledge. There are two important phrases in this definition which are: “systematic way”, a phrase that suggests that research is based on logical relationships and not just belief, and “to find out things”, which suggests there are multiplicities of possible purposes for any research. These may include describing, explaining, criticizing and analyzing (Ghauri and Gronhaug, 2005). Yin (2009) identified three different categories of research purposes; explanatory, descriptive and exploratory as outlined;

i) **Explanatory research** establishes causal relationship between variables, it study problems and situations with the main purpose of explaining relationships between variables (Saunders et al, 2003).

ii) **Descriptive research** portrays an accurate profile of events or situations (Robinson, 2002). Descriptive research also is known as statistical research which describes data and characteristics about a phenomenon being studied. Although the data description is factual, accurate and systematic, the research cannot describe what caused a situation. Thus it cannot be used to show a causal relationship where one variable affects another. From the above-mentioned points, descriptive research is more of a qualitative research.

Description in business and management research has a clear place. However, it should be thought of as a means to an end rather than an end itself (Saunders et al., 2009). This means that if your research utilizes description it is likely to be a precursor to explanation. Such studies are known as descripto- explanatory studies (Saunders et al., 2009).

iii) **Exploratory research** provides valuable means of finding out what is happening, seeking a new insight, asking questions, or accessing a phenomenon in a new way (Saunders et al., 2003). This type of research is useful when one wishes to clarify their understanding of a particular problem or when there is uncertainty on the precise nature of the problem one is looking at.

Based on the description of all the three research categories mentioned above, this research was mainly descripto-explanatory since the study focused on an ongoing event, namely, microfinance, trying to answer questions through the use of different sources, information and providing links with existing theories to explain any impact of existing MFIs in the development of textile industry SMEs in Tanzania.

3.3 Research Approach

The two main types of research approaches used in social sciences are: quantitative and qualitative research approaches. There is no one best approach to study business management research, rather the approach that is the most effective for resolution of a given problem depends on a large number of factors such as nature of the problem (Gill & Johnson, 2006).

Quantitative research approach refers to the systematic empirical investigation of phenomena and quantitative properties and their relationships. That is to say, it emphasizes on collection of numerical data, which is a deductive approach (Bryman and Bell, 2003). This deductive approach develops theories, hypotheses and designs a research strategy to test the hypotheses (Saunders et al., 2003) .Quantitative research approach provides a relation between empirical observation and mathematical expression of quantitative relationships. Quantitative method is based on already decided and well-structured questions, whereby all the respondents will be asked the same questions. Open questions are used to give the respondent the flexibility to answer from different perspectives.

Qualitative research approach refers to all non-numeric data or data that have not been quantified and can be a product of all research strategies (Saunders et al, 2009). It can range from a short list of responses to open-ended questions in a questionnaire to more complex data gathering materials such as transcripts of in-depth interviews or entire policy documents. (Saunders et al, 2009). This method emphasizes on inductive approach; the researcher collects data and develops theory from data analysis. Moreover, qualitative and quantitative methods can be used in the same study (Saunders et al, 2003).

In this research, we utilised a combination of qualitative and quantitative research methods. It is not easy to express the impact of microfinance with the help of few descriptive sentences. On one hand, some impacts can be shown only in numerical figures like, savings and income, while on the other hand other impacts can be expressed only in descriptive ways, for example, access to education and business experience. The questionnaires in this study were structured in such a way to allow to broadly probe the impact of microfinance on the SMEs. In the questionnaires, we tried to combine the numerical questions as well as some non-numerical questions. With our set objectives, and to understand our chosen subject, we laid emphasis on the qualitative research method, though we induced some level of quantitative approach realized through direct interviews with some representatives of MFIs and SMEs.

3.4 Research Strategy

3.4.1 Case Study

This method of research is one of the many ways of carrying out social science research. Others include experiments, surveys, and the analysis of historical and archived information (Yin 2003). Each of these methods has its own advantages and disadvantages, depending on the type of research questions, the control the investigator has over actual behavioural events and the focus on the contemporary as opposed to historical phenomena.

Case study is good when we ask “how” and “why” questions, when investigators have little control over events, and when they focus on a contemporary real life events. In a nutshell, the case study method allows investigators to retain the holistic and meaningful characteristics of real-life events such as individual life cycles, organizational and managerial processes, neighbourhood change, international relations, and the maturation of industries (Yin 2003).

Definition of Case Study: The essence of a case study, the central tendency among all types of case studies, is that it tries to illustrate a decision or set of decisions: why they were taken, how they were implemented, and with what result (Schramm, 1971,emphasis added, Yin 2003). Bryman and Bell, (2003) said that case study is mostly associated to qualitative research method used to study complex organizations.

In undertaking this research we used a case study strategy since it investigates a real-life phenomenon, and can provide answers on the extent of the impact of microfinance in the development of textile industry SMEs in Tanzania. This was mainly done by using the qualitative methodology.

3.5 Data Collection

Evidence for case studies may come from six sources: documents, archival records, interviews, direct observation, participant-observation and physical artefacts (Yin, 2003). It should be noted that no single source has an advantage over all the others. In fact, all the sources are highly complementary, and a good case will therefore incorporate as many sources as possible (Yin, 2003).

Since incorporating as many sources as possible is highly complementary (Yin, 2003) therefore triangulation will be good for researchers to combine primary and secondary information in a single case study to ensure that the data they have is telling what they think the data is telling them (Saunders et al, 2003). For example, semi-structured interviews may be valuable way of triangulating data collected by others means, such as questionnaires (Yin, 2003).

In this research a single source was used to gather data to complete the research questions, where direct interviews using questionnaires and retrieval of information from relevant sources were personally performed by the researcher. To this end, data was collected through primary and secondary means. The primary sources included questionnaires, which rely on observation, interviews and records of information of interest. Questionnaires were administered to selected MFIs and small textile industry businesses owner. Secondary data was taken from articles, textbooks and already prepared materials from libraries as well as the Internet.

3.6 Sample Selection and Sampling Techniques

3.6.1 An Overview of Sampling Designs

Sample design is a definite plan for obtaining a sample from a given population (Kothari, 2004). It refers to the techniques or the procedures adopted in selecting the items for the sample. Sample design may as well lay down the number of items to be included in the sample (that is the size of the sample). In selecting the sample, consideration will be put in the information contents of the sample selected. Most sampling methods aim to give every number of the population the same probability of being included in the sample.

Sampling design is divided into two major areas; that is probability and non-probability- designs. Probability sampling is divided into simple random sampling, stratified random sampling and cluster random sampling whereby no-probability sampling is divided into quota sampling, convenience sampling and purposive sampling. It is important for the researcher to understand the applicability, advantages and disadvantages of each in order to come up with a sound conclusion and recommendations.

3.6.2 Sampling Technique Adopted

In this study a combination of the sampling techniques involving cluster random and purposive sampling methods described above were employed. Due to the nature of the study, the purposive sampling approach was used extensively. Purposive sampling is a deliberate non-random method of sampling which aims to sample a group of people or settings, with a particular characteristic, usually in qualitative research designs where respondents were selected because of their inherent knowledge for the research process. This ensured selection of respondents who were recipients of some form of microfinance or were practitioners in the microfinance institution concerned.

3.7 Area of Study

The study was conducted in Dar es Salaam region. The choice of this area was based on the fact that Dar es Salaam is the industrial and commercial capital of Tanzania (URT, 2003). Other reasons include time limitation, funds and accessibility of data in the country.

3.8 Study Population

A target population is a researcher's population of interests to which she or he would like the results of the research to be generalized. In particular, the target population for this study consisted the garment sector SMEs particularly women in the batik business within the study area. The conclusions that can be drawn from the sample depend critically on both the population sampled and the procedures used for generating the sample (Sharp et al., 2004). The targeted population in this research comprised of SME owners or managers in Dar es Salaam, as well as the Microfinance Institution PRIDE.

3.9 Data Collection Methods and Instruments

3.9.1 The Concept of Data Collection

Data can be collected as Primary data or Secondary data. Primary data includes data which are directly collected from the field using tools like questionnaires and interviews. Again secondary data are those data which are collected from past written document on related topics. The most desirable approach with regards to the collection of appropriate technique for data collection depends on the nature of a particular problem and on time and resources available along with the desired degree of accuracy. Now the following are some data collection methods.

3.9.2 Questionnaire Methods

A questionnaire is a document consisting of specific questions intended for certain targeted interviewees. Questionnaires in this study were formulated in such a way that interviewees were to give information without fear or bias. Questionnaires consisting of both open and closed ended questions were prepared by the researcher and administered to the sampled textile SMEs and representatives of PRIDE (see the *Appendix Section*). Also, other two methods were used and these include; interviews and documentary review.

3.9.3 Interview Methods

According to Cohen (2001), an interview is regarded as an interchange of views between two or more people on a topic of mutual interest. It is a research instrument for data collection that involves a collection of data through verbal interaction between the interviewee and the interviewer. In this research structured interviews were conducted in the SMEs' support institutions.

There are two main types of interviews: which are formalized and structured, using standardized questions for each research participants (often called a respondent), or they may be informal and unstructured conversations (Mark Saunders, et al, 2009). Structured interviews use questionnaires based on a predetermined and standardized or identical set of questions and we refer to it as interviewer-administered questionnaires (Mark Saunders, et al, 2009).

Each question is being read and response is done on a standardized schedule, while it's a social interaction between the participants. As structured interview are used to get a quantifiable results, they are referred to as quantitative research interview (Mark Saunders, et al 2009). On the other hand, semi-structured and in depth interview are non-standardized. These are often referred to as qualitative research interviews (King, 2004).

The researcher conducted interviews in order to generate information about challenges faced by SMEs in the textile industry in Tanzania. Such interviews were used because they constitute flexible research strategy. The researcher was taking notes during the interviews. The researcher personally conducted all the interviews for two reasons. First, it was to ensure accuracy and consistency of the data collected, and secondly the size of the sample was small, a factor that made the task manageable.

3.9.4 Documentary Review

The researcher reviewed documents including different publications on SMEs development in Textile Industry and Microfinancing services. The review from these documents aimed to probe and understand the state of MFIs contribution in development of SMEs in the Textile Industry in general. The method was chosen by the researcher because data from these documents augmented evidences from the other sources of data obtained.

3.10 Reliability and Validity of Data

Pattern (1998) describes validity as a mechanism that ensures that the process implemented to collect data has indeed captured the intended data successfully. Validity refers to the extent in which an empirical measure adequately reflects the real meaning of the subject under investigation. To ensure the data acquired was valid in this study, the following steps were taken. Self-administered questionnaires were given to respondents who got educated about the intention of the research and assured of their anonymity and confidentiality. An extensive literature review, interview and self-administered questionnaire surveys were conducted. The above steps ensured that the multiple sources of data collection such as were conducted under conditions and in an environment acceptable to the respondents, ensuring the process and findings derived were trustworthy and valid.

3.11 Data Analysis and Report Writing

Data from questionnaires were analyzed using Statistical Package for Social Sciences (SPSS) computer program and Microsoft Excel; that involved determining frequencies of responses whereby numbers was converted into percentages in order to make sense. Interviews and reviewed documents was analyzed using content analysis whereby the researcher coded, categorized, compared and made conclusions of the data. The findings were reported by using cross- tabulations and charts.

3.12 Summary

This chapter has presented research types, research design, information collected as well as sampling techniques used in the research. The data collected were obtained from Textile Industry SMEs as well as support institutions and the criteria for sampling focused on the adequacy of responses to be given by the chosen sample.

CHAPTER FOUR

4.0 RESEARCH FINDINGS

4.1 Introduction

This chapter presents the empirical results, interpretation and discussion gleaned from collected data. The research data was obtained through primary and secondary sources. In particular, the chapter covers in-depth analyses of findings pertinent to the specific research objectives. The chapter described extensive information on operations of PRIDE TANZANIA, the MFI chosen for this case study, is presented. Findings on social and demographic characteristics of the research respondents, sampled borrowers of PRIDE TANZANIA, are presented, analysed and extrapolations on any impact of MFIs in the development of SMEs in the Tanzanian textile industry are made. The chapter also delves on empirical findings on the question of whether the SME members have reasonable and fair access to microfinance services. Opinions of the studied group of SMEs on enhancement of accessibility of microfinancing services to SMEs in textile industry are presented.

4.2 General Overview of PRIDE Tanzania

Promotion of Rural Initiative and Development Enterprises (PRIDE) was incorporated in Tanzania in 1993 as a company limited by guarantee. It derived initial funding under a Bilateral Agreement between the Government of Tanzania and the Royal Government of Norway from 1993 to 2001 through NORAD; the Swedish Government joined as a donor through SIDA in 2000. It started its operations in January 1994 with its first branch and head office in Arusha, Tanzania. The operations started first on a two-year pilot phase running from September 1993 to

August 1995 involving three branches in Arusha, Tanga and Dar es Salaam regions. After the successful completion of the two-year pilot phase an expansion phase was rolled out. Figure 1 shows a map of PRIDE's branch network in Tanzania.

Figure 4.1: A Map Showing Network of Branches of PRIDE Tanzania

Source: PRIDE, 2011

PRIDE's target clients are the poor but economically-active individuals owning and running SMEs in urban and rural areas of Tanzania. PRIDE's main objective is to promote small-scale business entrepreneurs in the informal sector through provision of non-collaterised credit. The MFI's has eight loan types with principal loan amounts ranging from TZS 50, 000 to 10,000,000; clients have to graduate from lower to higher loan cycles and interest is charged based on the loan terms with typical repayment schedule between 25 to 100 weeks depending on the loan size.

4.3 Demographic Characteristics

4.3.1 Age Distribution

Table 4.1 and Figure 4.2 provide statistical information on age distribution amongst the respondents. The analysis revealed that 51.8% of respondents were in the age group 21 to 25 years. 29.4% of the respondents comprised those in the age range of 16 to 20 years. 9.4% of the studied respondents were aged between 26 and 30 years. 7.1% of the studied participants were in the age range 31 to 35 years and the remaining 2.4% of the respondents were 36 years and above. These results indicate that in an urban area like Dar es Salaam, where this case study was undertaken, the youth (less than 35 years) are the most active in running small Batik businesses within the textile industry. This is consistent with socio-economic reality in a low-income country such as Tanzania where the youth have very few options when it comes to formal employment. Therefore, informal and SME sectors provide alternative income-generating opportunities for the youth.

4.3.2 Gender Distribution

Table 4.2 and Figure 4.3 exhibit the gender distribution amongst the respondents. 72.9% of all SMEs involved in the study were of the female gender and only 27.1% were of male. These results indicate that more women own Batik businesses and access credit for development of their small enterprises. Traditionally, African men have financially been in charge of their families while women took care of the household and/or engaged in home-based income-generating activities. Due to socio-economic dynamics there is a trend of increased participation of women as most economically-active members in Least-Developing Countries (Mahmud, 2003).

Table 4.1: Age Distribution of the Respondents

Age (Years)	Frequency	Percentage (%)	Cumulative Percentage (%)
16 – 20	25	29.4	29.4
21 – 25	44	51.8	81.2
26 – 30	8	9.4	90.6
31 – 35	6	7.1	97.6
> 36	2	2.4	100
Total	**85**	**100.0**	

Source: Field Study 2012

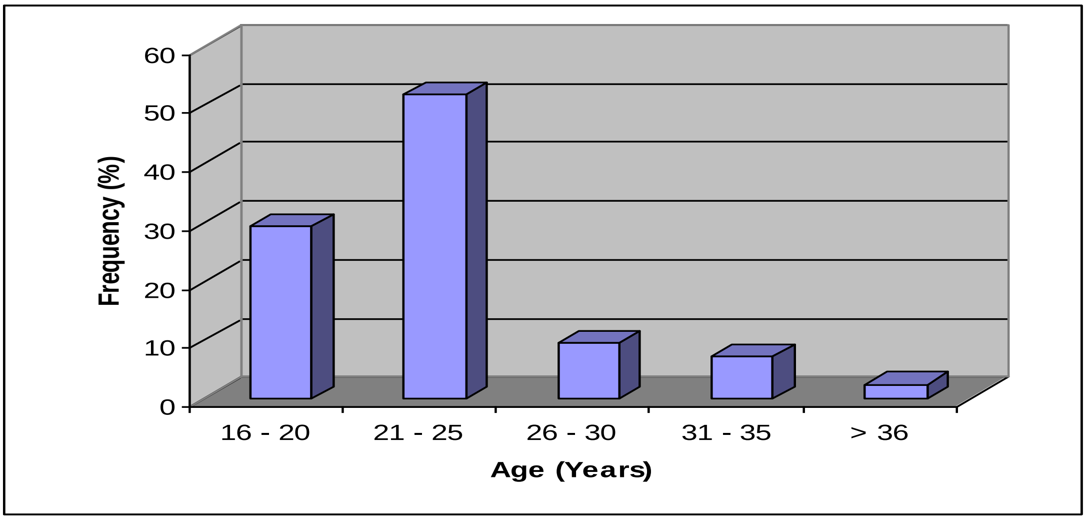

Figure 4.2: Age Distribution of the Study Participants

Source: Field Study 2012

Table 4.2: Gender of the Respondents

Gender	Frequency	Percentage (%)	Cumulative Percentage
Male	32	37.6	37.6
Female	53	62.4	100
Total	**85**	**100.0**	

Source: Field Study 2012

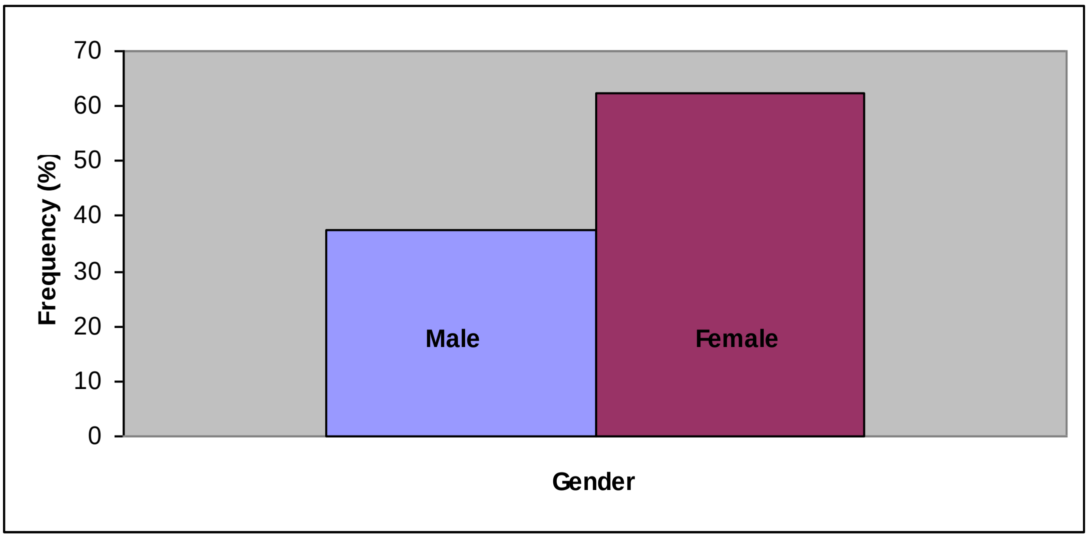

Figure 4.3: Gender Distribution Amongst the Study Participants

Source: Field Study 2012

4.3.2 Educational Profile

The respondents were probed in terms of their educational experiences as this aspect could affect the way in which they manage their businesses. Results of the educational background survey (see Table 4.3 and Figure 4.4) indicate that many of the respondents received at least basic primary education, which represents 64.7% of the sample; 28.2% of the sampled Batik business owners had secondary educational experiences. Only 7.1% had some tertiary educational background, in fact none of the participants had a degree or post-graduate qualification. Since our case study was focused in the City of Dar es Salaam, the observed educational backgrounds of the SME owners are consistent with the SME sector in urban areas in general. These results also correlate with the age distribution of the participants discussed above, where most were found to be in the youth category of the general population. Perhaps due to educational limitations experienced the respondents could not access higher education to allow them access to formal employment as skilled workers in other sectors.

Table 4.3: Educational Profile of Study Participants

Educational Level	Frequency	Percentage (%)	Cumulative Percentage (%)
Primary	55	64.7	64.7
Secondary	24	28.2	92.9
Certificate/Diploma	6	7.1	100
Degree/Postgraduate	0	0	100
Total	**85**	**100.0**	

Source: Field Study 2012

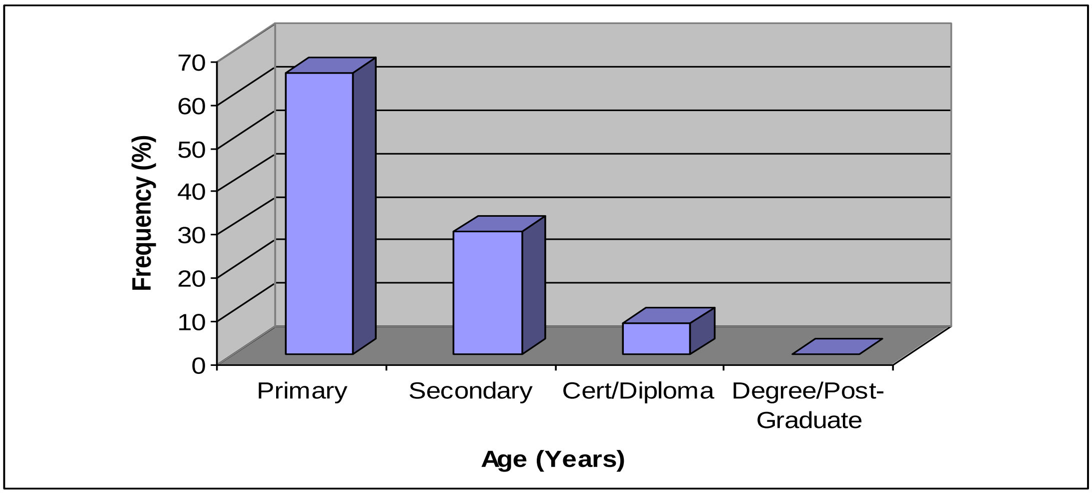

Figure 4.4: Educational Profile of Studied Participants
Source: Field Study 2012

4.4 Awareness and Accessibility of Financial Services

In Table 4.4, a descriptive analysis on the respondents' degree of awareness on availability of various financial services, types of service providers and nature of their usage of these services as small business owners in the textile industry. All respondents were aware of various financial service provisions available to individuals and business owners accordingly. 12.9% indicated they utilise commercial banks, 18.8% have accessed services of microfinance companies, 31.8% have used Savings and Credit Societies (SACCOS) and other cooperative financial services and 36.5% have accessed financial services through other establishments such as Self-Help Groups (SHGs), Rotating Savings and Credit Associations (ROSCAs) and Village Community Banks (VICOBAs). The respondents seem to be sparsely divided at 45.8% and 54.2% on using financial services for saving and credit purposes, respectively.

Table 4.5 and Figure 4.5 show sources of start-up capital of the studied small Batik businesses. 45.9% began their businesses after securing individual loans from friends or relatives. 12.9% were able to kick-start the Batik business after receiving either grants or soft loans from donor agencies such as NGOs or Trust Funds. 17.6% of the respondents indicated that they converted their own personal savings into start-up capital. 18.8% of the SMEs probed utilised some form of MFI loan as start-up capital. Formal bank loans were used by only 4.7% of the Batik businesses. These results strongly indicate that major source of initial capital is from individual loans negotiated by the business owner on person-to-person basis, particularly from family members and friends, in informal arrangements. Donor and Trust Funds also play a significant role in providing start-up capital to Batik businesses. The MFIs seem to play a fair role in providing financing for start-up projects in the Batik textile SMEs.

Table 4.4: Descriptive Analysis of Level of Awareness and Access to Financial Services by Batik SMEs

Item	Variable	Response	Frequency	Percentage (%)	Cumulative Percentage (%)
1	*Awareness on Existence of Financial Services*	Yes	85	100	100
		No	0	0	
		Total	**85**	**100.0**	
2	*Type of Financial Service Provider Used*	Commercial Bank	11	12.9	12.9
		Microfinance Companies	16	18.8	31.8
		Cooperative (e.g SACCOS)	27	31.8	63.5
		Other (SHGs, ROSCAs, VICOBA/ VSLA)	31	36.5	100
		Total	**85**	**100.0**	
3	*Purpose for Using Financial Services*	Savings	39	45.9	45.9
		Credit	46	54.1	100
	Total		**85**	**100**	

Source: Field Study 2012

Table 4.5: Information of Sources of Start-up Capital

Variable	Response	Frequency	Percentage (%)	Cumulative Percentage (%)
Source of Start-up Capital	Loan from MFI	16	18.8	18.8
	Bank Loan	4	4.7	23.5
	Personal Savings	15	17.6	41.2
	Individual Loan (Friends or Relatives)	39	45.9	87.1
	Donor /Trust Funds	11	12.9	100
Total		**85**	**100.0**	

Source: Field Study 2012

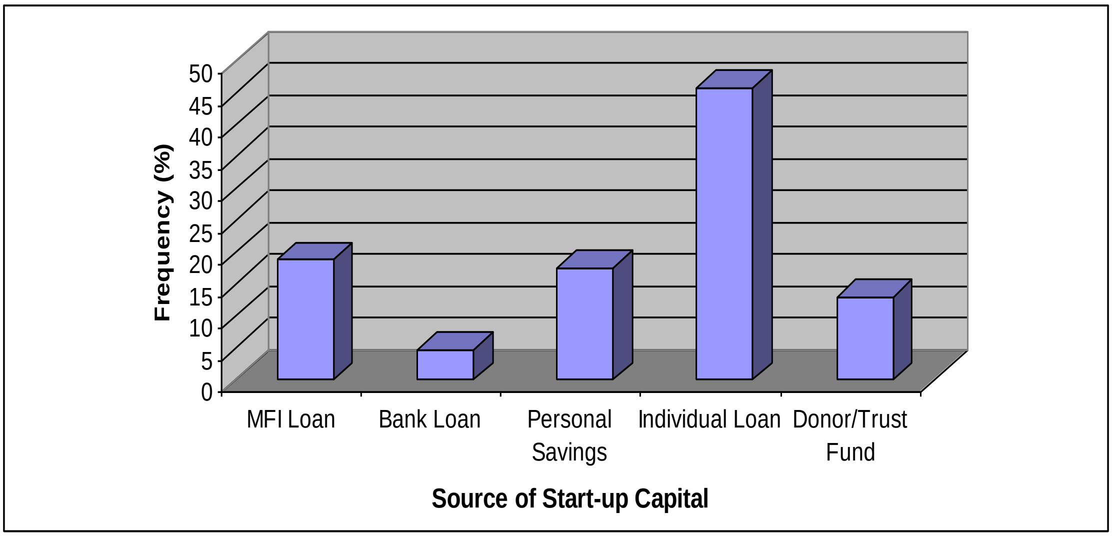

Figure 4.5: Sources of Start-up Capital of SME Study Participants

Source: Field Study 2012

4.5 Impact of Microfinance Institutions in Provision of Funding to SMEs

To ascertain on impact of MFIs in general and PRIDE TANZANIA in particular, comparative analysis of the microfinancing portfolios of various MFIs operating in Tanzania were performed as shown in Table 4.6. It was estimated that 319,000 active borrowers utilised MFIs in Tanzania in 2011 and 420,000 were depositors. Collective loans disbursed by MFIs in Tanzania in 2011 amounted to USD 965 million, whereas total deposits were USD 1.3 billion (Mixmarket, 2012). It is evident that MFIs in Tanzania have a notable presence. However, the population of Tanzania is estimated at about 45 million as of 2011 (NBS, 2012). Looking at the number of depositors and borrowers in the country's MFIs, there appears to be a huge gap and potential for expansion of services to reach a wider section of the economically-active adult populace in the informal sector.

Table 4.6: Gross Loan Portfolio and Active Borrowers of MFIs Operating in Tanzania-2011

Name	**Gross Loan Portfolio (USD)**	**Number of Active Borrowers**
National Microfinance Bank (NMB)	832,980,317	—
PRIDE TANZANIA	37,028,179	100,055
Akiba	36,524,661	21,843
BRAC TANZANIA	20,607,411	116,749
AccessBank	18,991,772	12,305
SEDA	5,023,311	25,209
MUCOBA	3,395,724	4,500
YOSEFO	2,521,617	18,120
Mwanga Community Bank	2,407,619	2,203
Mtoni	2,004,364	1,351
Opportunity Tanzania	1,795,494	7,230
PTF	1,147,468	6,108
VICTORIA Finance	342,857	155
MBF	212,031	2,478
K – Finance	194,029	572
IDYDC	—	—

Source: Mix market 2012 (www.mixmarket.org)

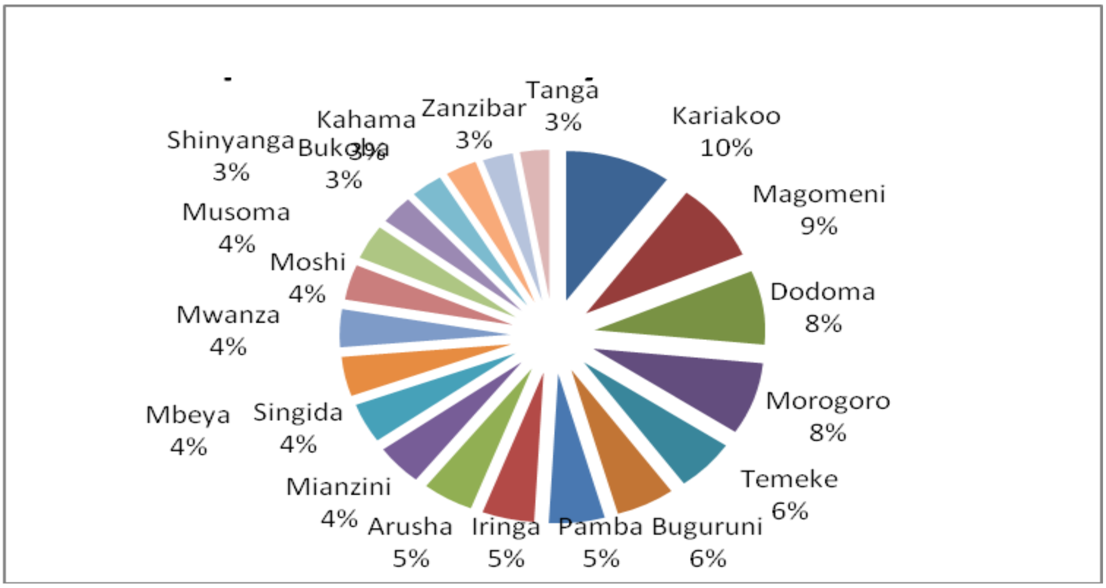

Figure 4.6: Loan Portfolio of PRIDE TANZANIA Branches

Source: Pride 2011 Performance Report

As of November 2011, the total loan portfolio for PRIDE was **TZS 52, 338,015,041** for all branches countrywide. Loan portfolio in Dar es Salaam (DSM) alone was **TZS 10,065,825,179.76** in November 2011, which accounted for 19.23% of the total portfolio. This indicates that much of loans disbursed were out of DSM. For DSM, where this case study was conducted, the loan portfolio by November 2011 is summarised in Table 4.7 and in the chart of Figure 4.7.

Table 4.7: Loan Portfolio in PRIDE's Dar es Salaam Branches

Branch	**Amount (Nov. 2011)**
Kariakoo	3,732,477,474.19
Buguruni	2,072,624,219.07
Magomeni	3,169,067,786.50
Gongolamboto	344,118,000.00
Tegeta	353,666,000.00
Mbezi	393,871,700.00
TOTAL	**10,065,825,179.76**

Source: Pride 2011 Performance Report

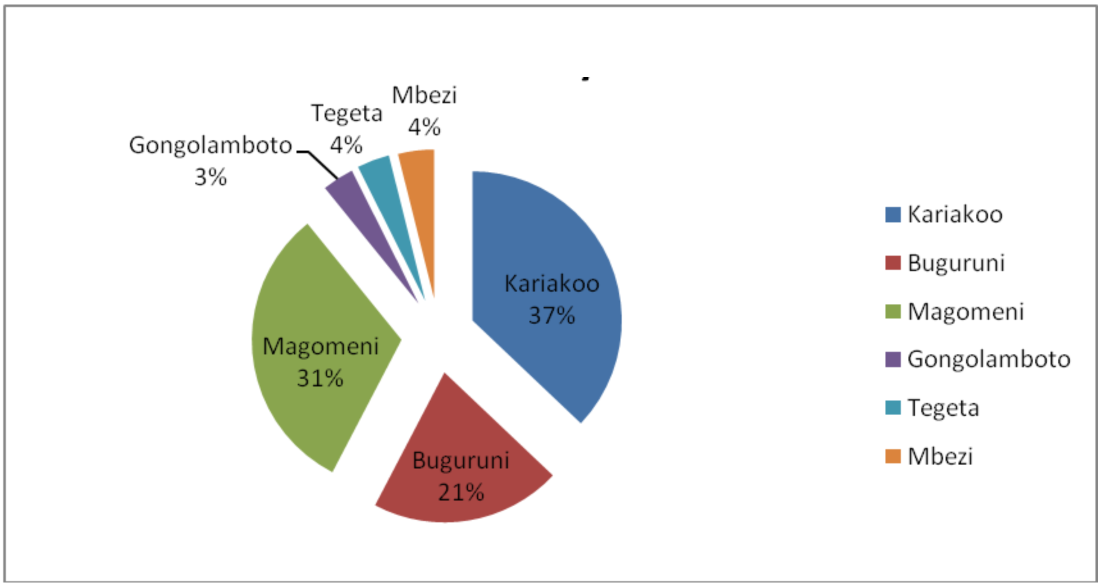

Figure 4.7: Loan Distribution in Dar es Salaam

Source: Pride 2011 Performance Report

4.5.1 Impact of Microfinance on SMEs in the Batik Textile Industry

In order to gain some insight on any impact of microfinance on SMEs in the Batik textile sub-industry, responses from a sample of ten SMEs who responded validly to the questionnaire capturing this type of information was analysed on the form, magnitude of microfinance and any effect the received funds from PRIDE Tanzania had on their business profitability and expansion.

The trends in magnitude of loans received by the Batik SME clients of PRIDE are shown in Table 4.8 and Figure 4.8. Over 70 % of the respondents accessed loans of less than TZS 1,000,000 showing typical microcredit nature of the MFI services. Indirectly, the loan amounts show the insufficiency of the funds for business start-up purposes. Indeed, most of these clients applied for the microcredit for expansion and working capital for their small businesses. Start-up funds were derived from other sources. This correlates very well with analysis of start-up capital by SMEs discussed in Section 4.4 of this chapter.

Table 4.8: Distribution of Loan Magnitude Received from PRIDE by Respondent SMEs in the Batik Textile Industry

Variable	Amount (TZS)	Frequency	Percentage (%)	Cumulative Percentage (%)
Amount of Loan	< 250,000	1	10.0	10.0
	250,000 – 500,000	2	20.0	30.0
	500,000 – 750,000	2	20.0	50.0
	750,000 – 1,000,000	2	20.0	70.0
	> 1,000,000	3	30.0	100.0
Total		**10**	**100**	

Source: Field Study 2012

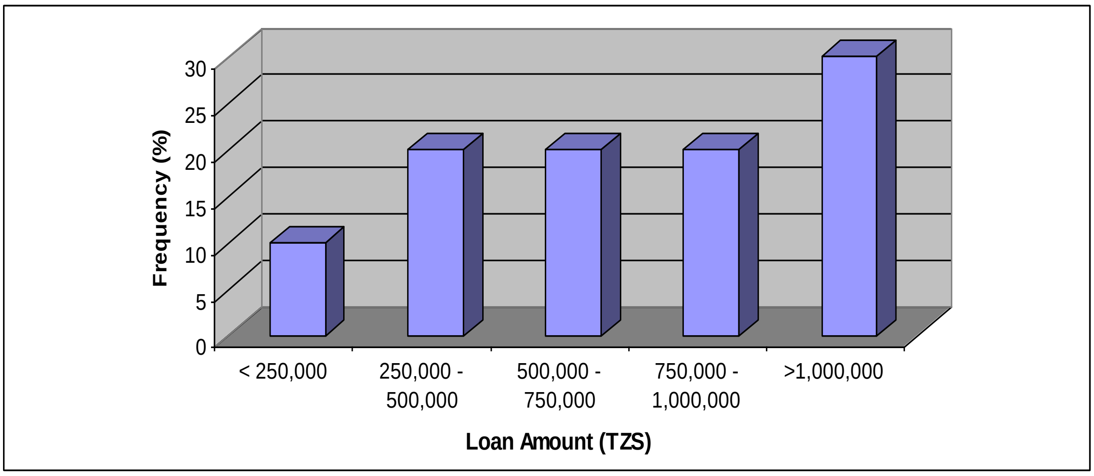

Figure 4.8: Distribution of PRIDE Loans Received by Respondent Batik SMEs

Source: Field Study 2012

Table 4.9 and Figure 4.9 provide descriptive analysis of effect of microfinance funds received by the sampled Batik businesses after they received PRIDE loans. 60 % of the respondents responded positively that their businesses net profits grew as a result of microfinance funds. However, 40 % of the respondents' businesses struggled with utilization of the loans received to grow their businesses profitably.

Table 4.9: Net Profit Analysis of Batik Businesses after Receiving Microcredit from PRIDE

Variable	Response	Frequency	Percentage (%)	Cumulative Percentage
Increase in Net Profit	Yes	6	60.0	60.0
	No	4	40.0	100
Total		**10**	**100.0**	

Source: Field Study, 2012

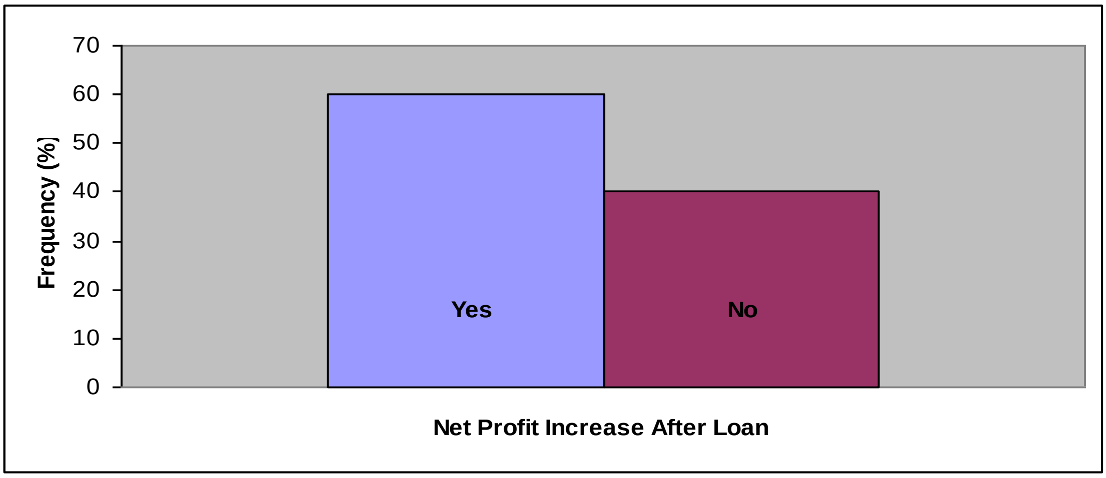

Figure 4.9: Effect of Microfinance Funds on Net Profit of Respondent Batik SMEs

Source: Field Study 2012

4.6 Accessibility of Microfinancing Services

4.6.1 Sensitivity Analysis of PRIDE's Loan Requirements

To address the question of whether SMEs have fair access to micro financing services, a random sample of participants were probed on loan requirements offered by PRIDE TANZANIA and whether the respondents qualify to meet them. When looking at this, the researcher tested key PRIDE requirements to the respondents to understand what kind of opinions the SME members had on such microfinancing requirements.

PRIDE offers the following types of loan products:

i) MEC Loan;
ii) Fahari Loan Product;
iii) Ajira Loan Product; and
iv) Wholesale lending.

Each type of loan has a set of requirements as summarised in Table 4.10 (Note: *The Ajira Loan Product* is only applicable to employees in the Government and other reputable organizations where the employers guarantee their employees to access the loan; this product is omitted in further analysis where focus is on SME access to financial services from PRIDE). Table 4.11 presents a descriptive analysis on favourability of relevant loan requirements to the studied group of SMEs.

The loan requirement sensitivity analysis revealed that for the MEC Loan product the percentage of minimum loan insurance balance of 25% is unfavourable to 30% of respondents. These respondents wished that the MFI can adjust the insurance balance so that they could access the funds to invest in expansion of their businesses to increase their profit margins. The position of PRIDE on the requirement of retainment of a mandatory minimum balance is to allow for a saving culture among its clients, maintenance of a healthy balance sheet of the company and as a recovery safety net in the event of loan defaulting. To the SMEs probed the consequence of the minimum balance insurance of 25% of loaned money appears to be a deterrent to potential clients to access PRIDE's services.

Table 4.10: Descriptions of Loan Products Offered by PRIDE Tanzania

Type of Loan	Description
MEC Loan	This product is based on modified Grameen model. i) To be eligible, a client must join a self-selected solidarity group guarantee of 5 members called Enterprise Group ii) 10 Solidarity groups combined into one large group of 50 called a market enterprise group (MEC), for ease administration and enhancement of group mechanism. iii) Peer pressure and a three tier loan guarantee system to ensure loan repayment iv) Weekly meeting lasting for a maximum of 1 hour v) Compulsory weekly savings as part of loan insurance scheme and refundable upon exit vi) Access to a loan is subject to minimum loan insurance balance amount to 25% of loan amount except for the first loan cycle. vii) Loan cycle ranges from TZS 100,000 to 1.0M viii) Involvement of the client in the administration of the program through elected leadership. ix) Half yearly bonus payout on compulsory savings
Fahari Loan Product	• Solidarity group of three to five self selecting from among MEC loan clients • Monthly loan repayment • Near collateral items pledged as additional guarantee to reinforce security supported by formal legal agreement • A client may select a variable loan term from 6 to 24 months • Half yearly bonus payout on compulsory savings • Meetings lasts only 20 minutes • Loan cycles ranges from TZS 2M to 15M
Wholesale Lending	The modality of the scheme involves the provision of loans to rural based microfinance institutions such as SACCOS and SACAS, which in turn would lend the funds to their members. • The product is targeting registered SACCOS • Board members guarantee the loan. • Less than a week processing time • Loan sizes range from TZS 10 million – 50 million • Competitive interest rate • Flexible loan term between 6 – 12 months

Source: PRIDE, 2011

Table 4.11: Respondents' Sensitivity Analysis on Loan Requirements

Loan Product	Tested requirement	Response
MEC Loan	Minimum loan insurance balance amount to 25% of loan amount	30% suggested a waiver or reduction of insurance balance
Fahari Loan Product	Near-collateral items	40% responded that most of the time they do not have any type of collateral
Wholesale Lending	Competitive interest rate	30% feel the interest rate is too high

Source: Field Study, 2012

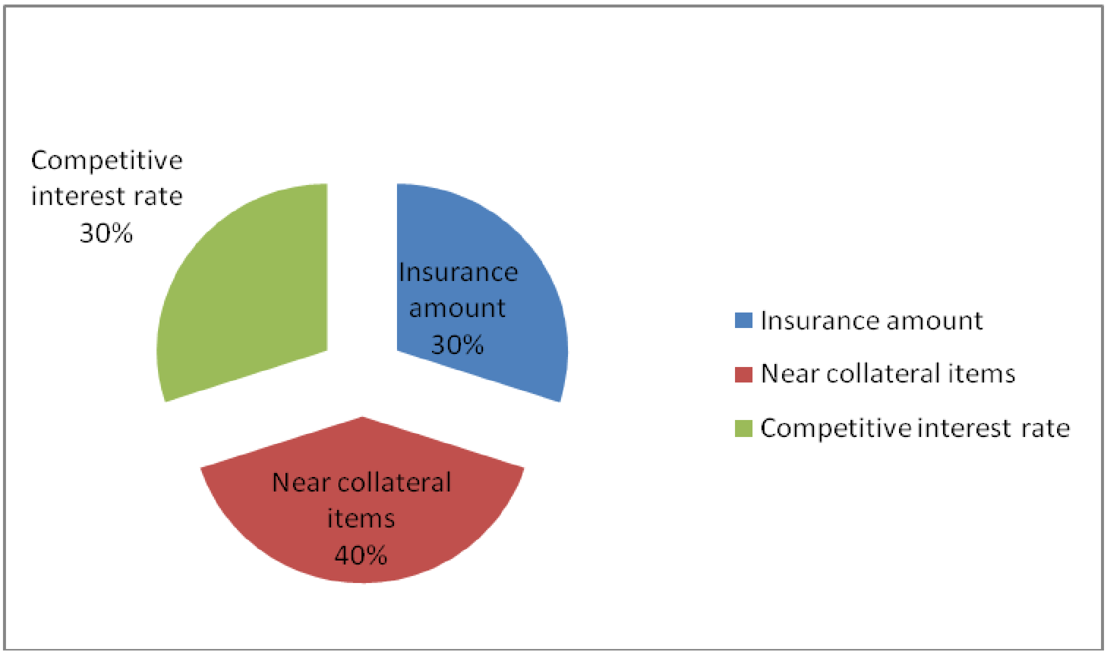

Figure 4.10: Sensitive Loan Requirements

Source: Field Study 2012

Overall, it was found that three out of the loan requirements were critical to respondents' decision making process to subscribe to loan products of PRIDE as indicated in Figure 4.10; the chart shows that, 30% of the respondents claim that interest charged is too high, 40% have difficulties in obtaining collateral and 30% complained that the loan insurance is too high. Of particular concern is the near-collateral requirement of the Fahari Loan Product which appears to be leaning towards conventional banking credit; a divergence from the microfinance principle of provision of non-collaterized credit for small and micro entrepreneurs.

The above findings are indicative of the soundness of Government of Tanzania efforts through its central bank (CBN) in 2000, to issue a microfinance policy that serves as a regulatory and supervisory framework. It was a decision in the right direction. Adherence to pro-poor fundamental principles of microfinance should be promoted through adjustments in the existing policies to allow for greater breadth of access to microfinance by SMEs in Tanzania.

After analyzing the above information and looking at the respondents weighing of PRIDE requirements to access loans, the researcher can respond to the question on whether the institution is fair and reasonable by declaring that to a larger extent, PRIDE is fair when providing funding as it does not require stringent collateral as compared to commercial banks. However, the institution appears not to be reasonable as far as the exorbitant interest rates charged are concerned, given the fact that majority of the clients are low-income earners and micro business owners.

4.6.2 Extent of Loan Defaults by Batik SME Clients of PRIDE

When analyzing this, the researcher had to go through the loan performance of PRIDE per branch in Dar Es Salaam to establish how SMEs in Batik business perform in terms of loan repayment. The researcher was then able to be in good position to analyze whether the loan defaults of most SMEs in this sector is due to PRIDE loan terms and conditions.

Table 4.12: Loan Defaults in DSM Branches

Year	Frequency	% of Loan Defaults	Cumm % of loan defaults
2007	40	11%	11%
2008	58	16%	27%
2009	65	18%	45%
2010	80	22%	67%
2011	120	33%	100%
Total Frequency	**363**		

Source: Pride 2011

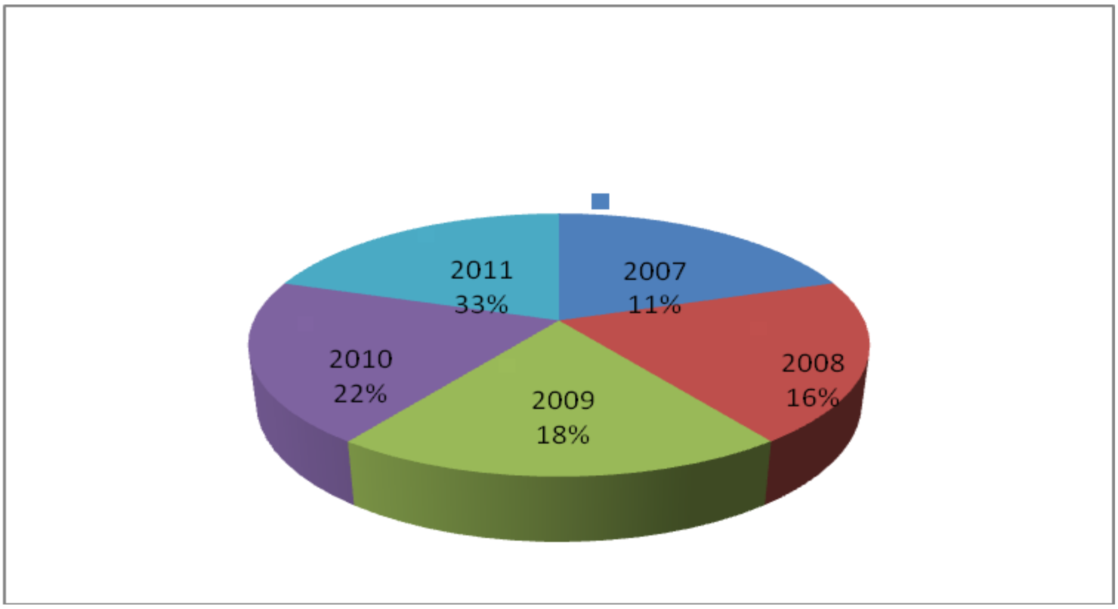

Figure 4.11: Loan Defaults in Dar es Salaam Branches

Source: Pride, 2011

As at November 2011, percentage of loan defaults in PRIDE for SMEs in Batik was 33% for all branches in Dar Es Salaam. The trend shows that loan default have continued to increase since 2007 from 11% to 33% in 2011 as shown in Table 4.12 and Figure 4.11.

Economic problems are often categorized in either merely microeconomic or merely macroeconomic issues and analysed accordingly. Microfinance, however, is a phenomenon that requires the involvement of both perspectives to be studied in all detail and to be understood comprehensively (Zaidi, 2009). In relation to the increase in loan defaults for Batik SME clients of PRIDE, it is important to understand macroeconomic factors which could have influenced their ability to repay their loans. To this effect, fluctuation in the inflation rate during the same period considered for the analysis of loan defaults , that is, 2007 – 2011, is accordingly shown in Figure 12.

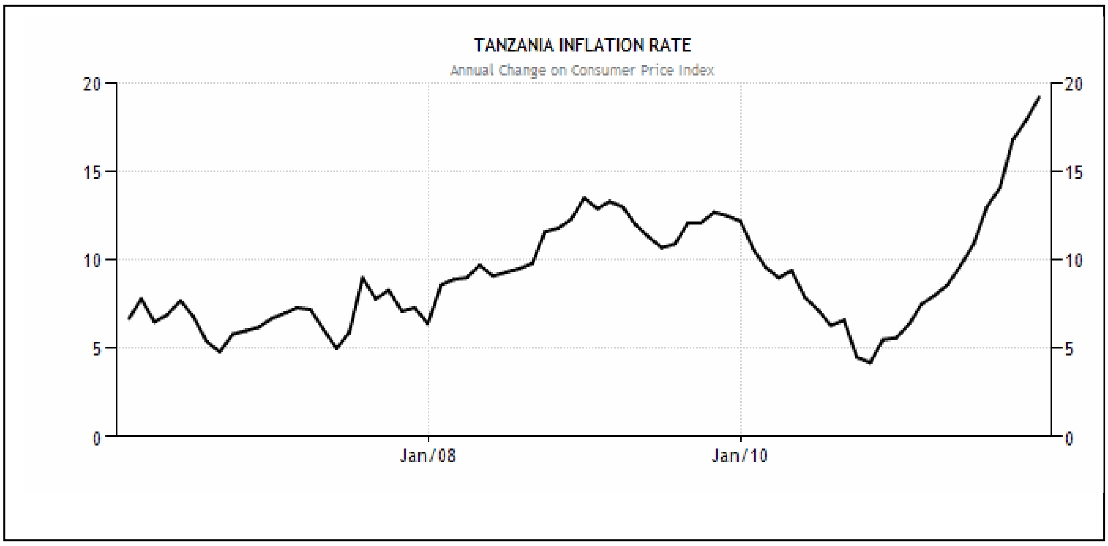

Figure 4.12: Annual Change in the Consumer Price Index in Tanzania Between January 2007 and January 2012

Source: www.tradingeconomics.com /NBS, 2012

In Tanzania, the National Consumer Price Index (NCPI) measures the change over time in the cost of a fixed basket of goods and services that are purchased by a representative sample of households. The index weights are based on expenditures of both urban and rural households in the 21 geographic regions. The most important categories in the NCPI are Food and Non Alcoholic Beverages (47.8 percent of total weight); Transport (9.5 percent); Housing, Water, Electricity, Gas and Other Fuel (9.2 percent). Clothing and Footwear account for 6.7 percent of total index and Furnishing, Housing Equipment and Routine Maintenance of the House for 6.7 percent. Restaurants and Hotels represent 6.4 percent of total weight and Miscellaneous Goods and Services (personal care, insurance and financial services) for 4.5 percent. Alcoholic Beverages and Tobacco represent 3.3 percent of total weight, Communication 2.1 percent, Education 1.7 percent, Recreation and Culture 1.3 percent and Health 0.9 percent (NBS, 2012).

It appears that prevailing economic conditions in the period 2007 to 2011 could have contributed to the increase in percentage defaults, as there was a significant change in the inflation rate from about 8% in 2007 to 13% in 2009, dropping to 5% by January 2011, and rapidly rising to 20 % by January 2012. Surely such inflationary pressures affected prices of raw materials used by the SMEs and the Cost-of-Doing business as a whole, with consequences in diminished turnovers and eventual loan non-repayment by a significant number of SME clients of the MFI. These trends are also indicated in the 40% of the respondents who had experienced diminished profits or losses as outlined in Section 4.5.1.

After analyzing the trend of loan defaults and looking on the respondents' perceptions of the loan requirements, the researcher can conclude that the loan terms from PRIDE have no link to the defaults. The researcher found that most SMEs in this sector loan defaults are due to multiple loan borrowing and loans not being utilized for the objective obtained; these hurdles were compounded by inflationary pressures. Over 70% of respondents also responded affirmatively on the question relating to concurrent multiple borrowing from different sources. Given the level of education of most of the business owners in the Batik industry it can be inferred that they also have insufficient business management and marketing skills, hence their vulnerability in loan management and business flexibility during harsh economic times.

4.7 Strategies to Enhance Accessibility of Microfinance to SMEs in Textile Industry

Tanzania is at the forefront in ensuring robust microfinancing strategies are in place to ensure development of SMEs. There several strategies and policies aiming to enhance accessibility of micro financing in Tanzania. Appropriate policies are in place, for example, The National Microfinance Policy, Community Development Policy, SME Development Policy, Vision 2025 and the National Land Policy. Also there several strategies in place including, the Rural Development Strategy, National Strategy for Growth and Reduction of Poverty, Operational Guidelines for Government and Donor Support to MFIs sector, and Guideline for evaluation of NGOs engaged in Microcredit activities.

For microenterprises, the most common constraint is the lack of access to working capital to grow their business. Low-income entrepreneurs want rapid and continued access to financial services rather than subsidies, and they are able – and willing – to pay for these services from their profits. The preceding analysis of borrowing trends of Batik business owners show that they borrow small amounts for short-term working capital and expansion purposes. However, the returns from their economic activities appear insufficient to pay high interest rates for loans and still make a profit.

Typically, small and micro entrepreneurs value the opportunity to borrow and save with MFIs since they provide services that are cheaper than those that would normally be available from commercial banks or Moneylenders who charge very high interest rates, often many times the rate charged by MFIs with terms that include some form of collateral to be deposited with the bank as a stringent requirement for accessing credit. On the other hand, MFIs cannot afford to subsidize loans. If the organization is to provide loans on an on-going basis, it must charge interest rates that allow it to cover its costs. These costs tend to be high because providing unsecured, small loans costs significantly more than loans in traditional banking. The costs to the institution include operating costs, the cost of obtaining the funds for loans, and the cost of inflation. More importantly, MFIs cannot rely on governments and donors as long-term sources of funding. They must be able to generate their own income from revenues, including interest and other fees.

Since the SMEs in the textile industry seek continued and reliable access to financial services and are able and willing to pay for it, provided that some adjustments on the loan requirements are made, it is advantageous to both the MFI and the clients for MFIs to charge some interest rate that cover the cost of the services at the same time distributed over repayment time so that the clients have sufficient time to invest in income-generating activities that will enable them to repay the loan with interest while growing their business earnings. The requirement by MFIs that 25% of the loaned amount must be retained as a savings balance should be revoked. Since for the low-income business owners in the Batik industry access to such retained funds can be utilised as working capital as the nature of the business involves purchasing materials at wholesale and reselling with margin at retail markets.

CHAPTER FIVE

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The research study was set to investigate existing challenges and opportunities that small businesses in the textile and garment industry in urban Tanzania face in their business development efforts. The key focus was access to microcredit provisions by PRIDE Tanzania and utilization of microfinance within the textile and garment industry. This chapter presents a summary of the findings, conclusions and recommendations derived from empirical evidence generated from this research with appropriate extrapolations.

5.2 Summary of Findings

The study involved two parts. The first one was the library-based research which involved investigating facts about Micro financing Institutions, SMEs development and the Textile Industry in Tanzania from different sources of past written documents, journals, and books, in print as well as on the Internet. The second part involved a case study research which involved collecting primary data from one of the largest MFI operating in Tanzania, namely PRIDE Tanzania, and a sampled subset of SMEs, with particular attention to Batik textile and apparel entrepreneurs in the City of Dar es Salaam.

5.2.1 Socio-Economic Characteristics of SMEs in the Textile Industry

In the quest to understand the demographic and other socio-economic backgrounds of the SMEs in the textile and garment industry the guiding research question was;

"What kind of socio-economic factors exist in small and medium scale business operations in the textile and garment industry in urban Tanzania?" The study found that most SME owners investigated were youth of female gender with secondary level educational backgrounds who turned to informal entrepreneurship as means of income-generation due to lack of formal employment opportunities for their level of education.

5.2.2 Financial Resources for Business Development

In the pursuit to identify the extent of awareness of financial services for business development and the ease of accessing finance by the SMEs in the study the guiding research question was "*Do SMEs in the textile and garment industry have reasonable access to reasonable financial resources needed for sustainable business development?*" The study revealed that that there was high level of awareness of financial services by the respondents who had utilised such services for both savings and credit purposes. However, business start-up capital was mainly derived from informal sources such as sourcing loans from friends and relatives.

5.2.3 Impact of Microfinance Services in Business Development

In the pursuit to identify the extent of awareness of financial services for business development and the ease of accessing microfinance by textile and garment SMEs the overall guiding research question was; *"Do microfinance institutions provide impact-oriented funding to develop small businesses in Tanzania in an acceptable way and on reasonable terms?"* The study showed that MFIs did not play a major role in provision of start-up capital. In general, the study found that MFIs have a notable presence in Tanzania with almost USD 1 billion in disbursed loans which appear to be accessed by entrepreneurs and individuals across most sectors with potential to grow to reach wider sections of the economically-active adult populace in the informal sector.

Specifically, the study found that PRIDE has reasonable set of risk management policies and guidelines which steer its credit risk. The researcher was also impressed by the trend of net liquidity gap which gives the institution a position to remain liquid throughout the year. PRIDE also has an in-house training program which helps to build the efficiency and capacity of the risk management team, this gives them a more ongoing system of updating their knowledge and learning about new things. The researcher was also impressed by the structure of the management and the role of the board in ensuring that there is good impact on SME growth in Tanzania.

The findings presented above also indicate that unlike large companies which can access formal capital markets or use cash flows to make large investments, SMEs in the textile and garment industry rely heavily on some form of microfinancing for their development and often lack track records to borrow at affordable rates in Commercial Banks.

5.2.4 Challenges in Accessibility and Utilization of Microfinance

Various challenges confront SMEs. The guiding research question in this study was; *"What challenges are SMEs facing with regards to access and utilization of funds from microfinance institutions?"* The study also revealed that, lack of capital is the key factor making SMEs to seek additional financing and that some loan requirements such as retention of a percentage of approved loan by the MFI and high interest rates as a cause for their caution in accessing the microfinance services. With respect to the Batik small and micro entrepreneurs who accessed services of PRIDE, about 60% had marginally experienced increases in net profit after accessing microfinance from the MFI as working capital whereas 40% struggled to convert the capital injection into profits, leading to loan defaults which could be attributed to multiple borrowing, pressure of high interest rates and lack of conducive business environment to support SMEs development.

In general, PRIDE was found to be fair when providing funding as it does not require stringent collateral as compared to commercial banks. However, the institution's interest rates charged to its customers appear as a deterrent to the clients to access credit for start-up and working capital purposes since the majority of the potential client base are low income earners and micro business owners.

5.3 Conclusions

The research centred on assessment of services (particularly conditions and procedures for credit) as offered by the microfinance institution PRIDE Tanzania in relation to business development by small and medium-sized textile enterprises in urban Tanzania. Moreover, it objectively focused on evaluation of performance of small and medium traders in the textile and garment sector in urban Tanzania in terms of growth, employment creation, income levels, and overall socio-economic impact after accessing some form of microfinancing. The study also aimed at establishing a set of recommendations on relevant policy and strategic adjustments for optimization of microfinance service delivery to small and medium entrepreneurs.

From what has been gathered from the study it is concluded that Microfinance Institutions generally have positive impact and play a big role in development of SMEs in general and textile industry in particular. However in order for the microfinancing to be effective and contribute positively to SMEs development, the Government has greater role in creating the economic conditions and financial infrastructure to allow SMEs to thrive. Moreover, the MFIs have to relax their stringent credit requirements such as interest rates to have broader outreach to SMEs, especially in provision of start-up capital to microentrepreneurs in the informal sector.

5.4 Recommendations

In light of the identified challenges in accessing and utilizing the microfinance services, there are some suggestions that have been made in order to improve service delivery. The guiding research question was *"What should be done to improve microfinance service delivery?"* The research established that the suggestions for improvement included the following: microfinance institutions should try as much as possible reduce the interest rates so that all the profits realized do not go towards paying back the loan and also increase the grace period to allow for concrete growth of the enterprise prior to loan repayment.

Microfinance organizations should also allow for the fact that microentrepreneurs have a variety of uses for funds, not only for the activity for which a loan is formally given, but also for household operations and other family enterprises. It would be too risky for the poor, particularly the poorest of the poor, to invest all their income in a single activity. If the single activity or enterprise failed, the consequences of this would be much greater than if they had several sources of income. Providers of quality financial services recognize this and place relatively few restrictions on loan use.

Most microfinance organizations do not monitor client loans to ensure that the loan is being used for its stated purpose because they recognize that it is part of the survival strategy of poor clients to make an on-going stream of economic choices and decisions. The clients themselves know how best to manage their funds as long as there is discipline, monitoring and evaluation for timely repayment. The latter requires training of SMEs on sound business principles and business management skills.

5.4.1 Recommendations to PRIDE Tanzania and other MFIs

a) PRIDE needs to review its interest rate policy and propose for more affordable and sustainable rates for small scale business owners;

b) MFIs should consider prevailing economic conditions to adjust loan repayment schedules ;

c) More capacity building is still needed for PRIDE’s officers to able to deal with more complex issues of SME business environment in Tanzania;

d) PRIDE also needs to design more proactive risk management tools for dealing with default issues and avoid charging exorbitant interest rates;

e) PRIDE should deepen and widen relationships with SMEs customers, rather than focusing on lending alone, gradually this will enable the institution to build up their level of comfort with risks of dealing with SMEs; and

f) Small businesses lack the capability to address issues such as tax and legal aspects. MFIs can help, by partnering with experts to offer them pertinent advice.

5.4.2 Recommendations to Policy Makers

a) The Government should increase efforts to ensure that there is conducive business environment to allow for sustainable growth of SMEs;

b) Policy makers should consider introduction of statutory incentives to SMEs utilising locally-produced raw materials, such as cotton, in their business ventures to ensure a competitive balance between importers and exporters of textile and garment related materials.

c) More studies need to be done in the area risk exposures and strategies for the very complex SME capacity building as it relates to access to capital and formal financial services.

d) Policy makers should consider streamlining the interest rate regulatory policy with uniform or capped interest rates for the microfinance industry across the board.

e) The researcher recommends more studies in the textile sector particularly the garment sub-industry to investigate more issues which affect the sub-sector such as marketing, technology, and quality assurance.

5.5 Limitations of the Study

Given the nature of the study programme, the research undertaken was limited in scope. The study aimed to probe the impact of microfinance in the textile industry in a case study approach. This restricted the scope of the study to one microfinance service provider operating in Tanzania and the sampled respondents were restricted in one geographical location, namely the City of Dar es Salaam as a representative urban area of Tanzania. The scope could be expanded to test widely the research questions by involvement of more MF service providers operating in Tanzania and participation of textile and garment SMEs in all major urban areas such as Arusha, Mwanza, and Mbeya in Mainland Tanzania as well as urban Zanzibar.

5.6 Areas for Further Research

The dynamics involved in the SME and microfinance services are complex and require multidisciplinary research efforts. Comparative studies could be carried out to probe the variations in strategic and administrative practices of major and minor MF service providers operating in Tanzania. Comparative studies of rural and urban SMEs in the textile and garment industry can be undertaken toward understanding underlying factors that influence distribution of SMEs and microfinance along various geographical locations in Tanzania.

The extent of accessibility of microfinance credit for small and medium level trading of imported textile and garments versus locally-fabricated materials could be taken further in a broader targeted research to understand the interplay of macroeconomics and microeconomics in the textile industry in Tanzania.

5.7 Concluding Remarks

The specific findings, conclusions and recommendations derived from this research can be useful by all stake holders of microfinancing and SME Development, from policy makers to practitioners, to ensure improved service delivery of microfinance with increased impact in the social and economic value chains in Tanzania.

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APPENDICES

Appendix I: Questionnaires

Research Project: Impact of Microfinance Institutions in Development of Textile Industries in Tanzania**.** The case of PRIDE Tanzania.

Objectives of the Research:

a) To examine the extent in which MFIs services impact the development of its members in their small and medium-sized textile industries;

b) To evaluate the accessibility of the SMEs in the garment sector to micro financing services; and

c) To formulate strategies to enhance accessibility of micro financing to SMEs in textile industry.

FILLING INSTRUCTIONS

Please fill in the blanks. In case the space provided is not enough, please write at the back of the page, clearly indicating the number of the question being answered. For range of values (multiple choice) questions, please tick/check only one box to the left, unless instructed otherwise.

Appendix ii: Profile of the SMEs

KINONDONI DISTRICT- DAR ES SALAAM

1. SME's Particulars

a) Name of the Enterprise: ……………………………………………...

b) Category (Batik or other textiles): ……………………………………

c) Date of Establishment: ……………………………………………..

d) Physical Location: ……………………………………………………

e) Postal Address: ……………………………………………………

……………………………………………………..………...

……………………………………………………..………...

f) Telephone No: ………………………………………..……………

g) Contact person: ……………………………………..………………

h) Position in the enterprise:

- ☐ Owner
- ☐ Director
- ☐ Manager
- ☐ Employee

i) The ownership structure of the enterprise is:

- ☐ Sole Proprietorship
- ☐ Partnership
- ☐ Cooperative
- ☐ Group

j) If owned by a Sole Proprietor, the owner is:

- ☐ Male
- ☐ Female

k) Highest qualification of the owner(s)

- ☐ Primary
- ☐ Secondary
- ☐ Certificate/Diploma
- ☐ Degree/Post Graduate

l) Manpower

i. How many employees are there in your enterprise?

....

ii. Out of the total above, how many are skilled?

....

iii. Out of the total above, how many are family members?

....

2. Development of SME (Conception)

a) How did you get the idea to embark on the textile industry SME venture?

- ☐ I saw someone do it and decided to copy.
- ☐ I was interested in this kind of business for quite some time.
- ☐ Someone offered to finance me.
- ☐ I was retrenched from my previous job and had to look for something to do in order to survive.

- ☐ I had to look for additional means of income (e.g Due to inadequate salary from my full-time job).
- ☐ Other (please explain):

  ……………………………………………………………………

  ……………………………………………………………………

3. Sources of Funding

a) What was the source of the start – up capital?

- ☐ Loan from a Microfinance Institution (e.g FINCA / PRIDE)
- ☐ Bank Loan
- ☐ Personal Funds
- ☐ Loan from an individual (e.g. a friend)
- ☐ Donor funds/NGO/Trust funds

4. Marketing

a) Who are the end-users of your product? (Tick one or more)

- ☐ General Public
- ☐ Government institutions
- ☐ Other (Please specify)

  ………………………………………………………..…………………

b) Is there good demand for your product(s)?

- ☐ Yes
- ☐ No

If yes, how do you know there is demand for your product(s)?

……………………………………………………………………

……………………………………………………………………

Appendix iii: Questionnaire to SMEs

i) To examine the extent in which MFIs services impact the development of its members in their small and medium-sized textile industry.

ii) To formulate strategies to enhance accessibility of micro financing to textile industry.

1. Business Performance

a) What is the estimated current value of your business?

☐ 0 to 500,000/=

☐ 500,000/= to 1,000,000/=

☐ 1,000,000/= and above.

b) On average how much profit do you earn from your enterprise?

....

2. Provisional of Financial Services

a) Are you aware of existence of financial services for enterprises such as yours?

☐ Yes.

If yes, have you accessed such services? Please explain your answer

……………………………….……………………………………

☐ No.

If no, why?

…………………………………………………………………………

……………………………………………………………………….....

b) If yes in (a) what type of financial institution have you dealt with?

	Saving	**Credit**
Formal Banking		
Microfinance Institutions		
SACCOS		

Other, please specify ………………………………………………………….

c) If you have accessed credit, what was the purpose of loan?

- ☐ Start-up Capital
- ☐ Expansion Capital
- ☐ Working Capital
- ☐ Other, please specify

  ………………………………………………………..

d) If you have accessed credit, what was the size of the loan?

e) If you accessed credit from MFIs, what benefits have you gained in development of your business? Please explain.

………………………………………………………………………………

………………………………………………………………………………

f) Do you normally get the loan amounts that you apply for? Give details.

………………………………………………………………………………

………………………………………………………………………………

g) Prior to receiving credit and afterwards how much was your net profit per month?

i. Net profit before accessing credit ……………………………..

ii. Net profit after accessing credit ……………………………..

iii. Explain in detail any differences between i) and ii) above……………………………………………………………….

…………………………………………………………………………

…………………………………………………………………………

h) Explain in detail what strategies should be used to enhance access of credit to MFIs for the SMEs in Textile Industry?

Appendix iv: Questionnaire to MFI

To evaluate the accessibility of the SMEs in the garment sector to micro financing services.

1. Respondent Profile

a) Name and Title of respondent:

…………………………………………………………………………………

b) Name and address of organization:

…………………………………………………………………………………

c) When was your organization/institution established………………………………………………………………

d) Under what acts are you registered and why?

…………………………………………………………………………………

2. Subject Matter

a) What were the major reasons for your establishment?

……………………………………………………………………………

b) Where did you source funds to establish such an institution?

……………………………………………………………………………

c) What are your current sources of funds, in order of importance

i)…………………………………………..

ii)…………………………………………..

iii)………………………………………….

d) Do you have financial policies?

☐ Yes

☐ No

e) If the answer in (d) is Yes, please briefly explain major highlights of the policies……………………..…………………………………

f) Who are your major customers?

……………………………………………..………………….

g) What are your lending criteria?

………………………………..………………….…………

h) What percentage of loan value must be backed by collateral, if any? ………………………………………………………………

i) Are clients happy with the conditions that exist for one to access credit? Explain your answer.

……………………………………………………………………

j) What are the most common purposes for and average sizes of loans that clients apply for?

k) What is the institution policy on

i. Delinquent clients……………………………………………..

ii. Follow-up of clients…………………………………………...

iii. Repeat loans ………………………………………………….

l) What is your current annual rate of interest on loans?

....