IMPACT OF CAPITAL STRUCTURE ON PERFORMANCE OF SMES IN TANZANIA:

A CASE OF SMES IN DODOMA MUNICIPALITY
IMPACT OF CAPITAL STRUCTURE ON PERFORMANCE OF SMES IN TANZANIA:
A CASE OF SMES IN DODOMA MUNICIPALITY

By
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A Dissertation Submitted in Partial Fulfillment of the Requirements for Award of the Degree of Master of Accounting and Finance (Msc A & F) of Mzumbe University

2015
CERTIFICATION

We, the undersigned, certify that we have read and here by recommend for acceptance by the Mzumbe University, a dissertation entitled Impact of Capital Structure on Performance of SMEs in Tanzania: A Case of Dodoma Municipality, in partial fulfillment of the requirements for award of the degree of Master of Accounting and Finance (MSc. A&F) of Mzumbe University.

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DEDICATION

This research is dedicated to my late Mother, Hamida Tungu and Father Juma Salamba, for realising the importance of education as they allowed me to attend school since I was childhood. Second to my Sister Mwanaisha Juma and brother in law Mr. Juma S. Nh’unga for their cooperation during the whole period of my studies at Mzumbe University.
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
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<tbody>
<tr>
<td>DMC</td>
<td>Dodoma Municipal Council</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>LTD</td>
<td>Long Term Debts</td>
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<tr>
<td>MMT</td>
<td>Modigliani and Miller Theory</td>
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<tr>
<td>OECD</td>
<td>Organisation Economic Co-operation and Development</td>
</tr>
<tr>
<td>PM</td>
<td>Performance Model</td>
</tr>
<tr>
<td>POT</td>
<td>Pecking Order Theory</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Assets</td>
</tr>
<tr>
<td>ROCE</td>
<td>Return On Capital Employed</td>
</tr>
<tr>
<td>ROE</td>
<td>Return on Equity</td>
</tr>
<tr>
<td>ROI</td>
<td>Return On Investment</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
</tr>
<tr>
<td>STD</td>
<td>Short Term Debts</td>
</tr>
<tr>
<td>TD</td>
<td>Total Debts</td>
</tr>
<tr>
<td>TOT</td>
<td>Tradeoff Theory</td>
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<tr>
<td>URT</td>
<td>United Republic of Tanzania</td>
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ABSTRACT

The aim of the study was to assess the impact of capital structure on SMEs performance in Tanzania particularly in Dodoma Municipality. Specifically, the study examined capital structure composition of SMEs, measured the performance of SMEs, examine the relationship between the capital structure and performance of SMEs based on profitability and liquidity and found out the factors affecting SMEs capital structure decisions. A case study design was used in this study. Dodoma Municipality was the case of the study findings.

The sample size selected was 100 SMEs stratified into textile shops, food vending, hardware and general supplies and secretarial and stationery. Primary data was collected from the SMEs Owners/Operators through structured personal interview questions. Secondary data was collected from financial records of SMEs. Documentary guide aided in data collection. Simple Regression Analysis and Karl Pearson Coefficient of Correlation were used to determine the relationship between the independent and dependent variables in determining the impact of the capital structure and SMEs performance, Simple Regression Analysis and Karl Pearson Coefficient of Correlation used to determine the relationship between variables. Descriptive analysis was used to compare and contrast between variables.

The findings revealed that capital structure had negative impact on SMEs profitability. However, capital structure had positive and significant impact on SMEs liquidity. Based on the study findings, increased debt finance on capital structure, firm’s profitability decreases. Increased debt financing, liquidity increases. Moreover, firms should avoid situations where they are highly leveraged since this may lead to bankruptcy if they are unable to make payment on their debts and SME owners should also make good investment decisions in order to increase profitability. Finally, the initial capital found to be the major factor affecting capital structure decision among SMEs under study.

Keywords: SMEs performance, Capital structure, Liquidity, and Profitability
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CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter sets the context for which the study is motivated. It looks at background of the problem, statement of the problem, research objectives, research questions, scope, and significance, limitations of the study and nature of SMEs in Tanzania particularly in Dodoma Municipality.

1.1 Background of the Study

The Small and Medium-sized Enterprise (SME) sector performs a significant roles worldwide (Abor, 2008). SMEs have a potential contribution socially and economically by contributing noticeably in job creation, revenue creation, innovations, as well as a catalyst for urban and rural area’s growth (Hallberg, 2000; OECD, 2004; Williams, 2006; Fatoki & Asah, 2011). Most of the industrialised countries, over 98% of all manufacturing sector firms originate from the SMEs sector and they are the main employment providers (Sanusi, 2003). The SME sector employs more than 22% of the productive labour force in the developing countries (Kayanula et al., 2000). Financing decisions are some of the most critical decisions for SME owners because they have direct impact on capital structure and performance of the SME (Brigham, 2004). Usually SMEs prefer internal funds over debt, growth oriented firms use more debt to fund their growth and higher educated firm owners use less debt (Lucey and Voronkova, 2008). Researches on SME sector have attracted attention from researchers, policy makers, and practitioners due to their contributions to economic growth (Kira, 2013)

SMEs have been and are still a central hub in generating income for the majority of urban dwellers with no formal paid employment; however enabling growth of SMEs has posed a major challenge (Kipilyango, 2012). Capital structure in SME sector is so far unique as compared to other business and thus optimal capital structure rules are often
not applicable to SMEs (Uzzi and Gillespie, 1999; Van der Wijst, 1989; Welsh and White, 1981). One of the reasons is the obstacle existing in the access of external financing for SMEs comparing to large firms (Da Silva et al., 2007). It is difficult for SME to access debt finance since the sector lacks of collateral to pledge in order to access external sources of finance (Barbosa and Moraes, 2004 and Fatoki and Asah, 2011). More importantly the study conducted by Kira (2012) found some of the reasons which lead difficult for SMEs to access debt in Tanzania are lack of collateral and poor accounting records. The problem is still found even to those SMEs that using different sources of financing some of them are still performing poorly and fail. This could be led to lack of knowledge on the best sources of financing mix for majority of SME owners and they have no ideas on how effective capital structure might influence their performance (Chepkemoi, 2013).

In spite of the statistical difficulties in defining SMEs and defining business failure in different countries, most of SMEs fail due to the lack of a consensus about what would qualify as optimal capital structure (Ahmad, Abdullah & Roslan, 2012). In fact the firm’s cost of capital is seen as function of its capital structure of which the choice of adequate and appropriate financing and investment reduce overall firm’s cost of capital and increase its market value and thus will maximise the shareholders wealth (Modarres & Abdoallahzadeh, 2008). The financial manager is required to take accurately and timely decisions on capital structure that derive the best combination of financial resources to reduce the cost of capital of the firm and the financing factors are the main cause of financial distress (Mamba & Nyanumba, 2013). Financing decisions result in a given capital structure and suboptimal financing decisions can lead to corporate failure. A great dilemma for management and investors alike is whether there exists an optimal capital structure (Mwangi et al., 2014). However, managers and practitioners still lack adequate guidance for attaining optimal financing decisions (Kibet et al., 2011).
The continued poor performance coupled with closure of medium sized enterprises has raised more questions than answers to researchers and practitioners. The performances of such firms have been deteriorating and even some companies like GTV, Lweza Clays, and Avis among others have been forced into receivership (Monitor 2008). Apart from companies like GTV facing closure, a survey by Global Entrepreneurship Monitor showed at least other 15 firms closing business by December 2008. It was also pointed out that the increase from 2.7% to 10.4% in December 2007 in commercial institutions’ non-performing assets was attributable to small and medium firms’ failure to service their loans due to insufficient financial resources (Background to Budget, 2008/9). Arising from the findings of Berger (2006), the capital structure employed by such firms could be a reason influencing their financial performance trends an issue that has not been given serious attention. This could be attributed to lack of knowledge on the best sources of financing with majority of SME owners having no ideas on how debts and internal sources of finance influence their financial performance (Chepkemoi, 2013).

The existing empirical studies have lacked systematic empirical evidence on which optimal financing mix that will benefit and improve performance of SMEs and provided mix results to help policy makers, financial managers and SME Operators in their financing decisions (Karanja, 2014). The study by Karanja (2014), Md. Abdus Salam (2013), Dube (2013), Fatoki (2011), San and Heng (2011), Saeed and Mahmoudi (2011), Ebaid (2009) and Wald (2009), are some studies which revealed that capital structure has positive impact on the SMEs’ performance where as the studies by Chepkemoi (2013), Abdul (2012), Adekunle (2009), Myers and Rajan (2008) and Chen (2004) revealed that the Capital Structure has negative impact on the SMEs performance. These contradicting results may not be generalised and most of these studies much less common and not applicable in Tanzania context particularly with a focus on the Tanzanian SME sector give room for introducing new study by the researcher in order to help all those policy makers and managers on the financing mix decision in Tanzania.
1.2 Statement of the Problem

An appropriate capital structure is a critical decision and important not only because of the need to maximise returns to various organisations, but also the impact such a decision has on an organisation’s ability to deal with its competitive environment (Siro, 2013). How much debt and equity the firm used to finance its assets is important, since it will impact on corporate financing decisions (Yahyazadefar et al., 2010). The real picture of SMEs business activities in Tanzania has not been unveiled entirely in reflecting the firm and owner-manager’s capital structure impact and key significance on SME’s growth (Kira, 2013). The initial capital and expansion capital fund for Tanzanian SMEs has been a perpetual problem in even though the government still intending to empower the sector (Kira & Zhongzhi He, 2012).

Studies relating to SMEs in Tanzania most of them conducted to reveal the impact of accessing finance for SMEs without indicating the appropriate capital structure for SMEs performance. These studies include The Evaluation of the Factors Influence the Access to Debt Financing by Tanzanian SMEs by Kira, (2013), The Impact of Firm Characteristics in Access of Financing by Small and Medium-sized Enterprises in Tanzania by Kira & Zhongzhi He, (2012), Impact of Size and Age on Firm Performance: Evidences from Microfinance Institutions in Tanzania by Kipesha (2013) pointed out only SMEs access finance from Financial Institutions without indicating what is the optimal financing mix for SMEs’ performance in Tanzania.

Similar studies covering the effect of capital structure of SMEs financial performance at Nakuru town in Kenya by Chepkemoi (2013), The Effect of Capital Structure on Financial Performance of Firms Listed at the Nairobi Securities Exchange in Kenya by Siro (2013) and the Relationship between Capital Structure and Firm Performance evaluation measures evidence from the Tehran Stock Exchange by Pouraghajan et al (2012) are much less common and inapplicable in Tanzania context particularly with a focus on the Tanzanian SME sector. Also, the existing studies have lacked systematic empirical evidence on which optimal financing mix that will benefit and improve
performance of SMEs in Tanzania to help policy makers, financial managers and SME Operators in their financing decisions. From these points of view, it was appropriate for the researcher to investigate further on the impact of capital structure on SMEs performance after accessing such funds in Tanzania particularly in Dodoma Municipality.

1.3 Research Questions

In order to deal with the above problem, specifically this research sought to answer the following questions:

1. What are the compositions of capital structure of SMEs in Dodoma Municipality?
2. What is the performance of SMEs in Dodoma Municipality?
3. What is the relationship between capital structure and performance of SMEs in Dodoma Municipality?
4. What are the factors affecting capital structure decision of SMEs in Dodoma Municipality?

1.4 Objectives of the study

1.4.1 General Objective

The main objective of the study was to assess the impact of capital structure on performance of SMEs in Tanzania.

1.4.2 Specific Objectives

1. To examine capital structure composition in SMEs found in Dodoma Municipality
2. To measure the performance of SMEs in Dodoma Municipality.
3. To examine the relationship between capital structure and performance of SMEs in Dodoma Municipality
4. To find out the factors affecting capital structure decision of SMEs in Dodoma
1.5 The significance of the study

The study will help the researcher to understand the impact of capital structure on performance of SMEs in Tanzania. Also the study will enable the researcher to acquire acknowledgement as a partial fulfilment of the Master of Science in Accounting and Finance. The findings will be good input for the policy makers in formulating effective strategies and policies which will assist the financial manager of the SMEs to determine effective financing mix to improve the performance of SMEs in Tanzania. The study may save as the stimulant for further studies to be conducted on similar or related topic by other researchers.

1.6 The Scope of the Study

This study focused on the capital structure influence on the performance of SMEs located within Tanzania. Thus, the geographical scope of this study only involved SMEs which are located within Dodoma Municipality and the data were collected from SME owners and Operators within Dodoma Municipality.

1.7 Limitations of the Study

They are the constraints on generalisability and utility of findings that are the result of the ways in which you choose to design the study and/or the method used (Thomson, 2007).

Poor cooperation from other respondents from the targeted SMEs owners/Operators because they were not willingly to provide the information relevant for the study because of confidentiality of such information; hence the researcher took up the responsibility of informing respondents on relevance of the study and assured confidentiality regarding their information. Also, the time allocated for the field work, data collection, data analysis and report writing was limited to enable carrying out a comprehensive field research with a large sample size. The researcher solved this problem by working even on weekends, asking the respondents to pardon him for the
inconvenience if any caused. Meanwhile, financial difficulties also affected a researcher during data collection. This is due to the fact that the researcher is sponsoring himself, thus was depending on her only source of income (salary), hence it was difficult to meet all expenses while conducting the research. To solve this problem first, the researcher tried as much as possible to lobby to the respondents to be confident with him so as to provide information readily. Second, the researcher tried to conduct the study as cheap as he could to curb financial constrain.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the theoretical and empirical literatures relevant for the Impact of Capital Structure on the performance of SME basically on the Modigliani and Miller, Trade-off theory, Pecking order theory, empirical and conceptual framework. The literature on capital structure has been expanded by many theoretical and empirical contributions since Modigliani and Miller (1958). These have been showing the impact of capital structure on the SME performance. The number of leverage relevance theories has been advanced by amending the perfect capital market assumptions of the original MM theorem (Hashemi, 2013).

2.2 Theoretical Review

Small medium enterprises (SMEs) operate a major role in national economies and considered as machine for economic growth all over the world. After the local commercial become to globalisation of market, SMEs have got many opportunities to deal business in integration with large-scale enterprises. They cannot exploit these opportunities and sustain their competitiveness if they focus only on certain aspects of their functioning and work in isolation. Therefore, majority of SMEs have simple systems and procedures, which allows flexibility, immediate feedback, short decision-making chain, better understanding and quicker response to customer needs than larger organisations (Singh, Garg and Deshmukh, 2008).

Financing decisions are some of the most critical decisions for SME owners in Tanzania because they have direct impact on capital structure and performance of the SME. The capital structure is described as the mix of debt and equity that a firm uses to finance its operations (Gitman, 2003; Brealey et al., 2008). Current changing and environmental evolution causes firm’s strategic plan to depend on the capital structure in terms of credit rating in order to select effective resources to achieve the goal of wealth maximisation to
their shareholders (Drobetz and Fix, 2003). The original hypothesis of capital structure originated from the Modigliani-Miller theorem (MM theory), the study argued that the value of the firm is irrelevant in financing decisions in a perfect market (Modigliani and Miller, 1958, 1963). According to Brigham (2004) Capital Structure is the way in which a firm finances its operations which can either, be through debt or equity capital or a combination of both. Capital structure refers to the way an organisation finances its assets through some combination of equity, debt or hybrid securities is measured as total debt divided by total equity (Peek and Rosengren (2000). In this study, capital structure refers to debt and equity sources. Debt and equity financing will be used as measure of capital structure applying pecking order theory for this research.

Financial leverage refers to the proportion of debt in the capital structure. Capital structure has for long been regarded as an important parameter from a financial economics standpoint since it is linked with a firm's ability to meet the demands of various stakeholders (Jensen, 1986). Firms can obtain funds from either external or internal sources. Internal sources of funds include retained earnings while external sources include loans from financial institutions, trade credit, issuance of loan stock, and issuance of equity shares. The creation of a capital structure, therefore, can influence the governance structure of a firm which, in turn, may influence the ability of a firm to make strategic choices (Jensen, 1986). Financing decisions which results into a given capital structure constitutes one category of managerial decisions (Mwangi et al., 2014).

According to Van Praag (2003), financial capital includes debt and equity. This is known as capital structure. Sogorb Mira (2002) points out that the most relevant capital structure theories that explain the capital structure of small and medium enterprises (SMEs) are those related to static trade-off, adverse selection and moral hazard (agency theory) and the pecking order theory. Andree and Kallberg (2008) point out that the genesis of modern capital structure theory lies in the work of Modigliani and Miller (1958) in their famous proposition I. Capital structure puts into perspective the way in which a firm finances its operations Brigham,(2004), this can either be through debt or
equity capital or a combination of both David, (1979). In fact the firm’s cost of capital is seen as function of its capital structure of which the choice of adequate and appropriate financing and investment reduce overall firm’s cost of capital and increase its market value and thus will maximise the shareholders wealth (Modarres & Abdoallahzadeh, 2008). The financial manager is required to take accurately and timely decisions on capital structure that derive the best combination of financial resources to reduce the cost of capital of the firm. The financing factor is the main cause of financial distress (Memba & Nyanumba, 2013).

There is no consensus definition of SME as various countries have definitions depending on the phase of economic development and their prevailing social conditions. In this, various indexes are used by countries to define the terms such as number of employees, invested capital, total amount of assets, sales and production capability (Kazungu & Moshi, 2014). In the context of Tanzania SMEs are defined on the SME Development Policy as those enterprises engaging up to 4 people, in most cases family members or employing capital amounting up to Tshs.5.0 million. The majority of micro enterprises fall under the informal sector (URT, 2003). A study conducted in Dar es Salaam has found that the small businesses contribute to alleviating poverty. It also showed that the average incomes generated by surveyed businesses (both profit margins and salaries) were above the basic and food poverty lines, much more for small-scale enterprises than micro-enterprises (Mnenwa and Maliti, 2008:viii).

A recent study (European Commission, 2012) pointed out that the most used factors in SMEs classification are: the number of employees, the annual turnover and the active balance. Other than these there are some more factors, of a smaller importance, like social capital or accessed credits. At the lower end of the SME sector, a large number of countries define a group, which is a mixture of the self-employed and “micro” enterprises, with less than 10 employees. Irrespective of the level of development of an economy, a significant proportion of micro and, sometimes, small enterprises are found in the informal sector or the shadow economy. Schneider (2003) compared the size of
the informal sector in 22 transition (former Soviet Union and Central and Eastern Europe) and 21 OECD economies from 2000-2002 and found that the size of the informal sector amounted to an average of 16.7%, 29.2% and 44.8% of GDP in OECD, Central and Eastern Europe and the former Soviet Union economies, respectively.

SMEs play important roles in many countries’ economy and make substantial contribution to employment and outputs regardless of the level of economic development of a country. SME businesses with less than 100 workers in the United States represent one-third of domestic employment and sales revenue (Velasco & Cruz 2001). SMEs represent 99.8 percent of all European Enterprises (European Small Business Alliance – The Independent Voice for Small Business, 2006). SMEs in the EU (those with fewer than 250 workers) account for about one-half of total value added and two-third of labour force (European Union 2002). SMEs contribute 40% and 50% of manufacturing output in Chinese Taipei, Japan and Republic of Korea in the 1990’s (UNCTAD 1998). Wattanapruttipaisan (2003) evidenced that SMEs in ASEAN contribute up to 90% of business establishments and 70% to 90% of Domestic workforce. Liu (2007) acknowledged SMEs as a major driving force in economic expansion in China, with more than 40 million SMEs and sole industrial and commercial proprietorships (getihu enterprises) are responsible for 59% of GDP, with 68.65% of imports and exports. They paid 48.2% of taxes and occupied more than 75% of employment in urban areas. SMEs have become the main driver of economic growth in China. SMEs in Kenya refer as the small enterprises have from 11 to 50 workers and medium enterprises have from 51 to 100 workers (Gray, Cooley and Lubatingwa, 1997). A Medium Sized Enterprise in Uganda is defined by the SME Business Guide (2008) as the one employing more than 50 people with an annual revenue of more than Uganda shillings 360M and assets of more than Uganda shillings 360M. This study will be guided by the definition of SMEs as per URT (2003).
2.2.1 Performance Models of SMEs

Performance is a measure of how well a mechanism/process achieves its purpose (Donglin, 2009). In enterprise management, Moullin (2003) defines an organisation’s performance as “how well the organisation is managed” and the value the organisation delivers for customers and other stakeholders.”

Performance Models (PM) of SMEs is the crucial factor in this research. According to Neely et al. (2002), PM area balanced and dynamic system, which gives a holistic view that, uses different measures and perspectives. The various models and perspectives are tied together and continuously monitor the internal and external context of organisations. Basically, PM and frameworks are designed to support management in measuring their performance, analysing and improving their performance through better decision making. Tatichi et al. (2008) mentioned that SMEs have used financial measurement tools such as ROI, ROE, and ROCE, which are basically used by large firms. Particularly, it is important to remark on the evolution of focusing on performance from a financial perspective to a non-financial perspective (Tatichi et al., 2008).

Based on Garengo et al. (2005), there are six of the most popular generic models which make no reference to company size, developed in the last 15 years, and two PM models created specifically for SMEs which are Organisational, Integrated and performance benchmarking models

2.2.1.1 Organisational Performance Model

Organisational Performance Model which was developed by Chennell et al (2000) and based on three principles: the selected performance measures support the alignment between people’s actions and company strategy; the measurement system makes reference to the process of monitoring, control and improvement systems; and at any level in the company there is a consistent process for identifying measures that should be considered and for ensuring the quality and suitability of data. Analyses of these models
show that performance measurement must be aligned with strategy (BSC, Results and Determinants, Performance measurement Matrix, Performance Prism, Performance pyramid) and have multi-dimensional measures (BSC, Results and Determinants). The multi-dimensional measures are particularly important and help to overcome the limitations of traditional performance measurement systems that only focus on the financial dimension (Jamil & Mohamed, 2011). The model is summarised below:

**Figure 2.1: Organisational Performance Frame work**

```
            Strategy

                     Performance Modes Financial and Non-financial

                     Monitoring, control and improvement systems

          Organisational Performance
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**Source:** Jamil & Mohamed (2011)

### 2.2.1.2 Integrated Performance Model

The next model of determining the performance of SMEs is Integrated Performance Model which was developed by Laitinen (1996) and based on seven main dimensions of measures, classified as two external dimensions (financial performance and competitiveness) and five internal dimensions (costs, production factors, activities, products and revenues) that are connected by a causal chain. The internal dimensions are used to monitor the whole production process, and the external dimensions are used to monitor the company’s position in its competitive context. However, Manville (2006)
stated that, to date, there are still significant barriers in the implementation of these systems in the SME context. As mentioned by Hashim (2011), the criteria to measure performance may vary from business to business, industry to industry and country to country. It is clear that using the same performance measurement approach for all firms is inappropriate due to complex variations that impact on the way they operate.

2.2.1.3 Performance Benchmarking Model

Also performance benchmarking is another model for building the best strategy in SMEs. For continuous improvement performance and change in environment business, SMEs have to benchmark themselves with the best in the industry beside this, for sustainable growth in highly competitive global market (Suttapong & Tian, 2012). As management challenges have increased in complexity, performance benchmarking has become a strategic tool for organisations of all sizes. In fact, in order to be relevant for SMEs, a benchmarking tool must remain simple and comprehensive but not too demanding in terms of resources and it must be able to guide owners-managers toward action when appropriate (Pierre and Delisle, 2006). It is possible to develop effective benchmarking tools for SMEs as the comparison of performance levels and the practices that led to such performance (Adebanjo and Mann, 2007). The main benchmarking activities that can define for the management process and positioned them with regard to three factors impacting the efficiency, the robustness and the maintenance of this process (Maire and Pillet, 2008). Suttapong & Tian (2012) pointed out that the most popular benchmarking indices that SMEs used were financial performance, customer satisfaction and quality of products / services and human resources. As regard to this study, the financial performance benchmarking model used for SMEs performance measurement.

Financial performance used as measure of the SMEs performance as regard to this study with emphasis on liquidity and profitability as proxy of SMEs performance. Tatichi et al. (2008) mentioned that SMEs have used financial measurement tools such as ROI, ROE, and ROCE, which are basically used by large firms. Particularly, it is important to remark on the evolution of focusing on performance from a financial perspective to a
non-financial perspective. Financial performance is generally defined as the use of outcome-based financial indicators that are assumed to reflect the fulfilment of the economic goals of the firm (Murphy et al., 1996). It has been widely used to measure business performance in both small and large firms. A great deal of accounting literature (Kaplan and Atkinson, 1998; Lau and Sholihin, 2005) recognises the inherent advantage of financial measures. Liquidity looks at the ability of a business to meet its financial obligations as they fall due in the short term, without operations being disrupted, thus being measured by current ratio and therefore indicated the ability of the business to meet liabilities with the assets available (Moya, 2010). Profitability reflects the effectiveness with which management has employed both the total assets and the net assets that are recorded on the balance sheet (Moya, 2010). Profitability means the returns achieved through the efforts of management on the funds invested by the owners (Helfert, 1991). Donovan (2005) demanded that all financial statements given by firms to the public must provide valuable information about their financial status. Profitability as regard to this study was determined as the percentage of actual profit obtained from targeted profit of the firm during a specified period of time.

2.2.2 Important of SMEs in economy

SMEs play important roles in many countries’ economy and make substantial contribution to employment and outputs regardless of the level of economic development of a country. Small and medium enterprises (SMEs) are considered the backbone of an economy, whether we are referring to a random state, or if we are talking globally. These companies represent an essential source of economic growth, dynamic and flexibility in advanced industrialised countries, just like they do in emergent economies and in development. The main argument for this is that SMEs are the dominant form of business organisation, representing roughly 95 – 99% of all companies (Robu, 2013). According to the Organisation for Economic Cooperation and Development (OECD), SMEs represent more than 95% of enterprises and ensure 60-70% of the jobs.
SMEs contribute to employment and income generation and export revenues. However, in order to tap into the potential of SMEs for development and poverty reduction, transition and developing country governments, development partners and SMEs themselves need to address a number of challenges (OECD, 2004). SMEs are an important source of export revenues in developing economies. For individuals, SMEs often represent the first job, the first step in the career. They are also a first step to the world of entrepreneurs. For the economy in whole, the SMEs are launchers of new ideas and assemblage of new processed accelerating the increase based on a more effective use of resources (Zaman, Vilceanu, 1999). An important involvement of the external impact of small and medium enterprises is the fact that their contribution in the development is not limited to the sector of SMEs of the economy, but more than that, it is extended as impact on the enterprises not in this sector, with significant influences (Raluca, 2011).

SMEs can in fact become the engines that sustain growth for long-term development in developing countries. When growth becomes stronger, SMEs gradually assume a key role in industrial development and restructuring. They can satisfy the increasing local demand for services, which allows increasing specialisation, and furthermore support larger enterprises with services and inputs (Fjose et al., 2010).

2.2.3 Theories of Capital Structure

2.2.3.1 Modigliani and Miller

The implication of capital structure on firm performance have been studied since the Seminar Paper of Modigliani and Miller (1958) which stressed under perfect conditions without bankruptcy costs, frictionless capital and with no taxes the capital structure of the firm has no impact on the value of the firm. Modigliani and Miller theorem is generally considered as the beginning point of the Modern Corporate Finance (Hillier et al., 2010). Their irrelevance theorem argued that the firm’s capital structure does not have any impact on its value. The original hypothesis of capital structure originated from the MM theory argued that the value of the firm is irrelevant in financing decisions in a
perfect market (Modigliani and Miller, 1958, 1963). They argued that the firm’s capital structure does not have any impact on its value. They believed that the firm value is determined based on the active side of the balance sheet and the value is generated by the earning power and risk of the underlying asset. In other words, obtaining capital from restrictive payout ratio, issuance of new equity or borrowing has the same impact on the firm’s value. Capital structure theory as attributed to Modigliani and Miller concluded that it doesn’t matter how a firm finances its’ operations and that the value of a firm is independent of its’ capital structure making capital structure irrelevant.

The theory lacks applicability in the real world since the firm’s value is relevant in financing decisions because of agency costs, bankruptcy costs, information asymmetry and tax components that impact firm’s capital structure. The benefit to employ debt in a firm’s capital structure exists as the interest on debt is tax-deductible, thus creating tax savings for the borrower (Modigliani & Miller, 1963). Therefore, it is possible to reduce firm’s costs of capital and maximise shareholders’ wealth by employing debts. Tax savings make debt finance cheaper than equity finance whenever employed in a firm’s capital structure (Alex Reuben Kira & Zhongzhi He, 2012).

Maina and Kondongo (2013) investigated the effect of debt-equity ratio performance of firms listed at the Nairobi Securities exchange. A census of all firms listed at the Nairobi Security Exchange from year 2002-2011 was the sample. The study found a significant negative relationship between capital structure (DE) and all measures of performance. These results concurred with the MM theory that indeed capital structure is relevant in determining the performance of a firm. The study further found that that firms listed at NSE used more short-term debts than long term.

Abdul (2012) conducted a similar study to determine the relationship between capital structure decisions and the performance of firms in Pakistan. The study concluded that financial leverage has a significant negative relationship with firm performance as measured by ROA, GM, and Tobin’s Q. The relationship between financial leverage and
firm performance as measured by the return on equity (ROE) was negative but not statistically significant. In another study, Javed and Akhtar (2012) explored the relationship between capital structure and financial performance. They concluded that there is a positive relationship between financial leverage, financial performance, and growth and size of the companies. The study, which focused on the Karachi Stock Exchange in Pakistan, used correlation and regression tests on financial data. The findings of the study are consistent with the agency theory. This study however isolated the other financing decisions and focused only on financial leverage.

2.2.3.2 Trade-off theory

Modigliani and Miller correct their initial work in 1963 after the realisation of the large tax merit of debt. The tax adjusted MM theory results to an incredible conclusion that firms should use only debt to maximise their value. According to the trade-off theory, firms select optimal capital structure by comparing the tax benefits of the debt, the costs of bankruptcy and the costs of agency of debt and funding, this is the fact that debt suffers less from informational costs than outside equity (Modigliani and Miller, 1963; Stiglitz, 1972; Jensen and Meckling, 1976; Myers, 1977; Titman 1984). This indicates that the optimal leverage minimizes cost of capital and maximises firm value. As a result, the firm value line with regard to debt holds a hump shape curve (Hillier et al., 2010).

The trade-off theory is built on the tax advantage of debt financing in business firms. The theory suggests the presence of optimal capital structure at a point where the tax benefit of the debt financing outweigh the leverage associated costs including the financial distress and bankruptcy costs. Hence, the theory proposes that firms should continue borrowing funds until the marginal tax advantage of additional debt is offset by the marginal expected costs of financial distress (Kipesha & Moshi, 2014).
According to the trade-off theory the optimal capital structure is the point where the marginal tax shelter benefit is equal to marginal bankruptcy-related costs. Therefore, firms would prefer debt over equity up to the point where the probability of financial distress and where bankruptcy costs starts to be important. Bas, Muradoglu and Phylaktis (2009) suggested that this theory could be applicable for large firms which are more likely able to generate high profits. But for small firms, because they are less likely to have high profits, they may not have an option to choose debt financing for the tax shields advantage (Pettit & Singer, 2005).

Krasauskaite (2011) explained that the main difference between the static and dynamic trade-off models is that dynamic tradeoff models emphasise the importance of time in capital structure decisions. The static tradeoff model provides the solution of the optimal capital structure for one period and, hence, suggests that firms should have the optimal capital structure in all periods. However, it is unlikely that companies plan their decisions regarding capital structure just one period ahead. In the dynamic trade-off models, what is the optimal capital structure choice in the current period depends on what is expected to be the optimal capital structure in the next period and so on. Some firms may plan to pay out funds in the next period, while others may plan to raise funds either in the form of equity or debt. Thus, the dynamic trade-off models incorporate roles of expectations and adjustment costs.

The early dynamic trade-off models consider the tax savings and bankruptcy costs tradeoff, but do not incorporate transaction costs (for example, Kane, Marcus & McDonald 1984; Brennan & Schwartz 1984). Firms receive annual adverse shocks to asset values, but, as a recapitalisation is costless, they react immediately and maintain high levels of debt to take advantage of the tax shields.

Later Fischer, Heinkel & Zechner (1989) developed a model of a dynamic capital structure choice with recapitalization costs. Their model allows avoiding the unrealistic rapid rebalancing prediction of the early dynamic models. The model also implies that
there is no optimal leverage ratio, but rather a range over which a firm allows its debt ratio to vary (Fischer, Heinkel & Zechner, 1989). Hence, they assert that even small recapitalisation costs are responsible for the observations of wide swings in the firms’ leverage ratios. As a constant rebalancing is costly, a company does not take any action regarding its capital structure as long as leverage does not reach an upper or lower bound. If leverage reaches a bound, a firm undertakes a discrete rebalancing.

Empirical studies that have tested the trade-off theory have reported mixed findings, some of them have supported the theory such as Boodhoo, 2009, Akintoye, 2008, Onaolapo and Kajola 2010 while others have presented findings which reject the arguments of the theory such as Myers, 2001, Zeitun and Tian, 2007, Rao and Syed, 2007, Victor & Badu, 2012 and Chechet and Olayiwola, 2014. This theory may explain differences in D/E ratios between industries, but it doesn't explain differences within the same industry (Strebulaev, 2012).

**2.2.3.3 Pecking order theory**

The pecking order theory is the order which shows the preferences of financial managers in rising new capital (Hashemi, 2013). According to the theory, manager’s choice is to use retained earnings then debts before going to equity shares. Also, the first choice in external finance is issuing debt. Debt is a safer security and less risky than equity. The pecking order allows issuing equity when the capacity of debt is fully used. The weakness of this view is that it is difficult for the firm to have an optimal capital structure since the focus of the firm is not on balancing the equity and debts financing options (Myers and Majluf, 1984). Pecking Order theory tries to capture the costs of asymmetric information.

In addition, Myers (1984) stated that in the event that external finance is required, firms are most likely to issue the safest security first that is to say, they start with debt then possibly convertible debt then equity comes as last resort. Pandey (2005) and concurred with Myers’ argument when he noted that managers always preferred to use internal
finance and would only resort to issuing shares as a last resort. He added that the pecking order theory is able to explain the negative inverse relationship between profitability and debt ratio within an industry however; the theory did not fully explain the capital structure differences between industries. Also Scherr et al. (1993); Holmes et al. (1991) and Quan (2002) considered the pecking order theory as an appropriate description of Medium Sized. Adherence to the POT is dependent not only on demand-side preferences, but also on the availability of the preferred source of financing. The supply of finance depends on many factors, particularly the stage of development of the firm. The most important source of funding for start-up and nascent firms are the personal funds of the firm owner, and funding from friends and family (Avery et al., 1998). Firms therefore would prefer internal sources of finance as compared to expensive or costly external finance and that firms that are profitable and generate earnings are expected to use less debt than those that do not generate high earnings (Siro, 2013).

2.2.3.4 Agency cost theory

Agency theory is concerned with the diverging interest when the firm ownership and management are separated. The main argument behind the agency theory is that the corporate managers act in their own interest. The agency cost theory which proposes the use of debt financing as a way of monitoring managers of the firm to focus on overall objective of the organisation apart from their own interests. Empirical studies on agency cost theory have also presented mixed findings; some of them have supported the theory by indicating that debt reduces the agency costs since manager’s efficiency increases as a push from requirement to pay interest and creditors concern which in turn enhance firm performance. Buferna et al. (2005), Jensen & Mackling (1976). Jensen and Meckling (1976) argued that there is less conflict between principals and agents in small and medium size enterprises because the SMEs owner and the manager is one person. Ang et al. (2000), Anderson & Reeb (2003) and McConaughy (2000) both argued that family or small firms may be considered as zero agency cost since the level of conflict is
low in this particular firm. However, SMEs may experience agency cost, when the principals and agents are separated.

Myers (2001) also suggests that, if a company is already in a situation where creditors could force bankruptcy or reorganisation, managers can ‘play for time’ by withholding problems. Such actions increase the effective maturity and the risk of debt. Again, debt holders suffer; while shareholders gain the agency theory can be viewed as overlapping with both the trade-off theory and the pecking order theory. The trade-off theory can also include the agency costs as a part of costs of financial distress. Conflicts of interest between managers and shareholders and between equity and debt holders may be equally relevant in the explanation why firms do not fully utilise tax advantages of debt. Myers (2003) argues that some versions of the agency theory infer a financing hierarchy as in the pecking order theory. For example, agency costs of equity might result in the pecking order. Having theoretical frameworks of capital structure theories constructed, the research has developed specific models and tested empirically capital structure theories. The tests of capital structure theories analyse if debt ratios vary across firms as predicted by the theory (Frank & Goyal 2008).

### 2.2.4 Differences in financing patterns of SMEs and large enterprises

Academic research has documented that there are differences in financing patterns between SMEs and large firms and analysed possible causes of these differences. Cressy & Olofsson (1997) note that smaller businesses are heavily reliant on retained earnings to finance their investment flows and obtain most of additional finance from banks, while other resources, especially equity, are less important. Brighi & Torluccio (2007) use data from an Italian SMEs survey and find that on average self-financing, as a major form of finance, is the preferred choice of the youngest firms. They also find that a preference for self-financing is related to the firm’s size: the smaller the firm, the more common self-financing of investments. Although these findings seem consistent with the predictions of the pecking order theory, there might be alternative explanations why
smaller firms prefer internal resources over debt and debt over outside equity, related to both the supply-side and demand-side effects.

Beck et al. (2006) find that small firms report significantly higher financing obstacles than medium firms, and both groups of firms report higher financing obstacles than large firms. Beck et al. (2006) further reported that the probability that a small firm rates financing as a major obstacle is 38.7%, while it is 37.7% and 28.5% for a medium and large firm, respectively. A survey, organised by the European Commission and conducted in late 2006 in twenty seven countries of the EU, has investigated the perceptions of SMEs on business constraints among other issues (European Commission 2007). The survey reveals that the limited access to finance is not the primary concern of most SMEs, but 21.1% of surveyed companies report it as a constraint. Moreover, it is also found that there are differences in the views regarding access to finance as a business constraint among the categories of companies according to their size. 20.3% of micro firms encounter limited access to finance, whereas the percentages for small, medium and large enterprises were 19.6, 17.6 and 15.5, respectively (European Commission, 2007). Hence, it seems that the smaller the enterprise, the more likely it is to experience difficulties in obtaining financing. It is also worth mentioning that, like many other constraints, limited access to the necessary finance is a more serious problem for companies in the twelve new member states of the EU than for firms in fifteen old member states. To conclude, both supply-side constraints, which have an impact on the availability of SMEs financing options, and demand-side effects related to preferences and knowledge of the owners of SMEs might be possible explanations of the differences in the financing patterns of SMEs and large enterprises (Krasauskaite, 2011).

2.2.5 SME Financial Performance

The outcome-based financial indicators have been widely used to measure business performance in both SMEs and large firms which assumed to reflect the fulfilment of the economic goals of the firm from such Murphy et al (1996). Tatichi et al. (2008) mentioned that SMEs have used financial measurement tools such as ROI, ROE, and
ROCE, which are basically used by large firms. Particularly, it is important to remark on the evolution of focusing on performance from a financial perspective to a non-financial perspective. Kaplan and Atkinson (1998); Lau and Sholihin (2005) argued that the financial measures might be beneficial because they are objective and certain to provide a summary view of the success of the organisation’s performance and operating tactics. Kaplan & Atkinson (1998) considered financial measures as traditional, most widely practiced and popular management accounting tool because they focus on what matters most in organisations is profitability. Financial measures consist of a wide range of dimensions which include liquidity (current ratio, quick ratio and cash ratios.), profitability (return on sales, net profit margin and gross profit margin.) and growth (sales growth, market share growth and change in net income.) are commonly chosen output. Liquidity looks at the ability of a business to meet its financial obligations as they fall due in the short term, without operations being disrupted, thus being measured by current ratio and therefore indicated the ability of the business to meet liabilities with the assets available (Moya, 2010).

Profitability is also a key component of financial performance measure. From the management’s point of view, profitability reflects the effectiveness with which management has employed both the total assets and the net assets that are recorded on the balance sheet (Moya, 2010). Profitability means the returns achieved through the efforts of management on the funds invested by the owners (Helfert, 1991). Donovan (2005) demanded that all financial statements given by firms to the public must provide valuable information about their financial status. Irwin (2001) also noted that many people find it difficult to look at a profit and loss account or a balance sheet and derive a full picture. Meanwhile, Sejpal (2006) advised that accounting ratios are normally used in interpreting financial statements and usually include comparison of results with other companies in a similar industry or the same company over a period of time. One ratio which gives an indication of solvency is the gearing ratio normally defined as the debt ratio (Moya, 2010).
2.2.6 SME Capital Structure

Capital structure in SME sector is so far unique as compared to other business and thus optimal capital structure rules are often not applicable to SMEs (Uzzi and Gillespie, 1999; Van der Wijst, 1989; Welsh and White, 1981). One of the reasons is the obstacle exists on access of external financing for SMEs comparing to large firms (Da Silva et al., 2007). It is difficult for SME to access debt finance since the sector lacks of collateral to pledge in order to access external sources of finance (Barbosa and Moraes, 2004 and Fatoki and Asah, 2011). More importantly the study conducted by Kira (2012) found one of the reasons which lead difficult for SMEs in Tanzania to access debt is lack of collateral. Due to that SME capital structure typically follows pecking order behaviour although the pecking order theory is doubtfully as SME managers highly value financial freedom, independence, and control while the pecking order theory assumes firms desire financial wealth and suffer from severe adverse selection costs in accessing external finance (Lopez-Garcia and Sogorb-Mira, 2008). Also, Holmes and Kent, (1991) argued that SMEs do not have easy access to equity of which it is expensive and raising it implies a dilution of control of the firm therefore, they proposed a restricted version of pecking order theory to explain SMEs capital structure.

2.2.7 Financing Pattern of SMEs

Firms in general and SMEs in particular have various sources of finance to support their activities that can be summed up as equity or shareholders funds, trade credit, short term and long term bank debt (Moro and Fink, 2010). Also Elaine et al, (2005) pointed out that financing decisions in SMEs have received comparatively little academic attention despite their economic importance. Cressy and Olofsson (1997) noted that smaller businesses are heavily reliant on retained earnings to finance their investments and obtain most of additional finance from banks, while other resources, especially equity are less important. Brighi and Torluccio (2007) used data from an Italian SMEs survey and found that on average, self-financing as a major form of finance is the preferred
choice of the small firms. These findings seem to be consistent with the predictions of the pecking order theory.

It is also likely that SMEs are more vulnerable to credit crunches during economic downturns or financial crises than larger enterprises. The European Central Bank (ECB) and the European Commission surveys from 2009 provided evidence that the financial and economic crisis had an adverse effect on the availability of external financing for SMEs (ECB, 2009, 2010). Also, the surveys revealed that access to finance was the second most serious problem, reported by 17% of SMEs in the first half of 2009 and by 19% in the second half of 2009 (ECB 2009, 2010). That consistent with Lindholm-Dahlstrand and Cetindamar (2000) who pointed out that the problem of bank financing to SMEs has been persistent for many years in the developing countries with both parties actively responsible for the lack of SME financing. Given the constraints on the supply side of debt financing, an option for SMEs would be to resort to external equity financing, for example, private investors and business angels (Mac and Bhaird and Lucey, 2010).

2.2.7.1 Equity financing on the SME Performance

Traditionally, SMEs are financed by the owners and their relatives (Fletcher, 2000). They do not like to access external finance since it implies a reduction in the freedom in managing the firm (Delmar, 2000), limitation in the possibility of accessing non-pecuniary benefits (Jensen and Meckling, 1976) and the implementation of additional control and management tools (Delmar, 2000). Moreover, if SMEs have unconstrained choice between external debt and internal resources, they will choose not to use debt financing because of a desire to retain control and independence (Bell and Vos, 2009). Therefore, potential investors face big problems in valuing the venture and making investment decisions (Block and McMillan, 1985). Chepkemoi (2013) noted that equity and return on equity cannot be quantified or even clearly defined for the majority of SMEs and therefore, cost of equity cannot therefore be ascertained and employed in capital structure decisions. Also, profit is not necessarily a source of finance since it is
the result of assets and it does not generate any financial benefit because there is a time lag between earning profit and generating cash (Moro and Fink, 2010).

### 2.2.7.2 Debt financing on the SMEs performance

SMEs financing challenges the proposition that capital structure can be modelled by looking at agency theory, asymmetry of information, and taxes as long as short-term debt is not affected by the trade-off between tax benefits and bankruptcy costs. Long-term debt is affected by collateral sable assets but short-term debt is not (Pindalo et al., 2006). From the entrepreneur’s point of view, short-term debt is the best financing tool because it is perceived to be cheaper both entrepreneur and bank prefer short-term debt (Landier and Thesmar, 2009). According to Moro and Fink (2010), repayment plan has a key role in building up the optimal debt structure of the firm since it is too short and from which the firm will end up again using short-term debt to finance long term assets, if it is too long, it can raise problems of underinvestment since the firm has additional, free cash temporarily available (Jensen, 1986). Moreover both SMEs and new ventures for which the access to finance is more limited than for traditional SMEs since new ventures are very risky due to lack of track record and frequently have not already entered the production and selling stage, finding a substitute for equity is very hard, notwithstanding the tax benefits linked to interest charges (Örtqvist et al., 2006).

### 2.2.8 SME in Tanzania

There is no consensus definition of SME as various countries have definitions depending on the phase of economic development and their prevailing social conditions. In this, various indexes are used by countries to define the terms such as number of employees, invested capital, total amount of assets, sales and production capability (Kazungu & Moshi, 2014). In the context of Tanzania SMEs are defined on the SME Development Policy as those enterprises are those engaging up to 4 people, in most cases family members or employing capital amounting up to Tshs.5.0 million. The majority of micro enterprises fall under the informal sector (URT, 2003). This is illustrated in the table below:
Table 2.1: Categories of SMEs in Tanzania

<table>
<thead>
<tr>
<th>Category of enterprises</th>
<th>Employees</th>
<th>Capital Investment in Machinery (Tshs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>1 – 4</td>
<td>Up to 5 mil.</td>
</tr>
<tr>
<td>Small</td>
<td>5 – 49</td>
<td>Above 5 mil. to 200 mil.</td>
</tr>
<tr>
<td>Medium</td>
<td>50 – 99</td>
<td>Above 200 mil. to 800 mil.</td>
</tr>
<tr>
<td>Large</td>
<td>100 +</td>
<td>Above 800 mil.</td>
</tr>
</tbody>
</table>


N.B: In the event of an enterprise falling under more than one category, then the level of investment will be the deciding factor.

The SME Development Policy points out that the SME philosophy is evident in almost all policy statements made since 1986 and in particular after 1996. The private sector has started playing an ever-increasing role in creating incomes and employment. SMEs account for a large share of the enterprises active in Tanzania and in fact are the emerging private sector and do form the base for private sector-led growth (URT, 2003). It is estimated that about a third of the GDP originates from the SME sector. The Sustainable Industrial Development Policy - SIDP (1996 - 2020) places specific emphasis on promotion of SME sector.

SMEs have been and are still a central hub in generating income for the majority of urban dwellers with no formal paid employment; however enabling growth of SMEs has posed a major challenge (Kipilyango, 2012). SMEs face with unique problems including heavy costs of compliance resulting from their size, insufficient working premises, services related to entrepreneurship, business training, marketing, technology development and information are underdeveloped and not readily available. On the other hand, SME operators lack information as well as appreciation for such services and can hardly afford to pay for the services. As a result, operators of the sector have rather low skills (URT, 2003). In recognition of the importance of SME sector, the Government has continued to design and implement a number of policies and programmes supportive to the development of the sector.
A recent (2013) review of the Tanzania SME Development Policy 2003 has provided the basic data about the SMEs in Tanzania. This review constituted vast number of SMEs: there were estimated to be more than 3 million SMEs employing more than 5.2 million people in Tanzania of which some 45% were located in urban and the remainder in rural areas; the industrial sector encompassed some 25,000 enterprises, 97% of which had less than ten employees (compared to 40 large manufacturing enterprises with 500+ employees, covering about one third of employment in industry). The estimated size of the informal economy as a percentage of GDP had decreased over time: from 62.5% in 1991 to 43.6% in 2005 and 39.7% in 2010; the estimated size of the informal sector as a percentage of GDP excluding agriculture is lower and moved from 43.1% in 1991 to 30.1% in 2010 and 27.4% in 2010 (showing a gradual trend from informal to formal) (Oyen and Gedi, 2013: 10).

It is also claimed that ‘since SMEs tend to be labour-intensive, they create employment at relatively low levels of investment per job created’. Further, it was considered that through business linkages, partnerships and subcontracting relationships, SMEs have great potential to complement large industries requirements. Moreover, they are expected to serve as a training ground for entrepreneurship and managerial development and enable motivated individuals to find new avenues for investment and expanding their operations (Economic and Social Research Foundation, 2009:68-69).

2.3 Empirical Review

The implication of capital structure on firm performance have long been studied since the seminar paper of Modigliani and Miller (1958) which stressed that under perfect conditions without bankruptcy costs, frictionless capital and with no taxes the capital structure of the firm has no impact on the value of the firm (Kipesha & Moshi, 2014). The empirical reviews look at determinants of capital structure; SMEs performance and capital structure. From the study; the researcher may conclude based on empirical evidences of the existence of relationship between capital structure and firm performance. Kaumbuthu (2011), Saeedi and Mahmoodi (2011), Ebaid (2009) and
Adekunle (2009) are among those who recognise such a relationship between capital structure and financial performance exist. Different empirical studies have since then been conducted to examine the relevance of MM theories in the business firms. Some of them have supported the irrelevance of capital structure (Carpentier, 2006, Myers, 2001) while other findings have stressed on the relevance of capital structure in business firms. Empirical evidence of SME sector has similarly presented mixed findings on the impact of capital structure on SMEs performance.

Karanja (2014) conducted a study on the effect of capital structure on financial performance of small and medium enterprises in dairy sector in Kiambu County in Kenya. Debt equity ratio; debt asset ratio and liquidity were used to measure variables of the study. 50 dairy SMEs in Kiambu County were selected as a sample. The results indicate that Debt equity ratio was significant at 5% level of significance (0.009). The estimate of coefficient value for Debt equity ratio was -0.179; Debt asset ratio was significant at 5% level of significance (0.006) with estimate of coefficient value of 0.195 whereas liquidity ratio was significant at 5% level of significance (0.01) with coefficient value of 0.012 which indicates that the three factors are predictors of financial performance of small and medium enterprises in dairy sector in Kiambu County.

Chepkemoi (2013) in his research investigated the effect of Capital Structure of SMEs on their financial performance, a case of Nakuru town in Kenya. The measurements as regard to this study were profitable, liquidity, sales growth, and debt ratio variables which were intervened by inflation, government policy and political environment variables. The study targeted 295 SMEs which are registered as companies in Nakuru town where a sample of 170 SMEs was selected. The findings revealed that capital structure have negative effect on firm profitability. However, capital structure has positive and significant effect on firm liquidity. Similarly, capital structure indicated a positive effect on sales growth. Based on study findings under increased capital structure, firm profitability decreases. On the other hand, under increased capital structure, liquidity and growth in sales increases.
Fatoki (2011) investigated the Impact of Human, Social, and Financial Capital on the Performance of SMEs for evidence from King Williams’ Town and Port Elizabeth in the Eastern Cape Province of South Africa study based in manufacturing, retail, wholesale and service SME sector. In this study, 248 SMEs were selected as samples. The results indicate that there is a significant positive relationship between human, social and financial capital and the performance of SME. Also, the findings by Saeedi and Mahmoodi (2011) indicate that financial leverage may affect different measures of performance in different ways.

Abdus (2013) ascertained the effects of lease finance on the financial performance of SME's located on Munshigang and Kushtia in Bangladesh and whether lease finance has a relationship with the Return on Equity (ROE) /Return on Assets (ROA) of organisations. This study selected 23 medium enterprises and 30 small enterprises as samples. The results show a positive correlation between lease finance and ROE/ROA through simple regression statistics.

Dube (2013) investigated the impact of debt financing on the operations of SMEs in Masvingo. This study used a sample of 80 SMEs. The results from the study show that debts finance have a positive impact on productivity of SMEs. The study also established that firms which receive adequate funding from banks improve their productivity. Another finding of the study was that the cost of borrowing was too high to enable firms to borrow adequate amount of required finance investment.

Ahmad et al. (2012) in their study on the impact of capital structure on firm performance by analysing the relationship between operating performance of Malaysian firms, measured by ROA and ROE with short-term debt (STD), long-term debt (LTD) and total debt (TD). This study covered two major sectors in Malaysian equity market which are the consumers and industrials sectors. 58 firms were identified as the sample firms and financial data from the year 2005 through 2010. The study revealed that only STD and TD have significant relationship with ROA while ROE has significant on each of debt
level. However, the analysis with lagged values shows that none of lagged values for STD, TD and LTD has significant relationship with performance. Also, Abor (2007) argued that quoted firms exhibit higher debt ratios than those of SMEs.

San and Heng (2011) in their research studied the relationship between capital Structure and Corporate Performance of Malaysian Construction Sector during 2005 to 2008. In this study, 49 companies were selected as a sample. Results showed that there is a significant relationship between capital structure and corporate performance. Meanwhile, Abdul (2012) conducted a similar study to determine the relationship between capital structure decisions and the performance of firms in Pakistan. The study concluded that financial leverage has a significant negative relationship with firm performance as measured by ROA, GM, and Tobin’s Q. The relationship between financial leverage and firm performance as measured by the ROE was negative but not statistically significant.

Sogorb (2005) surveyed the impact of small and medium companies’ features on their capital structure in Spain during 1994 to 1998. In this study, he used data from 6482 non-financial companies in 8 industry order. Results show that tax reserves and profitability of these companies have negative relationship with capital structure while size, growth opportunities and assets structure have positive relationship with capital structure.

Rajan and Zingales (2005) in their study of firms in G-7 countries to determine whether size of a business is a factor in determining capital structure where 21 businesses in each category for small and big were used as the sample of the study to compare the results from the two groups observed that large firms tend to be more diversified and therefore, have lower probability of default. Their argument is also consistent with the predictions of the trade-off theory which suggests that large firms should borrow more because are more diversified less prone to bankruptcy, and have relatively lower bankruptcy costs. Furthermore, large firms have lower agency costs of debt, for example, relatively lower
monitoring costs because of less volatile cash flows and easy access to capital markets. These findings concluded that there is a positive relationship between the firm size and leverage. On the other hand, the pecking order theory suggests a negative relationship between firm size and the debt ratio because the issue of information asymmetry is less severe for large firms. Owing to this, large firms should borrow less due to their ability to issue informational sensitive securities like equity. Empirical findings on this issue are still mixed. Wald (2009) has shown a significant positive relationship between size and leverage for firms in the USA, the UK, and Japan and an insignificant negative relationship for firms in Germany and a positive relationship for firms in France. Chen (2004) has shown a significant negative relationship between size and long-term leverage for firms in China.

Myers and Rajan (2008) carried out an exploratory research to assess the impact of agency cost on liquidity in German banking sector. The study revealed that there is a negative relationship when agency costs are high outside creditors limit the amount of debt financing available to the company. Thus, a negative relationship between debt and liquidity would be expected. Similarly, the effect of asset liquidity is an ambiguous signal to institutional investors. A high liquidity ratio may be considered to be a negative signal because it indicates that the firm faces problems regarding opportunities for its long-term investment decisions. Hence, a high liquidity ratio may be considered to be a negative signal for institutional investors. However, a high liquidity ratio may be considered to be a positive signal from the firm because it indicates that the firm can easily pay its obligations and hence faces lower risk of default. Thus, high liquidity would be a positive signal for institutional investors.

Saeedi and Mahmoodi (2011) examined the relationship between capital structure and performance of listed firms in the Tehran Stock Exchange. According to their study, market measures of performance are positively related to capital structure and whereas ROA is positively related to capital structure, no significant relationship exists between ROE and capital structure. The finding by this study indicates that financial leverage
may affect different measures of performance in different ways. Also, the study conducted by Adekunle (2009) to examine the impact of capital structure on the performance of pharmaceutical industries in Kenya. This study used debt ratio to proxy capital structure while return on asset and return on equity were used as measures of firms’ performance. Also the study used the Ordinary Least Squares method of estimation. The results indicate that debt ratio has a significant negative impact on the firm’s financial measures of performance. This study however did not consider other financing decisions in the analysis, including the mediating effect of internal cash flow available.

Kaumbuthu (2011) carried out a study to determine the relationship between capital structure and return on equity for industrial and allied sectors in the Nairobi Securities Exchange during the period 2004 to 2008. Capital structure was proxy by debt equity ratio while performance focused on return on equity. The study applied regression analysis and found a negative relationship between debt equity ratio and ROE. The study focused on only one sector of the companies listed in Nairobi Securities Exchange and paid attention to only one aspect of financing decisions. The results of the study, therefore, may not be generalised to the other sectors.

Ebaid (2009) carried out a study to investigate the impact of choice of capital structure on the performance of firms in Egypt. Performance was measured using ROE, ROA, and gross profit margin. Capital structure was measured by short-term debt to asset ratio, long-term debt to asset ratio, and total debt to total assets. Multiple regression analysis was applied to estimate the relationship between the leverage level and performance. The study revealed that capital structure has little to no impact on a firm’s performance. This result is inconsistent with other empirical studies such as Hadlock and James (2002) and Ghosh et al. (2000) which revealed a positive relationship between financial leverage and choice of capital structure. Other studies revealed a negative relationship such as Berger and Bonaccorsi di Patti (2006), Gleason et al. (2000) and Simerly and Li
(2000) whereby lower equity capital ratio is associated with higher firm performance. The contradicting results give room for introducing additional variables in new studies.

Maina and Kondongo (2013) investigated the effect of debt-equity ratio performance of firms listed at the Nairobi Securities exchange. A census of all firms listed at the Nairobi Security Exchange from year 2002-2011 was the sample. The study found a significant negative relationship between capital structure (DE) and all measures of performance. This results collaborated MM theory that indeed capital structure is relevant in determining the performance of a firm. The study further found that that firms listed at NSE used more short-term debts than long term.

Abdul (2012) conducted a similar study to determine the relationship between capital structure decisions and the performance of firms in Pakistan. The study concluded that financial leverage has a significant negative relationship with firm performance as measured by ROA, GM, and Tobin’s Q. The relationship between financial leverage and firm performance as measured by the return on equity (ROE) was negative but not statistically significant. In another study, Javed and Akhtar (2012) explored the relationship between capital structure and financial performance. They concluded that there is a positive relationship between financial leverage, financial performance, and growth and size of the companies. The study, which focused on the Karachi Stock Exchange in Pakistan, used correlation and regression tests on financial data. The findings of the study are consistent with the agency theory. This study however isolated the other financing decisions and focused only on financial leverage.

2.4 Conceptual Framework

It is the time now to get more knowledge on the impact of capital structure on the SMEs performance from which managers should consider when making financing decisions. It is also possible that management does not perceive the right skills and experience to assess appropriate financing mix to achieve the goal of the firm. From the point of my understanding, there are many factors which could lead managers to have inappropriate
capital structure such as poor skills and knowledge on the adequate financing mix and lack of collateral to secure debt for SMEs.

The overall objective of the study was to determine the SMEs capital structure patterns and their impact on their performance. To provide the link between capital structure and firm performance, a conceptual framework was developed to assist in analysing data in relation to the study. The topic under study was guided with the following variables:-

2.4.1 Independent Variable

This is the variable which is self-sufficient to describe the event. It is the predictor of the desired outcome. The independent variable as regard to this study was the capital structure which was measured by the debt and equity finances.

2.4.2 Dependent Variable

This is the variable which depends in the presence of other variables; the study focused on the SMEs performance as the dependent variable which measured by profitability which expressed as a percentage of actual profit from targeted profit and liquidity which determined by taking current assets divide by current liabilities as regard to this study.
Figure 2.2: Represents the relationships between Independent Variables and Dependent Variables

Source: Researcher (2015)
CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter describes the research approach, study area, the sample, techniques for data collection and their administration. The chapter further shows research design, research approach, area of the study, population of study, sampling design and procedures, data collection methods, and instrumentation, and data analysis plans and expected results.

3.1 Research Design

A case study design used in this study since it narrows down a broad field of research into few easily researchable fields. The case study design is much suitable since this type of design involves looking at historical information from SMEs Financial records for past three consecutive years of business operation. Dodoma Municipality was the case of the study findings since it might be very complex to conduct the research throughout all the district and municipal of Tanzania because of time and resources constraints. Lamnek (2005) explained that “Case study is a research strategy of an empirical inquiry that investigates a phenomenon within its real life in a single representation from multiple representations.

3.2 Research Approach

This study used both quantitative and qualitative approaches since it focuses on impact of capital structure on SMEs. Quantitative approach used because the data that collected were used in computing the frequencies, percentages and tabulations. Referring back from other authors Burns and Groove (2005) defined that “Quantitative research is a formal, objective, systematic process in which numerical data are used to obtain information about the World” also John (2010) has put down some benefits of using Quantitative approach he said “Quantitative research tests a theory which is composed of variables, measuring numbers and analysing statistical procedures in order to determine whether the predictive generations of the theory hold true”.

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The qualitative approach also used because the approach gives an opportunity of examining the impact of one aspect to another that enables the researcher to collect facts and study their relationship in depth.

3.3 Targeted study population

The targeted study population consisted a total of 333 SMEs registered by the Dodoma Municipal Council (DMC Business record, 2014), from which the researcher drawn the sample for data collection and analysis.

3.4 Sample size

From the targeted population of 333 SMEs the sample size was 100 SMEs which represent 30% of the study population. Krishnaswami (2002:144) recommended that a sample size of 30% of the population is enough for the entire population.

3.4.1 Sampling Unit

For this study, sample units were Madukani ward which has a busy centre with SMEs around Nyerere Square and Independent Square. The Majengo area has Majengo Market and Mshikamano bus stand (DMC, 2009). These areas in particular harbour considerable shops and other small businesses (Barder, 2009) also the Viwandani and Tambuka reli wards are among the most populated area in Dodoma town because it hosts Saba Saba market, Regional bus stand, Jamatini stand and Headquarters of Dodoma Municipality, Bahi and Chamwino District Councils.

3.4.2 Sampling Frame

Sampling frame of this study included all those who are registered and concerned with SMEs operations particularly textile shops, food vending, hardware and general supplies and secretarial and stationery supplies in Dodoma Municipality to ensure efficiency, representativeness and reliability. The sample was selected so as to represent the population under study and thus get enough data for analysis due to financial and time constraints.
3.4.3 Sampling Procedure

The study used stratified random sampling technique to select the SMEs where owners/managers will be picked from. Therefore, SMEs will be stratified into four (4) strata sectors where the sample size was allocated under stratified proportional allocation. The purpose of the method was to maximise survey precision with a given fixed sample size. With stratified proportional allocation, the best sample size for stratum h was:

\[ n_h = \frac{(N_h/N) \cdot n}{1} \]

Where,

- \( n_h \) - The sample size for stratum h,
- \( n \) - Total sample size,
- \( N_h \) - The population size for stratum h,
- \( N \) - The total population

Therefore, a distribution will be as follows;

**Table 3.1: Sampling procedure**

<table>
<thead>
<tr>
<th>Type of SME</th>
<th>Target population</th>
<th>Sample size of SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Textile shops</td>
<td>87</td>
<td>26</td>
</tr>
<tr>
<td>Food vending</td>
<td>103</td>
<td>31</td>
</tr>
<tr>
<td>Hardware and general supplies</td>
<td>53</td>
<td>16</td>
</tr>
<tr>
<td>Secretarial and stationery supplies</td>
<td>90</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>333</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

**Source:** Researcher (2015)

3.5 Data Collection Methods

This study used both secondary and primary data. Secondary data obtained from SMEs business records. Secondary data are data that are to be collected from another project and have already been published (Diyamett, 2012). The study only collected data related to debts, internal source of financing, profits, current assets and current liabilities for a period of the past three years, which was from the year 2012 to 2014. Primary data were collected using structured oral personal interview questions to get some important
information about the factors affecting capital structure decision from SME Operators in Dodoma Municipality.

3.6 Data Processing

The method of handling data in this study was Field Editing Method, whereby data were received and reviewed in their reported forms and any ambiguous terms were translated to enhance understanding of the information collected from the source. The data processing involved activities such as editing, coding, classifying, and tabulating of data so that they can be easily interpreted in the context of the study (Mlowe, 2012).

3.7 Data Analysis

Simple Regression Analysis and Karl Pearson Coefficient of Correlation used to determine the relationship between the independent and dependent variables in determining the impact of the capital structure and SMEs performance, the descriptive analysis was used to compare and contrast between variables. The data under each specific objective was analysed using Statistical Package for Social Sciences (SPSS) and presented using Microsoft Excel.

Figure 3.1: Relationship between One independent variable against one dependent variable

![Figure 3.1: Relationship between One independent variable against one dependent variable](image)

Source: Researcher, 2015

Figure 3.1 above shows that Capital Structure which was measured by using the composition of debt and equity financing based on the Debt-Equity ratio is the cause of behaviour of performance of SME which was measured by liquidity which determined by taking current assets divide by current liabilities as the current ratio and profitability was determined by the total targeted profit as the percentage of actual profit obtained from SMEs operation in a specified period of time, it was illustrated as follows:-
\[ Y_0 = a + b_0 X_0 + \mu \] .................................................................1

Whereby:

\( X_0 \): Capital structure

\( Y_0 \): SME Performance

\( \mu \): Measurement error

Application of Karl Pearson Coefficient of Correlation to determine how the relation between these two variables can simply be calculated as.

\[ r = \frac{\sum (x_i - \bar{x})(y_i - \bar{y})}{n \cdot \alpha_x \cdot \alpha_y}. \] .................................................................2

Where by:

\( \bar{x} \) is the mean of \( x \)

\( \bar{y} \) is the mean of \( y \)

\( n \) number of pairs of observations of \( x \) and \( y \)

\( \alpha_x \) standard deviation of \( x \)

\( \alpha_y \) standard deviation of \( y \)

From the above determination the value of ‘\( r \)’ will be +1,-1 or 0 positive value of \( r \) indicate that changes of one variable take place in the same direction of the other variable whereas negative \( r \) indicates that changes between variables taking place in the opposite directions and zero \( r \) there is no association between the variables.

3.8 Ethical Considerations

The researcher used purely information collected for the purpose of this study and not forwarded to any other party. The information from any SME was treated with high degree of confidentially without disclosing the respondents’ identity, and was open minded as possible and express opinions as they were given.

The researcher did not modify anything and also appreciated all the literatures that contributed in one way or another to this research.
CHAPTER FOUR

PRESENTATION AND ANALYSIS OF RESEARCH FINDINGS

4.0 Introduction

This Chapter presents research findings on the basis of data that were collected from the research field work. It entails presenting and analysing the data concerning the impact of capital structure on performance of SMEs in Tanzania and Dodoma Municipal in particular. On the other hand, this chapter will also present capital structure composition in SMEs, measure the performance of SMEs, examine the relationship between capital structure and performance of SMEs and the factors affecting capital structure decision of SMEs in Dodoma Municipality.

4.1 Descriptive Analysis

A number of firm characteristics were included in the formulation of the research interview questions whose responses are discussed below:

4.1.1 Period of Existence of the SMEs

Table 4.1 below illustrates the period of existence of the SMEs that participated in the research study on capital structure and financial performance.

<table>
<thead>
<tr>
<th>Years of existence</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-5 years</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>6-8 years</td>
<td>53</td>
<td>53</td>
</tr>
<tr>
<td>9-11 years</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>12 years and above</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Results as presented in Table 4.1 above revealed that 53% of the SMEs surveyed had been in operation for a period between 6 to 8 years where as those that were above 12 years of operation were 10% representing 10 SMEs operations. Further to that 16% of
SMEs had operational experience between 3 to 5 years. These results imply that all the surveyed SMEs operations had exceeded the infancy stage and hence had enough and reliable business experience and information for assessing the impacts of capital structure on performance of SMEs in Tanzania.

### 4.1.2 Percentage of Small and Medium Enterprises surveyed

**Figure 4.1 Average Percentage of SMEs surveyed**

![Average Percentage of SMEs surveyed](chart.png)


From the above presentations of Figure 4.1 data show that 63% of the surveyed enterprises were small while 37% enterprises were medium, this means that in a total of 100 surveyed SMEs there were 63 small enterprises and 37 medium enterprises that meet the study requirements for selection. This shows that the municipal council has more small enterprises than medium enterprises.
4.1.3 The number of employees employed by SMEs

Table 4.2: Number of employees

<table>
<thead>
<tr>
<th>Number of employees</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 – 14</td>
<td>48</td>
<td>48</td>
</tr>
<tr>
<td>15 – 24</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>25 – 34</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>35 – 44</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>45 – 54</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>55 – 64</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>65 – 74</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>75 and above</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Table 4.2 above shows majority (48%) of employees are in the group of employees ranging from 5 to 14, this implies that employment opportunities (more than 73 employees equivalent with 73%) are in small enterprises than medium enterprises (less than 27 equivalent with 27% of the total employees) in SMEs surveyed. This statistics suggests that small enterprises have an important role to play on creating employment opportunities in the country. The number of employees were also in line with the definition of Small and Medium Sized Enterprises under the Tanzania categories of enterprises which defines Small Enterprises as those employing more than 4 but less than 50 employees and Medium Enterprise as those employing more than 49 but less than 100 employees (SMEs Policy, 2003). Different literature review indicated that the number of employees working in one enterprise or establishment tends to be one of the main criteria used in size-categorization of SMEs (Jamil & Mohamed, 2011)
4.1.4 Capital size of the SMEs

Table 4.3: Capital Size of the SMEs

<table>
<thead>
<tr>
<th>Capital size of the SMEs</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 million – 44 million</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>45 million – 84 million</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>85 million – 124 million</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>125 million – 164 million</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>165 million – 204 million</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>245 million – 284 million</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>285 million – 324 million</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>325 million – 364 million</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>365 up to 800 million</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>


From Table 4.3 above, present a capital size of SMEs surveyed, most small enterprises surveyed had a capital size ranging from 5 to 44 million representing 42.9% of total small enterprises surveyed, this was followed by capital size ranging from 45 – 84 million making 20.6% of small enterprises surveyed, few small enterprises had a capital size ranging from 85 – 124 million, 125 – 164 million and 165 – 204 million with a total of 36.5% of small enterprises. It was also noted that 14 equivalent with 37.8% of surveyed medium enterprises had a capital size of ranging from 285 to 324 million, this was followed with 11 ranging a capital size of 245-284 million representing 29.7% of the surveyed medium enterprises like wise 5 enterprises ranging a capital size of 325 to 364 represents 13.5% of medium size enterprises surveyed, few (3) medium size enterprises surveyed had a capital size ranging from 365 up to 800 million which indicate 8.1% of the total surveyed medium enterprises. These statistics show that most of the medium enterprises have a capital size ranging between 201 to 364 representing 91.9% of the total medium enterprises surveyed, however very few (3) enterprises had a capital size of 365 million up to 800 million which represented 8.1% of the medium enterprises surveyed.
4.1.5 Wards of Operation

**Figure 4.2: Division of Operation**

![Wards of Operation](image)

Source: Researcher Findings (2015) 0675655305

Figure 4.2 showed that out of the 100 SMEs operations surveyed, data were collected from each of the four wards. However, Viwandani ward recorded the highest willingness in disclosing the data with a rate of 29% SMEs owners willingness, it was followed by Madukani ward representing 27% of SMEs surveyed, Tambuka reli and Majengo responded by 23% and 21% respectively.. It was also noted that SMEs operating in wards like Majengo and Tambuka reli were not at liberty to disclose information that they felt was confidential thus the low response rate as illustrated above.
4.2 Presentation and Analysis of research findings

4.2.1 SMEs Capital Structure Composition

Table 4.4: SMEs Capital structure Compositions

<table>
<thead>
<tr>
<th>SMEs Category</th>
<th>Equity (%)</th>
<th>Debt (%)</th>
<th>Capital Structure (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Textile shops</td>
<td>62.88</td>
<td>37.12</td>
<td>100</td>
</tr>
<tr>
<td>Food vending</td>
<td>69.06</td>
<td>30.94</td>
<td>100</td>
</tr>
<tr>
<td>Hardware and general supplies</td>
<td>39.31</td>
<td>60.69</td>
<td>100</td>
</tr>
<tr>
<td>Secretarial and Stationery supplies</td>
<td>55.22</td>
<td>44.78</td>
<td>100</td>
</tr>
</tbody>
</table>


Result from Table 4.4 presents the capital structure composition of SMEs found in the study area. Textile shops show that 62.88% and 37.12% of the capital structure is equity and debt financed respectively, Food vending is financed by 69.06% and 30.94% equity and debt respectively meanwhile, Hardware and general supplies comprise 39.31% and 60.69% of capital structure is equity and debt respectively where as Secretarial and Stationery supplies capital structure is made up by 55.22% and 44.78% of equity and debt respectively. The findings show that Hardware and general supplies capital structure consists of more debts than equity financing when comparing with other SMEs category and this indicates that Hardware and general supplies are most accessible to loan facilities.
4.2.2 Analysis of SMEs Performance

4.2.2.1 SMEs Performance dealing with Textile shops

Table 4.5: Textile shops

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Skewness</th>
<th>Kurtosis</th>
<th>Std. Error</th>
<th>Std. Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability</td>
<td>26</td>
<td>.24</td>
<td>.98</td>
<td>.6163</td>
<td>.25794</td>
<td>.316</td>
<td>.456</td>
<td>-1.232</td>
<td>.887</td>
</tr>
<tr>
<td>Liquidity</td>
<td>26</td>
<td>1.46</td>
<td>2.22</td>
<td>1.831</td>
<td>.26320</td>
<td>-.316</td>
<td>.456</td>
<td>-1.232</td>
<td>.887</td>
</tr>
<tr>
<td>Equity</td>
<td>26</td>
<td>.24</td>
<td>1.00</td>
<td>.6288</td>
<td>.26320</td>
<td>.316</td>
<td>.456</td>
<td>-1.232</td>
<td>.887</td>
</tr>
<tr>
<td>Debt</td>
<td>26</td>
<td>.00</td>
<td>.76</td>
<td>.3712</td>
<td>.26320</td>
<td>-.316</td>
<td>.456</td>
<td>-1.232</td>
<td>.887</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>26</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Data in Table 4.5 indicates that SMEs dealing with textile shops had profitability of 61.63% achieved out of the targeted profit. Further, analysis reported that capital structure was 37.12% debt (mean=0.3711) against 62.88% equity sources (mean=0.6288). Also SMEs category recorded liquidity at 1.8312 current assets over current liabilities (mean=1.8312).
### 4.2.2.2 SMEs Performance dealing with Food vending

#### Table 4.6: Food vending

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum Statistic</th>
<th>Maximum Statistic</th>
<th>Mean Statistic</th>
<th>Std. Deviation Statistic</th>
<th>Skewness Statistic</th>
<th>Kurtosis Statistic</th>
<th>Std. Error Statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability</td>
<td>31</td>
<td>.36</td>
<td>.98</td>
<td>.6768</td>
<td>.24913</td>
<td>.193</td>
<td>.421</td>
<td>-.68</td>
</tr>
<tr>
<td>Liquidity</td>
<td>31</td>
<td>1.07</td>
<td>1.7</td>
<td>1.3764</td>
<td>.25422</td>
<td>-.193</td>
<td>.421</td>
<td>-.68</td>
</tr>
<tr>
<td>Debt</td>
<td>31</td>
<td>.00</td>
<td>.63</td>
<td>.3094</td>
<td>.25422</td>
<td>-.193</td>
<td>.421</td>
<td>-.68</td>
</tr>
<tr>
<td>Equity</td>
<td>31</td>
<td>.37</td>
<td>1.0</td>
<td>.6906</td>
<td>.25422</td>
<td>.193</td>
<td>.421</td>
<td>-.68</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>31</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Researcher Findings (2015)

Findings as shown in Table 4.6 reported that SMEs in food vending general disclosed profitability at 67.68% (mean=0.768). Further, the analysis reported that capital structure was 30.94% (mean=0.3094) debt against 69.06% (mean=0.6906) equity sources (mainly retained earnings). Liquidity was recorded at 1.3764 current asset over current liabilities (mean = 1.3764)
4.2.2.3 SMEs Performance dealing with Hardware and general supplies

Table 4.7: Hardware and general supplies

<table>
<thead>
<tr>
<th>Statistic</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Skewness</th>
<th>Kurtosis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability</td>
<td>16</td>
<td>.30</td>
<td>.54</td>
<td>.3853</td>
<td>.09547</td>
<td>.769</td>
<td>.564</td>
</tr>
<tr>
<td>Debt</td>
<td>16</td>
<td>.45</td>
<td>.69</td>
<td>.6069</td>
<td>.09741</td>
<td>-.769</td>
<td>.564</td>
</tr>
<tr>
<td>Equity</td>
<td>16</td>
<td>.31</td>
<td>.55</td>
<td>.3931</td>
<td>.09741</td>
<td>.769</td>
<td>.564</td>
</tr>
<tr>
<td>Liquidity</td>
<td>16</td>
<td>2.80</td>
<td>3.04</td>
<td>2.956</td>
<td>.09741</td>
<td>-.769</td>
<td>.564</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>16</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


As depicted in Table 4.7 SMEs dealing with food vending had a profitability of 3.583% (mean=0.3853). In addition, the SMEs specialising in food vending reported a capital structure of 60.69% (mean=0.6069) debt against 39.31% (mean= 0.3931) equity sources. Further the findings reported that the SMEs category had a liquidity of 2.9569 current assets over current liabilities (mean=2.9569).
4.2.2.4 SMEs Performance dealing with Secretarial services and Stationary supplies

Table 4.8 Secretarial services and stationary supplies

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Skewness</th>
<th>Kurtosis</th>
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<td>.49</td>
<td>1.05</td>
<td>.5794</td>
<td>.15155</td>
<td>2.437</td>
<td>.448</td>
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<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt</td>
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<td>.00</td>
<td>.53</td>
<td>.4478</td>
<td>.14444</td>
<td>-2.43</td>
<td>.448</td>
</tr>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>27</td>
<td>.47</td>
<td>1.00</td>
<td>.5522</td>
<td>.14444</td>
<td>2.437</td>
<td>.448</td>
</tr>
<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquidity</td>
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<td>1.90</td>
<td>2.43</td>
<td>2.345</td>
<td>.14444</td>
<td>-2.43</td>
<td>.448</td>
</tr>
<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Valid N (listwise)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Study findings in Table 4.8 illustrated that profitability, capital structure and liquidity for secretarial services SMEs in Dodoma Municipality. Results reported that profitability was 57.94% (mean=0.5794). It was also shown that capital structure was 44.78% (mean=0.4478) debt against 55.22% (mean=0.5522) equity sources. Liquidity was reported to be 2.3458 current assets over current liabilities of SMEs (mean=2.3458).
4.2.3 Summary of SMEs Profitability from the Output

Figure 4.3 Summary of SMEs Profitability

Source: Researcher (2015)

From Figure 4.3 above the result shows that Food vending has more profitability (67.68% of the targeted profit achieved) followed by Textile shops 61.63% followed by Secretarial and stationery supply 57.94% and the last was Hardware and general supply which achieved only 38.53% of the targeted profit. These findings imply that as you increase debt financing in the capital structure the profit tends to decrease due to the fact that debt financing increases operating settlement of the firm.

4.2.4 Summary of SMEs Liquidity from the Output

Table 4.9: Summary of SMEs Liquidity

<table>
<thead>
<tr>
<th>SMEs Category</th>
<th>Equity (%)</th>
<th>Debt (%)</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Textile shops</td>
<td>62.88</td>
<td>37.12</td>
<td>1.8312</td>
</tr>
<tr>
<td>Food vending</td>
<td>69.06</td>
<td>30.94</td>
<td>1.3764</td>
</tr>
<tr>
<td>Hardware and general supplies</td>
<td>39.31</td>
<td>60.69</td>
<td>2.9569</td>
</tr>
<tr>
<td>Secretarial and Stationery supplies</td>
<td>55.22</td>
<td>44.78</td>
<td>2.3458</td>
</tr>
</tbody>
</table>

Source: Researcher (2015)
From Table 4.9 above the result shows that Hardware and general supplies are more liquid (2.9569) than other SMEs Category under the study, Secretarial and stationery supplies falls the second with liquidity of 2.3458. The remaining categories are Textile shops and Food vending with liquidity of 1.8312 and 1.3764 respectively. These findings show that as you increase debt financing in the capital structure the liquidity tends to increase due to the fact that debt financing increases operating financial obligations of the firm required to be settled periodically.

4.3 Relationship between capital structure and SMEs Performance

4.3.1 Results from Correlation Test

**Table 4.10: Correlation results**

<table>
<thead>
<tr>
<th></th>
<th>Debt</th>
<th>Equity</th>
<th>Profitability</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td>-1.000**</td>
<td>-1.000**</td>
<td>1.000**</td>
</tr>
<tr>
<td>Debt Sig. (2-tailed)</td>
<td></td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>N</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>-1.000**</td>
<td>1.000**</td>
<td>-1.000**</td>
<td></td>
</tr>
<tr>
<td>Equity Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>-1.000**</td>
<td>1.000**</td>
<td>1</td>
<td>-1.000**</td>
</tr>
<tr>
<td>Profitability Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1.000**</td>
<td>-1.000**</td>
<td>-1.000**</td>
<td>1</td>
</tr>
<tr>
<td>Liquidity Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

**Source:** Researcher Findings (2015).

The Pearson correlation test for the variables (capital structure made up with debt and equity and SMEs performance) to assess the relationship between the variables is reported in Table 4.10 The relationship between capital structure and profitability indicated a Pearson correlation ratio = (-1.000, p <0.01) indicating a significant negative correlation between debt and profitability of SMEs and significant positive (1.000, p <0.01) correlation between equity and profitability. The relationship between capital
structure and liquidity of SMEs showed a positive significance correlation between debt and liquidity shown by the Pearson correlation ratio = (1.000, \( p <0.01 \)) and a negative (-1.000, \( p <0.01 \)) correlation between equity and liquidity.

### 4.3.2 Results from Regression Analysis

#### 4.3.2.1 Relationship between Capital Structure on Profitability of SMEs

**Table 4.11: Capital structure and profitability**

<table>
<thead>
<tr>
<th>Unstandardised Coefficients</th>
<th>Standardised Coefficients</th>
<th>Co linearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
</tr>
<tr>
<td>(Constant)</td>
<td>.983</td>
<td>.001</td>
</tr>
<tr>
<td>Capital Structure</td>
<td>-.980</td>
<td>-.1000</td>
</tr>
<tr>
<td>R Square</td>
<td></td>
<td>1.000</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td></td>
<td></td>
</tr>
<tr>
<td>F</td>
<td></td>
<td>192724.367</td>
</tr>
<tr>
<td>Sig.</td>
<td></td>
<td>.0000</td>
</tr>
</tbody>
</table>

Dependent Variable: Profitability

**Source:** Researcher Findings (2015).

The coefficient for Capital Structure (-1.000), in Table 4.11 indicate that as capital structure (debt) increases by one unit profitability would decrease by -1.000 units. The results showed that capital structure explained 100% variation of profitability (Refer Table 4.11. This showed that, considering the independent variable (capital structure), there is a probability of predicting profitability by 100% (R squared =1.000). It was also revealed that the above discussed coefficient of determination was significant as evidence of F ratio of 192724.367 with p value 0.000 <0.05 (level of significance), see Table 4.11. Thus, the model was fit to predict profitability using capital structure. Profitability plays a key role in financial performance of SMEs. However, the utilisation of different levels of debt and equity in the firm’s capital structure is one of the methods employed by managers in order to improve performance. Usually, most SMEs are
financed by the entrepreneurs and their relatives. (Fletcher, 2000) hence it becomes hard for SMEs to access non-pecuniary benefits, for instance flexibility over one’s schedule and being one’s own boss (Jensen and Meckling, 1976). Therefore, access to debt from external sources creates complexity in management thereby impacting negatively on profitability.

4.3.2.2 Relationship between Capital Structure on the SMEs Liquidity

Table 4.12: Capital structure and liquidity

<table>
<thead>
<tr>
<th></th>
<th>Unstandardised Coefficients</th>
<th>Standardised Coefficients</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
</tr>
<tr>
<td>(Constant)</td>
<td>. 1.257</td>
<td>.085</td>
<td>14.841</td>
</tr>
<tr>
<td>Capital Structure</td>
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<td>1.000</td>
</tr>
<tr>
<td>R Square</td>
<td>1.000</td>
<td>1.000</td>
<td>1.000</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>1.000</td>
<td>1.000</td>
<td>1.000</td>
</tr>
<tr>
<td>F</td>
<td>104.018</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>Sig.</td>
<td>104.018</td>
<td>.000</td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Liquidity


The coefficient for capital structure (1.000) in Table 4.12 indicates that as capital structure increase by one unit liquidity would increase by 1 units. The results showed that capital structure explained by 100% variation of liquidity. This showed that considering the independent variable (capital structure), there is a probability of predicting liquidity by 100% (R squared =1.000) (Refer Table 4.12). Table 4.12 indicates that the above discussed coefficient of determination was significant as evidence of F ratio of 104.018 with p value 0.000 <0.05 (level of significance). Thus, the model was fit to predict liquidity using capital structure. The research findings concur with Moya (2010) that liquidity focuses on the ability of a business to meet its financial obligations without disruption of its operations. Therefore, a liquid SME is one that promptly pays all its obligations and as such is desirable for funding sources thereby affirming that capital structure has a positive significant effect on liquidity. The research
findings are also in agreement with (Garcia-Terul and Martinez-Solano, 2007 that it is important for a business to always hold enough current stocks in order to cover current liabilities like overdrafts from financial institutions and creditors.

4.4 Factors affecting capital structure decision of SMEs

These are the factors affecting capital structure decision which influence the capital source of SMEs interviewed under this study. They have been summarised during collection of data therefore; they have been not used as variables of measurement. There were five factors identified by the respondents, these were asset size for the ability to secure capital source conditions as regard to kind of financing such as security, cost of capital and repayment, Business records for performance verification, Nature of the business for equity and debt financing criteria, and the last pointed out was initial capital for the SMEs category as summarised on the table below:

<table>
<thead>
<tr>
<th>Table 4.13 Factors affecting SMEs capital structure decision</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SMEs Category</strong></td>
</tr>
<tr>
<td><strong>Factors</strong></td>
</tr>
<tr>
<td>Asset size</td>
</tr>
<tr>
<td>Capital condition</td>
</tr>
<tr>
<td>Business records</td>
</tr>
<tr>
<td>Nature of business</td>
</tr>
<tr>
<td>Initial capital</td>
</tr>
</tbody>
</table>

*As some of the respondents gave more than one factor, percentages would not necessarily add to 100*

**Source:** Research findings (2015).

4.4.1 Textile Shops

From Table 4.13 Asset size was pointed by 19 (73.1%) of SMEs dealing with textiles as a major factor affecting capital structure decision, this was followed by business records 18 (69.2%) and 16 (61.5%) of the SMEs mentioned Capital source conditions as the factor among five factors pointed out during survey.
4.4.2 Food Vending

Asset size was the major factor affecting capital structure decision as supported by 27 (87.1%) of food vendors. Business records ranked the second 26 (83.9%), Capital source condition was the third factor from which 25 (80.6%) of the SMEs pointed out where as nature of the business mentioned by 23 (74.2%) of all factors mentioned by this SME category (Refer Table 4.13 above).

4.4.3 Hardware and General Supplies

Results from Table 4.13 above shows initial capital 15 (93.8%) as the leading factor pointed affecting capital structure decision, nature of business ranked the second 26 (75.0%), asset size was also mentioned by 11(68.8%) as the last factor mentioned by this SMEs category.

4.4.4 Stationery supply and Secretarial services

Initial capital, Business records were pointed out by 18 (66.7%) and 16 (59.3) respectively as the leading factors which affect capital structure decisions in this SMEs category and nature of business ranked the third 14(51.9%) among the factors affecting capital structure decision in this SMEs category (Refer Table 4.13 above).
4.4.5 Results from Correlation Test

Table 4.14: Correlation results

<table>
<thead>
<tr>
<th></th>
<th>Capital</th>
<th>Initial</th>
<th>Asset</th>
<th>Record</th>
<th>Condition</th>
<th>Nature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
</tr>
<tr>
<td>Capital Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
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<td>100</td>
<td>100</td>
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<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
</tr>
<tr>
<td>Initial Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
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<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
<td>1.000**</td>
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<tr>
<td>Asset Sig. (2-tailed)</td>
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<td>.000</td>
<td>.000</td>
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**. Correlation is significant at the 0.01 level (2-tailed).


The relationship between capital structure and initial capital, asset size, business financial records, capital source conditions and nature of the business as the factors affecting capital structure decision of SMEs showed a positive significance correlation shown by the Pearson correlation ratio = (1.000, p <0.01) (Refer Table 4.14 above).
4.4.6 Results from Regression Test

Table 4.15: Regression results

<table>
<thead>
<tr>
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<th>Unstandardised Coefficients</th>
<th>Standardised Coefficients</th>
<th>Co linearity Statistics</th>
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<td>(Constant)</td>
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<td>Adjusted R Square</td>
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<tr>
<td>F</td>
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<tr>
<td>Sig.</td>
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</table>

a. Dependent Variable: Capital Structure


The coefficient for capital structure (1.000) in Table 4.15 indicates that as factors increase by one unit capital structure would also increase by 1.000 units. The results also showed that capital structure explained by 100% variation of the given factors. This showed that considering the independent variable (factors), there is a probability of predicting capital structure by 100% (R squared =1.000) (Refer Table 4.15). Table 4.15 above indicates that the coefficient of determination was significant as evidence of F ratio of 4904.00 with p value 0.000 <0.05 (level of significance). Thus, the model was fit to predict liquidity using capital structure (Refer Table 4.15 above).
4.4.7 Summary of the factors

Figure 4.4: Factors affecting capital structure decision

Results from Figure 4.4 above indicates that SMEs are more affected by initial capital which pointed out by 93.8% of the SMEs surveyed, Asset size ranked the second mentioned by 87.1% of the SMEs followed by business financial record, capital source condition and nature of the business which were pointed out by 83.9%, 80.6%, and 75.0% respectively. This study affirms that capital structure decision is more affected by initial capital, business records, capital source conditions, asset size and nature of the business of the SMEs under study as well as in Tanzania.
CHAPTER FIVE

DISCUSSION OF RESEARCH FINDINGS

5.0 Introduction

This Chapter is going to interpret and describe the significance of my findings in light of what was previously known about the research problem being investigated, and to explain any new understanding or new insights about the problem after taking the findings into consideration.

5.1 Capital structure composition of SMEs

The capital structure was found to be generally composed with both equity and debt financing among the surveyed SMEs in Dodoma Municipality. Most of them are found to be financed by more equity comparing with debt except for the SMEs Category relating to Hardware and general supplies whose capital structure was financed by 60.69% debt (Refer to Table 4.4). This was due to the fact that SMEs engaging with hardware and general supplies had the requirements as regard to loan conditions from lending institutions when compared with other SMEs categories surveyed.

These findings were consistent with the findings of Lema (2013) found that most of the SMEs owners got their initial capital from personal savings followed by loans in Tanzania. Wachilonga (2013) found that SMEs capital structure is made up most with equity particular internal sources of financing during the initial or final stages of operation. Chepkemoi (2013) revealed that most of SMEs under study relied on internal source because external sources of financing particularly debt were more difficult. Abor (2007) argued that quoted firms exhibit higher debt ratios than those of SMEs. Also, the study findings are consistent with Pecking Order Theory of hierarchical preference order for equity particularly internal and debt financing. According to the pecking order theory in the presence of asymmetric information, a firm will prefer internal finance, but would issue debt if internal finance was exhausted. (2013) also find the pecking order theory relevant for short-term debt rather than long-term debt.
5.2 SMEs Performance

5.2.1 SMEs Profitability

The performance of the SMEs in Dodoma Municipality was found to perform above average (more than 50%) actual profit of their targeted profit based on the capital structure employed in the business (Refer to Figure 4.3). This is the fact that most of the SMEs surveyed had a capital structure financed by more equity than debt. Further to that the findings show that as one increases debt financing in the capital structure the profit tends to decrease due to the fact that debt financing increases operating settlement of the firm. Also, the poor performance of hardware and general supplies was due to the fact that their capital structure comprised more debt financing compared to its equity financing which reduced profitability under this category of SMEs (Figure 4.3).

These findings were consistent with the findings of Chepkemoi (2013) in his study found that as capital structure (debt) increases, firm profitability decreases. Also, Wakida (2011) revealed that many of the medium sized enterprises that employed debt in their capital structure alluded to paying a lot in terms of interest rates, hence a reduction in profitability of the overall business. He recommended that SMEs that pursue a high debt policy compared to the industry average should seriously consider increasing the equity component in their capital structure in order to avoid the negative effects of excessive debt on performance. Other studies such as Berger and Bonaccorsi di Patti (2006), Gleason et al. (2000) and Simerly and Li (2000) whereby lower equity capital ratio is associated with higher firm performance as regard to profitability. Zeitun and Tian (2007) was similarly of the opinion that Capital structure is closely linked to the financial performance (profitability). Myers (1984) prescribed a negative relation between profitability and debt. Profitable firms are likely to have more retained earnings. Successful companies do not need to depend so much on external finance. Empirical evidence from previous studies (Al-Sakran, 2001; Kayo and Kimura, 2010) appears to be consistent with the pecking order theory. Most studies found a negative relationship between profitability and debt financing (Myers and Majluf, 1984;
Daskalakis and Psillaki, 2008, Vasiliou et al., 2009). The return on equity is used as an index for firm profitability in this study. Kebewar (2013) finds a negative influence of debt on profitability of French SMEs and Forte, Barros and Nakamura (2013) finds that profitability is negatively related to leverage for Brazilian SMEs. Similar evidence is also provided by Akdal (2010) for UK SMEs who finds profitability to be negatively related to leverage for total debt and long-term debt ratios and by Hashemi (2013) for Iranian SMEs.

5.2.2 SMEs Liquidity

The study showed Hardware and general supplies are more liquid (2.9569) than other SMEs Categories under the study (Refer Table 4.9). These findings show that as you increase debt financing in the capital structure the liquidity tends to increase due to the fact that debt financing increases operating financial obligations of the firm required to be settled periodically.

These findings were consistent with the study of Chepkemoi (2013) who argued that as capital structure (equity) increases, firm liquidity decreases. Anderson (2002) has proved in his research on British companies the relationship between high leverage, high liquidity and slower growth of the firm. Williamson (1988) concluded that the optimal level of debt of the firm is limited by the liquidity of the assets and it depends on the average usage of the debt in the particular industry. According to Morallec (2001) the importance of liquid assets is conditioned by the value of its assessment whether the value of liquid assets is measured by the liquidation value of the firm’s assets or by the selling price of assets over the entire life of the firm. Sibilkov (2004) in her study, which was based on a sample of U.S. public companies, came to the conclusion that liquid assets increased leverage and debt of the companies. According to this finding, it can be concluded that firms with more liquid and thus reversible assets, are more leveraged. Šarlija & Harc (2012) pointed out that if such firms are not able to repay its current liabilities, they are safe obligors because they have enough liquid assets that can cover the arrears.
5.3 Relationship between capital structure and SMEs Performance

The study results indicated that capital structure (debt) has significant negative relationship with profitability of SMEs by a Pearson correlation ratio (-1.000) and a positive significant relationship with liquidity as evidenced by Pearson correlation ratio (1.000) (Refer to Table 4.10). Also, regression results reported that R square = 100% this means that capital structure explained 100% variation of profitability and a beta (-1.000) implies that as capital structure increases by one unit profitability would decreases by 1 unit (Refer Table 4.10). Also, the results showed that capital structure explained 100% variation of liquidity and a beta of (1.000) which means that as capital structure increases by one unit, liquidity would increase by 1 unit.

These findings were in line with San and Heng (2011) in their study which revealed that there is a significant relationship between capital structure and corporate performance. Sogorb (2005) found that tax reserves and profitability of the companies have negative relationship with capital structure. Also, findings by Chepkemoi (2013) identified a negative relationship between capital structure and profitability and a positive significant relationship between capital structure and liquidity.

5.4 Factors affecting capital structure decision

There were five factors pointed out by the SMEs owners/operators when interviewed. Results from Figure 4.4 above indicate that SMEs are more affected by initial capital which was pointed out by 93.8% of the SMEs surveyed, Asset size ranked the second as mentioned by 87.1% of the SMEs followed by business financial record, capital source condition and nature of the business which were pointed out by 83.9%, 80.6%, and 75.0% respectively. This shows that the capital structure decision is much affected by initial capital, business records, capital source conditions, asset size and nature of the business of the SMEs under study as well as in Tanzania.
The relationship between capital structure and initial capital, asset size, business financial records, capital source conditions and nature of the business as the factors affecting capital structure decision of SMEs showed a positive significance correlation shown by the Pearson correlation ratio = (1.000, p <0.01) (Refer Table 4.14 above). Also The coefficient for capital structure (1.000) in Table 4.15 indicates that as factors increase by one unit capital structure would also increase by 1.000 units.

These findings were consistent with the findings with those by Cassar and Holmes (2003), Esperanca et al., (2003), Hall et al., (2004), Mateev & Isanov (2011) and Mateev et al., (2013) who identified that greater the asset size of SMEs, greater the use of borrowed funds for both long as well as short-term. Mashenene and Rmumanyika (2014) argued that insufficient initial capital constraints capital structure and potential growth of SMEs in Tanzania. Wachilonga (2013) in his study concluded that there was a relationship between firm size and capital structure preference. Hashemi (2013) found that size and asset structure appear to have an impact on leverage level in compare with other factors affecting capital structure decision of SMEs. Sogorb (2002) identified that asset size and firm characteristics influence positively on SME capital structure. Also, Wakida (2011) pointed out that many of SMEs will be forced to shut down as a result of their inability to meet financial obligations such as repayment and cost of capital. This may indicate that SMEs find it difficult to collateralise their fixed assets in order to obtain debt (Sarkar, 2005). Valentin (2012). Akdal (2010) and Hashemi (2013) also report a positive relationship between asset tangibility and leverage for UK and Iranian SMEs respectively.
CHAPTER SIX
SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

6.0 Introduction

In this chapter, the major findings are discussed in summary; the conclusions are drawn based on the findings and recommendations are made with reference to concerned stakeholders and policy makers. The general purpose of this study was to assess the impact of capital structure on performance of SMEs in Tanzania and Dodoma Municipal in particular. The study was guided by the following specific research objectives: to explore capital structure composition in SMEs found in Dodoma Municipality, measure the performance of SMEs in Dodoma Municipality, examine the relationship between capital structure and performance of SMEs in Dodoma Municipality and find out the factors affecting capital structure decision of SMEs in Dodoma Municipality.

6.1 Summary of Findings

Four categories of SMEs were surveyed (Textile shops, Food vending, Hardware and general and Secretarial and Stationery supplies) out of these 63% were small and 37% medium enterprises.

Textile Shops indicated 62.88% and 37.12% of the capital structure is equity and debt financed respectively, Food Vending is financed by 69.06% and 30.94% equity and debt respectively meanwhile, Hardware and General Supplies comprise with 39.31% and 60.69% of capital structure is equity and debt respectively whereas Secretarial and Stationery Supplies capital structure ae made up with 55.22% and 44.78% of equity and debt respectively.

The measurement of SMEs capital structure showed that Food vending has more profitability (67.68%) of the targeted profit achieved) followed by Textile shops
61.63%, Secretarial and stationery supply ranked the third with 57.94% and the last was Hardware and general supply which achieved only 38.53% of the targeted profit. The relationship between capital structure and profitability indicated a Pearson correlation ratio = (-1.000, p <0.01) indicating a significant negative correlation between debt and profitability of SMEs and significant positive (1.000, p <0.01) correlation between equity and profitability. The relationship between capital structure and liquidity of SMEs showed a positive significance correlation between debt and liquidity shown by the Pearson correlation ratio = (1.000, p <0.01) and a negative (-1.000, p <0.01) correlation between equity and liquidity.

The coefficient for Capital Structure (-1.000) indicated that as capital structure (debt) increases by one unit profitability would decrease by 1 unit. The results showed that capital structure explained 100% variation of profitability. Profitability plays a key role in financial performance of SMEs. The coefficient for capital structure (1.000) indicated that as capital structure increase by one unit liquidity would increase by 1 unit. The results showed that capital structure explained by 100% variation of liquidity. Thus, the model was fit to predict profitability and liquidity using capital structure.

SMEs Owners/Operators surveyed indicated capital structure decision is affected by initial capital which pointed out by 93.8% of the SMEs surveyed, Asset size ranked the second mentioned by 87.1% of the SMEs followed by business financial record, capital source condition and nature of the business which were pointed out by 83.9%, 80.6%, and 75.0% respectively.

6.2 Conclusions

There is enough evidence of a negative relationship between capital structure and profitability. It has also been revealed that utilisation of different levels of debt and equity sources enables firms to invest more hence more profits. From the study findings there is enough proof that capital structure enables SMEs to engage in financial
investments. A high degree of equity financing (internal sources) implies relative high degree of profitability

Capital structure has a significant positive impact on liquidity. From the findings, firm’s with more liquid stock is highly likely to meet its financial obligations in the required time and higher liquidity is as a result of proper organisation of equity and debts. Therefore, it is true to state that there is a positive significant relationship between capital structure and liquidity. This is supported by Ahmad (2007) who argued that there is a need to examine more closely the factors that may contribute to a firm’s ability to secure capital for success and performance of SMEs. Also, the study revealed that SMEs capital structure decision is much affected by initial capital, business records, capital source conditions, asset size and nature of the business.

6.3 Recommendations

The study find strong support for the argument that capital structure impacts on SMEs performance very highly, thus SME owners should be willing to come up with ways to increase the amount of liquid stocks in order to increase financial viability. This will improve financial performance among the SMEs in the different sectors.

From the study findings it was conceived that capital structure has a remarkable role in profitability. Therefore, SME owners' should utilise funding from equity financing to ensure achievement of the targeted profit. Once this is done, there will be high profit turnover leading to better SMEs performance.

From the study findings, there is an association between capital structure and profitability. Therefore, firms should avoid situations where they are highly leveraged since this may lead to bankruptcy if they are unable to make payments on their debt obligation when due and SME owners should also make good investment decisions in order to increase profitability.
6.4 Recommendations for Further Studies

The main objective of this study was to analyse the impact of capital structure of small and medium enterprises on financial performance in Dodoma Municipality. From the study findings, the findings were only limited to capital structure and SMEs performance. Thus, more research and studies should be carried out to determine if indeed capital structure is the only determinant that affects profitability and liquidity. There should be a policy implication for concerned parties which consider impact of the determinant (capital structure) while setting the strategic plans of SMEs which will see an increase in liquidity and profitability among the SMEs. Also, the study was limited to only four SMEs category which were textile shops, food vending, hardware, general supplies and secretarial and stationery supplies. Therefore, other studies are encouraged in respect of other SMEs categories in relation to capital structure and performance.
REFERENCES


Kipilyango L.N, (2012), Empowering Small and Medium Enterprises (SMEs) through Public procurement and Supplies 3rd PSPTB Professionals Annual Conference


APPENDICES

STRUCTURED PERSONAL INTERVIEW QUESTIONS

1. How much capital injected in your business?
2. How much capital of your business is debt?
3. What are the factors affecting your business capital structure decision?
4. How long have you been operating your business?
5. How much profit you expected to generate from your capital employed in a year?
6. What actual profit generated during that period?