ASSESSMENT OF THE IMPACT OF MICROFINANCE CREDITS ON THE PROSPERITY OF SMALL AND MEDIUM ENTERPRISES THE CASE OF ARUSHA MUNICIPAL COUNCIL

By

Kombe, Brenda G

A Report Submitted in Partial/Fulfillment of the Requirements for Award of Master of Accounting and Finance (MSc A&F) of Mzumbe University

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CERTIFICATION

We, the undersigned, certify that we have read and hereby recommend for acceptance by the Mzumbe University, a dissertation/thesis entitled **Assessment of the Impact of Microfinance Credits on the Prosperity of Small and Medium Enterprises: The case of Arusha Municipal**, in partial/ fulfillment of the requirements for award of the degree of Master of Accounting and Finance of Mzumbe University.

Signature

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Major Supervisor

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Internal Examiner

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I, Brenda George Kombe**,** declare that this thesis is my own original work and that it has not been presented and will not be presented to any other university for a similar or any other degree award.

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Writing an academic report is extremely tough work to be accomplished by a student himself or herself, it requires support and inputs from different sources and individual as well. I am therefore duty bound to express my sincere and heartfelt gratitude for whoever helped me in any way to accomplish this work.

All these could not be possible without the Grace of God who gave me strength, power of reasoning and good health from the beginning and forever and ever.

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DEDICATION

I would like to dedicate this work to my parents, siblings and respondents who played a great role in the completion of my studies

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ABBREVIATIONS

B.O.T	Bank of Tanzania
DCF	Discounted Cash Flow
I.L.O	International Labor Organization
I.R.R	Internal Rate of Return
MFI'S	Microfinance Institutions
N.M.B	National Microfinance Bank
N.B.C	National Bank of Commerce
N.P.V	Net Present Value
P.P	Payback Period
SACCOS	Savings and Credit Cooperative Societies
SIDO	Small Scale Industries Development Organizations
S.M.E	Small and Medium Enterprises
U.N	United Nations
W.A.C.C	Weighted Average Cost of Capital

ABSTRACT

The research was done with the objective on the assessment of the impact of microfinance credits on the prosperity of Small and Medium Enterprises (SME) and its social impacts. The supply of microfinance credits to SME's has been believed to improve a country prospects for economic development which in turns believed to enhance a country's ability to improve the lives of its citizens

The researcher had employed a case study as a research design in order to get in depth on the subject matter. Details were sought on the nature, extent and impact of Microfinance credits on the prosperity of Small and Medium Enterprises in Arusha from the staff of National Microfinance Bank (NMB Plc). Information was mostly collected using questionnaires, interviews, although perusal of records also enriched the study. The study was analyzed by taking a random sample of 150 customers in their reproductive age (18-49). The data was collected through structured questionnaires. The analysis of data consisted of simple graphical presentations and tabulation was made showing percentages.

Then the conclusion and recommendations were followed on the basis of the obtained results. The present study confirms that, for the development of SME's, awareness of business management is very necessary though many entrepreneurs were reported being aware of microfinance credits, but still the amount of development is very low.

Therefore, to improve the use of microfinance credit to help the development of SME's in the country, we need to use multimedia sources to educate more entrepreneurs so as to increase the awareness, close look on the match of loan size and its collateral, skills of workers and the increase of products flexibility

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INTRODUCTION

This chapter covers the historical background of the company that was used on the study, statement of the problem, objective of the study, research questions, significance and scope of the study and delimitation of the study.

1.0 Historical Background of the Organization

NMB was established in 1997 **under act No 22 of 1997** after the split of National bank of commerce (NBC), which was a public institution with majority of shares held by the government of Tanzania. NBC at that time was divided into two separates banks.

A) NBC 1997 LTD

B) NATIONAL MICRO FINANCE BANK LTD.

Although NMB was privatized in 2008, its name remained the same i.e. NMB. In 2009, NMB sold some of its shares to the public and his/her name changed to NMB PLC, the name under which it is still operating with. The bank was mandated to promote savings and allow deposits from low and high Income earners.

As part of its privatizing policy, the Government commenced the privatization process of NMB in 2004. Specifically the repeal of the NMB Ltd Incorporation Act of 1997 was assented by the president on 30th January 2004, paving way for its privatization and on 30th September 2005, the Government sold 49% of its shareholding in the Bank to a consortium led by the Cooperative Centrale Raiffeisen- Boerenleen bank B.A. (Rabobank) of the Netherlands. The Government is now selling a further 21% of the NMB’s shares to the public in accordance with the undertakings given under the shareholders agreement executed with Rabobank consortium.

NMB has over its lifetime consolidated its market position to become the most profitable and largest bank in Tanzania. In the last five years, its financial performance has improved from a profit of about TZS 5 billion in 2002 to about TZS 39 billion in 2007, this shows that the profit has increased about 600% in five years. Similar, the shareholders funds has increased from TZS 11 billion in 2002 to TZS 122 billion in 2007, while total assets have more than doubled over the same period.

Vision

To ensure that the wider public in Tanzania gets banking services

Mission statement

NMB will provide access to a full range of financial services for the rural and (peri) urban population in Tanzania and its current and prospective client base, in a sustainable and viable way. Special attention will be given to micro entrepreneurs, SME's, rural enterprises and agriculture.

In order to achieve its mission of providing the rural and (peri) urban population in Tanzania, access to full range of financial services, NMB has formulated a pillar of three values namely;

- Customer value; to become recognized as the leading rural bank in Tanzania
- Financial value; to generate sufficient profits to remain financially sustainable
- Employee value; to be a challenging employer for its workforce providing sample opportunities for their career development

NMB'S services and Products

NMB offers both commercial banking and microfinance services and products to its customers. Some of these services and products include;

Microfinance loans;

The NMB microfinance product focuses on the financial needs of micro and small entrepreneurs with short-term needs up to two years, Example of these loans are small and medium enterprises loans, MFI and SACCOS loans, corporate loans, personal loans, salaried workers loans and Pensioners loans.

The micro entrepreneurs as individuals will also have access to other personal banking products.

Deposits;

This include saving account, business account, bonus account, junior account, time deposit and short-term deposit.

1.1. Background Information on Research Problem

Microfinance covers a broader range of small-scale financial services encompassing credit, savings, insurance, leasing, housing, payment transfers, remittance services. In addition, they are both set to play a significant role in the poverty alleviation effort in developing countries like Tanzania. (Business Times Friday June 24-30, 2005) Many local banks in Africa could contribute a lot to their respective economies and facilitate the objectives of financial linearization by boosting competition in banking markets, stimulating improvements to customers, contribute to employment and expanding access to credit, but the attainment of these benefits have been jeopardized because the local banks have been vulnerable to financial distress.

In the period of 1980's the strategy based on the poverty alleviation through provision of loans that means microcredit fund being a source of finance. As from 1990's onwards, the emphasis has also been the provision of broader range of financial services to include those of microfinance. To reduce poverty to the customers, they need financial advices on how to run their business, stabilize cash, build asset and shield them against risk. Financial services needed by the poor include loans, savings, insurance, and money transfer. However, the poor rarely access services through the formal financial sector. They address their need for financial services through a variety of financial relationships, mostly informal like savings clubs, moneylenders, which proved to be costlier, erratic and insecure to borrowers (The Guardian Thursday, June 2, 2005).

Olomi, (2009), access to finance is often cited as the most serious constraint by small and medium enterprises in Tanzania. Access is even more difficult for the disadvantaged groups, such women, youths, the disabled and rural dwellers. Typically, these groups are trapped in a vicious cycle of marginalization, with limited social and human capital, limited access to resources and limited power, making it difficult for the conventional markets to work for them. To meet the needs of the people, different institutional and product innovations are required.

It has been difficult for the poor to access the credit facilities, and these difficulties arise from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. There is some evidence that the poor people, after having been given a certain amount of loan, have been able to invest, pay up their loans and obtain some profit that thereby alleviating their poverty. Community Banks, microfinance institutions , NGO's and grassroots savings and credit groups around the world have shown that these micro-enterprise loans can be profitable for both borrowers and lenders, making microfinance one of the most effective strategies in poverty reduction.

In most cases, the commercial banks and non-financial institutions together with the non-governmental organizations are the main parties that carry out the microfinance operation in Tanzania. In addition, Tanzanian's financial sector is undergoing reforms, which are aiming at improving the efficiency and effectiveness of the country's financial system to be able to meet the need of various interest groups in the country. The government's economic and financial reforms have brought to the forefront the plight of low-income people and Small and micro enterprises (SME's) in accessing microfinance services from the formal financial sector. The government is committed to promoting, through private initiative, the operation of financial institutions, which serve the financial needs of low-income people and SME's.

The fact is the current banking, financial sectors environment has not generated the institutional capacity for meeting the financing needs of the informal sector, and SME's despite the huge economic activities and potential of these sectors, their needs have been ignored due to the stringent conditions imposed by the formal banking and financial sectors. Consequently, the informal financial institutions have tried to meet the financial needs of those not served by the formal financial system. Such institutions are perceived to be playing a vital investment- financing role.

The research studies on the impact of microfinance on the prosperity of SME's have established that there is a big gap between the supplies of microfinance credit as compared to its actual demand. Hence, there is a huge need of providing microfinance services to the poor people and SME's. It has, further, been established that well developed microfinance banking services, is the one with pricing based on full cost recovery and a profit margin, as it can provide very strong inputs to the development of market based SME's and thereby contributing to the improvement of the livelihood of a great number of people.

1.2 Statement of the Problem

There have been a lot of emphasis, from the government and other agencies, on supporting the microfinance activities to the poor people who are economically active, together with the small and medium enterprises, but still there are bottlenecks to overcome pertaining the demand and supply of the microfinance service. While microfinance institutions are complaining of lack of clients, potential clients are complaining for not being able to access microfinance services.

The main business of banking institutions is to receive deposits and lend money. Receiving deposits involves no risk, since it is the banker who owe the deposit whenever it is in demand. On the other hand, lending always involves much risk because there is no certainty of repayment (Myneni, 2006). Banks lends money to customers as a way of expanding business or investing. The lending institutions are afraid of lending money to some customers due to lack of collateral, entrepreneurial skills, formal business address, and high operational costs which lead to higher interest rate. SME’s on their side are not borrowing due to short repayment period, high interest rate, terms and straighten conditions for borrowing due requirements for collateral and sometimes, the formation of groups as a condition of lending.

These conditions have mainly affected the young entrepreneurs, women and other small business owners who are not in a position to provide enough collateral as compared to the amount of loan they require. This has been contrary to National Strategy for Growth and Reduction of Poverty (MKUKUTA) and other poverty reduction strategies, which aim at alleviating poverty, as stipulated in the Tanzania Development Vision 2025.

This research, therefore, was conducted to assessing the impact of microfinance credits on the prosperity of small and medium entrepreneurs in Arusha, Tanzania.

1.3 The Objectives of the Study

1.3.1 General Objective

The general objective of this study was to determine the impact of microfinance credit on the prosperity of SME's in Arusha.

1.3.2 Specific Objectives

The specific objectives in this study were;-

i. To determine the extent that the formation of group lending facilitate the development of small and medium entrepreneurs
ii. To find out the extent at which capital budgeting may have an impact on the development of Small and Medium Enterprises.
iii. To examine the impact of payment period on credits provided by the microfinance on the development of small entrepreneurs

1.4 Research Questions

The following are the research questions;-.

i. On what extent does the formation of group lending facilitate the development of small and medium entrepreneurs?
ii. How does capital budgeting have an impact on the development of Small and Medium Enterprises?
iii. What was the impact of payment period on credits provided by the microfinance on the development of small entrepreneurs?

1.5 The significance and scope of the study

The main theme of this dessertation is to understand the impact that the microfinance institution has on the development of small and medium enterprises in Arusha. Therefore; this study is significant to;-

a) The financial Institutions dealing with loans/credits especially NMB Bank to understand and put into practice the preventive and control measures, which will be, suggested upon researchers findings.

b) The clients to understand how better they can be involved in micro enterprises activities that are within the microfinance institutions areas of interest.

c) The findings may also shed light on what further areas need to be considered by future researchers conducting research studies in the same field. As how they can improve the quality of their products and even introduce new ones as the method of winning the market

1.6 Delimitation of the study

The study was carried out in Arusha region and involved only the NMB Ngarenaro branch, Opportunity bank and some customers from Akiba commercial bank. The study dealt with assessment of effectiveness of microfinance services to the Small and Medium Enterprises (SME's). Some of the customers were not all friendly especially those who had medium size of business and this make it difficult for me to get the actual situation of their development and on how they have improve by the use of loans obtained from the microfinance institutions.

CHAPTER TWO

LITERATURE REVIEW

2.1. Theoretical Review

This chapter focuses on some of the concepts of microfinance and the role they play in the development of SMEs. The concepts chosen are those that are in relation with the area of this thesis. The chapter opens with an overview of microfinance. This shows the various products and services that MFIs have and explain how they are of importance to the development of SMEs and also the extent to which transaction cost affects the delivery of these products and services the next centre of attention is SME growth and development. This gives an idea on how firms are considered by financial institutions before they are offered their services. The type of microfinance is of significant importance in getting the services. This is explained and further to look for what determines the capital structure of a business. This will explain why some firms prefer borrow to equity capital and vice versa

2.1.1 What is Microfinance

Microfinance is the provision of financial services such as loans, savings, insurance, and training to people living in poverty and in need. It is one of the great success stories in the developing world in the last 30 years and is widely recognized as a just and sustainable solution in alleviating global poverty.

(Kabir et al, 2002) states that 'Microfinance is the provision of financial services such as credit, savings, cash transfer and insurance to poor and low-income people'. (Srinivas, 1997) in the same line defines Microfinance as the extension of small loans to entrepreneurs who are poor and do not qualify for traditional bank loans.

Furthermore (Jolly, 2001) points out that, financial services generally include savings and credit; however some microfinance organisations provide insurance and payment services.

In the same way (Yunus, 1989) defines Microfinance ‘as formal schemes designed to improve the well-being of the poor through better access to savings services and loans’.

The industry began by providing small loans to emerging entrepreneurs to start or expand businesses. Opportunity International (OI) was one of the first nonprofit organizations to recognize the benefits of providing capital to people struggling to work their way out of poverty (Morduch, 2001). Over the years, with OI leading the way, the microfinance sector has expanded its financial service offerings to meet client needs. Along with providing more flexible loan products and business and personal development training, Opportunity offers savings and insurance to help clients effectively navigate the daily hardships they face. Without these services, clients are continually at risk of slipping back into poverty because of unforeseen circumstances.

Microfinance organizations make it a priority to serve the particular needs of women, since a staggering 70 percent of all those living in extreme poverty are women. Women are mostly excluded from education, the workplace, property ownership and equal participation in the politics. They produce one-half of the world’s food, but own just one percent of its farmland (Likwelile, 2002). Nearly 85 percent of Opportunity International’s loan clients are women. While OI gladly extends loans to men, the organization believes the greatest opportunity for interrupting cycles of extreme poverty come from microfinance programs that target female entrepreneurs. When women improve their circumstances, they also improve the lives of their children. By investing in nutrition and education, they help to create a better future for their children and their communities.

Microfinance refers to a variety of financial services that target low-income clients, particularly women. Since the clients of microfinance institutions (MFIs) have lower incomes and often have limited access to other financial services, microfinance products tend to be for smaller monetary amounts than traditional financial services. These services include loans, savings, insurance, and remittances. Microloans are given for a variety of

purposes, frequently for microenterprise development. The diversity of products and services offered reflects the fact that the financial needs of individuals, households, and enterprises can change significantly over time, especially for those who live in poverty. Because of these varied needs, and because of the industry's focus on the poor, microfinance institutions often use non-traditional methodologies, such as group lending or other forms of collateral not employed by the formal financial sector.
Microfinance Information Exchange recognizes many general definitions of microfinance, but for analysis purposes, employs a functional definition as Microfinance services – as opposed to financial services in general – are retail financial services that are relatively small in relation to the income of a typical individual. Specifically, the average outstanding balance of microfinance products is no greater than 250% of the average income per person (GNI per capita). (Mix microfinance information exchange). Micro credit is an aspect of Microfinance (Srinivas, 1997) Microfinance focuses on the provision of small loans to help the poor to develop micro enterprises in order to increase their income and their well-beings.

The services provided to microfinance clients can be categories into four broad different categories:

a) Financial intermediation or the provision of financial products and services such as savings, credit, insurance, credit cards, and payment systems should not require ongoing subsidies.
b) Social intermediation is the process of building human and social capital needed by sustainable financial intermediation for the poor. Subsidies should be eliminated but social intermediation may require subsidies for a longer period than financial intermediation.
c) Enterprise development services or non financial services that assist micro entrepreneurs include skills development, business training, marketing and technology services, and subsector analysis. This may or may not require

subsidies and this depends on the ability and willingness of the clients to pay for these services.

d) Social services or non financial services that focus on advancing the welfare of micro entrepreneurs and this include education, health, n nutrition, and literacy training. These social services are like to require ongoing subsidies and are always provided by donor supporting NGOs or the state (Bennett, 1997; Legerwwod, 1999)

2.1.2 What is Small-scale Enterprises (SME)

The SMEs nomenclature is used to mean micro, small and medium enterprises. It is sometimes referred to as micro, small and medium enterprises (MSMEs). If your business engages in activity contributing to the economy regardless of whether it is a sole proprietorship, corporation, partnership or other legal entity it can be considered a small- or medium-sized enterprise (SME) and a driving force of the Tanzania and global economy. As an SME, you create competitiveness in the market, improve the business environment and foster growth. The SMEs cover non-farm economic activities mainly manufacturing, mining, commerce and services. There is no universally accepted definition of SME. Different countries use various measures of size depending on their level of development. The commonly used yardsticks are total number of employees, total investment and sales turnover.

The purpose or goal of any firm is to make profit and growth. A firm is defined as an administrative organization whose legal entity or frame work may expand in time with the collection of both physical resources, tangible or resources that are human nature (Penrose, 1995). The term growth in this context can be defined as an increase in size or other objects that can be quantified or a process of changes or improvements (Penrose, 1995). The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state (Penrose, 1995). The growth of a firm can be determined by supply of capital, labour and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of resources to the firm (Ghoshal, Halm and Moran, 2002). SMEs are the Driving Force of Business; - SMEs account for more than 90 percent of businesses across the globe, 99 percent of all businesses in the European Union and 99.7 percent of U.S. businesses, according to International Labor Organization and the U.S. Small Business Administration. SMEs are critical for social and economic development in creating jobs, stimulating entrepreneurship and driving innovation. Moreover, SMEs Impact the Economy, the pressures on an SME can affect the economy. As large companies tighten their budgets, they reduce orders to SMEs. The weak demand and challenge of obtaining working capital pressures SMEs to stay afloat. The government recognizes that SMEs need assistance for the benefit of the economy and provides financial support through small business loans and other government programs.

Small scale enterprises which is termed as Micro, Small and Medium Enterprises (SME's) play an important role in employment creation and income generation in Tanzania (Ngasongwa, 2002). 'Indeed, SME's all over in the world are known to play a major role in social economic development. This is apparently the case of Tanzania, where SME's contribute significantly to employment creation, income generation and stimulation of growth in both urban and rural areas' (Fatwa, 2004)

In the context of Tanzania, micro enterprises are those engaging up to four people, in most cases family members or employing capital amounting up to Tshs.5 million. The majority of microenterprises fall under the informal sector. Small enterprises are mostly formalized undertakings engaging between 5 and 49 employees or with capital investment fromTshs.5 million to Tshs.200 million. Medium enterprises employ between 50 and 99 people or use capital investment from Tshs.200 million to Tshs.800 million. This is illustrated in the table below:

CATEGORIES OF SMEs IN TANZANIA

Table 1:0 Definition of SME's in Tanzania

Category	**Employees**	**Capital Investment (Tshs)**
Micro enterprise	1-4	Up to 5 million
Small enterprise	5-49	Above 5 million To 200 million
Medium enterprise	50-99	Above 200 million To 800 million
Large enterprise	100+	Above 800 million

Source: URT, 2003(SME Development Policy)

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

2.1.3 Development of Microfinance and Small-scale Enterprises in Tanzania

The major categories of Small-scale enterprises in Tanzania are agriculture, trade, services and manufacturing. The range of activities involved is very wide but the important ones are cereals farming, keeping dairy cows, poultry keeping, retail shops, restaurants, food processing, tailoring, selling cooked food, bites vending, second hand clothes trade, selling charcoal, grain milling and hairdressing/beauty salons. In Tanzania the importance of micro-financing and micro enterprises, own their origin from the efforts taking in the provision of micro credit financing to small business enterprises. These can be explained by looking at different changes in the economic policy before and after independence.

Before independence, 1950s to 1960s most of the Tanzanians were craftsmen and small and medium size traders. This means colonialism forcibly restructured its goods and services that complemented the economic needs of the colonizing power. Colonialist opened up local production of basic consumer goods, which naturally out-competed local producers (Biesteker, 1978).

The foreign commercial banks that were later opened in the colonies tended to discriminate against indigenous entrepreneurs. Likewise in Tanganyika, a former country of east Africa, a British mandate after 1920 it become independent in 1961 and joined with Zanzibar to form Tanzania in 1964, there was a regulation that prohibited foreign wholesalers from selling to African trader goods worth more than Tshs 600 on credit. Africans require specific government permission before they could apply for a loan (Rweyemamu, 1972, pp. 29).

After independence, national entrepreneurs pressurized the government to initiate immediate legislative interventions to repeal all discriminatory colonial laws. They proposed specific policy incentives like soft loans, free industrial estates, control of retail trade and immediate representations in key government decisions organs. Financial and non-financial institutions were established in order to grant loans and to solve liquidity problem faced by micro-enterprises in the country as well as to promote National Policy for the development of the informal sector and micro-enterprises as adopted by International Labour Organisation (ILO) in 1972.

In 1973, the government established Small Scale Industries Development Organisations (SIDO) vide Act No.28 as Parastatal organisation. Among the objectives for establishment were to promote and assist small-scale industries and provide loans for working capital, management support, equipment, and training.

In 1983, the government also passed Human Resources Development Act (Nguvu Kazi), which was mainly targeted the emerging small entrepreneurs and required all Tanzanians to either to be employed or create self-employed through entrepreneurship? The recent moves include, establishment of the donor support fund for promoting micro-entrepreneurs Development Trust (NEDF), Presidential Trust Fund (PTF) where as the major objectives of its establishment is to supplement and complement others national production efforts, especially in agriculture, animal husbandry, fisheries and small-scale industries, and variety of NGOs to promote the same.

2.1.4 Regulation of Microfinance in Tanzania

In this case, the microfinance sector has involved and developed according to different patterns and growth paths in various countries and regions. The literature on microfinance identifies the legal and regulatory framework as one factor that influences the emergence of different kinds of institutional providers of microfinance and especially, their development into self-sustaining commercial microfinance institutions capable of reaching growing numbers of SME's especially in rural areas.

According to Chavez and Gunzalez-vega (1993), regulation of microfinance refers to the government regulation that should serve three basic goals. The first one, macroeconomic in nature, is to ensure the solvency and financial soundness of all intermediaries, in order to protect the stability of the country's payment system. The second objective is to provide consumer protection against undue risks of losses that may arise from failure, fraud or opportunist behavior of the suppliers of financial services, the third goal of financial regulation is to provide the efficient performance of institutions and markets and the proper working of competitive market forces.

Moreover, Banks are regulated to protect their depositors and prevent risks to the financial system. Credit only MFI's do not take deposits from the public and are too small to pose much risk for the financial system. Regulation by the financial authorities is needed for MFI's that do take deposits, for instance, savings based financial co-operative or credit based MFI's that want to start taking deposit to finance their growth (CGAP) (2006)

However, supervision of MFI's consists of the examination and monitoring mechanisms through which the authorities verify compliance with regulation and determine the actual risks faced by an intermediary. Therefore, in Tanzania commercial banks, non-bank financial institutions, regional banks and rural unit banks are subject to licensing, regulation and supervision by the Bank of Tanzania under the provisions of the Bank of

Tanzania Act (1995), Banking and Financial institutions Act (1991), Foreign Exchange Act (1992).

In addition to that, there are two categories of financial providers of microfinance, which are not subject to prudential regulation by the Bank of Tanzania. That is, the savings and credit cooperative societies (SACCOS) and the financial non-governmental organizations (NGO's). SACCOS though are subject to little effective regulation and supervision by the cooperatives Development Department.

Furthermore, microfinance regulations in Tanzania which was published in March 2005 as "Banking and Financial institutions, (microfinance institutions and micro credit Activities) regulation 2005. To qualify for the license financial or microfinance institutions are required to be incorporated as company limited by shares with a minimum capital of Tshs 800 million for microfinance company (MFC) with nationwide branches and 200 million for unit microfinance company (MFC).(CGAP)(2005). In that case, licensed companies can open branches in any district of Tanzania upon BOT approval except for single unit MFC. They are also allowed to established mobile agencies in rural and urban area. Subject to evidence of insurance cover, make micro loans, remittances, payments orders and funds transfer domestically and to do any other activities as may be authorized by BOT. Restricted business for licensed MFC includes, opening clients current accounts, foreign trade business, trust operations and investment in enterprise capital and any business other than banking business.

2.1.5 Importance of Microfinance in the Economy

A Review of microfinance efforts from various parts of the world suggest that, by and large access to microfinance had a positive economic impact. That this impact has been often larger for those closer to the poverty line than those that are further away and that they increase with duration of membership or intensity of loans, as members begin to invest in assets rather than consumption, Morduch and Haley (2001).

As credit plays vital role in beginning and expanding the business, microfinance has been treated as an important tool for economic development. Microfinance lenders offer small loans to aspiring as well as current business owners. These loans assist people in getting access to traditional financing and offer jobs to local communities.

Yunus, (1989) argued that, availability of credit to low income households and small business could greatly enhance their economic strength and eventually break the vicious circle of low income, low saving, low investment and low productivity and emphasized the importance of micro-finance in assisting the poor on self-employment

The size of microfinance loan may vary from lender to lender and can range from Tshs. 50,000 to Tshs. 7,5000,000. Microfinance plays vital role in economic development through following ways-

- **Job Creation:** A business that starts and operates because of microfinance aid can create jobs in equal number as those created by multi-national corporations. Most of the microfinance lenders provide loans to borrowers who reside in some of the remote and most deprived areas of the world. The employment opportunities created by these small businesses are substantial, especially for communities where jobs are rare. As people of these communities earn an extra income, they can spend that earning within their community, which assists in stimulating the economic growth.
- **Financial Stability:** One of the greatest roles microfinance has played by providing financial stability to people, which contributed to local economies in substantial extent. Small loans have offered an opportunity to create extra income, so that people can pay for their extreme necessities. After availing financial aid through microfinance, people do not rely on any public assistance programs, which is indeed beneficial for the national economy.
- **Global Poverty:** The supporters of microfinance believe that offering financial stability to poor and low-income families through small loans may break the poverty cycle for future generations.

Poor access to credit markets is the key reason why most of the economies cannot expand. However, microfinance can provide economic interventions, which help to improve an access to financial technologies. A durable microfinance system with well-equipped resources can help to stimulate the economic growth from very basic level

2.1.6. Importance of Small and Medium Enterprises

It is estimated that about a third of the GDP originates from the SME sector. According to the Informal Sector Survey of 1991, micro enterprises operating in the informal sector alone consisted of more than 1.7 million businesses engaging about 3 million persons that was, about 20% of the Tanzanian Labour force. Though data on the SME sector are rather sketchy and unreliable, it is reflected already in the above data that SME sector plays a crucial role in the economy.

Since SMEs tend to be Labour-intensive, they create employment at relatively low levels of investment per job created. At present, unemployment is a significant problem that Tanzania has to deal with. Estimates show that there are about 700,000 new entrants into the Labour force every year. About 500,000 of these are school leavers with few marketable skills. The public sector employs only about 40,000 of the new entrants into the labor market, leaving about 660,000 to join the unemployed or the underemployed reserve. Most of these persons end up in the SME sector, and especially in the informal sector. Given that situation and the fact that Tanzania is characterized by low rate of capital formation, SMEs are the best option to address this problem.

SMEs tend to be more effective in the utilization of local resources using simple and affordable technology. SMEs play a fundamental role in utilizing and adding value to local resources. In addition, development of SMEs facilitates distribution of economic activities within the economy and thus fosters equitable income distribution. Furthermore, SMEs technologies are easier to acquire, transfer and adopt. In addition, SMEs are better positioned to satisfy limited demands brought about by small and localized markets due to their lower overheads and fixed costs. Moreover, SME owners tend to show greater resilience in the face of recessions by holding on to their businesses, as they are prepared to temporarily accept lower compensation. Given the fact that Tanzania is endowed with abundant natural resources, the creation of enabling business environment will facilitate exploitation of these resources through SMEs. This is again an opportunity for SMEs development.

One of the significant characteristics of a flourishing and growing economy is a booming and blooming small and medium enterprises (SMEs) sector. Small and medium enterprises play an important role in the development of a country. SMEs contribute to economic development in various ways by creating employment for rural and urban growing labor force, providing desirable sustainability and innovation in the economy as a whole .In addition to that, a large number of people rely on the small and medium enterprises directly or indirectly. There are a number of market entry barriers faced by small to medium scale enterprises (SMEs) as they try to make a living in an economy that does not offer equal opportunities. Limited access to precision engineering equipment, capital and information, are some of the barriers faced by skilled and semi-skilled artisan as they try to run viable business ventures.

However, the linkages between SME's and large enterprises are very weak in Tanzania. SME's development policy therefore, creates the potential for enhancing linkages within the economy. In addition, SME's serve as a training ground for entrepreneurship and managerial development and enable motivated individuals to find new avenues for investment and expanding their operations.

2.1.7 Policy Review

2.1.7.1. The Microfinance Policy

For the majority of Tanzanians as provided by The National Microfinance Policy (2000), whose incomes are very low, access to financial services offers the possibility of managing scarce household and enterprise resources more efficiently, protection against risks, provision for the future and taking advantage of investment opportunities for economic returns. Microfinance addresses the financial needs of major sectors of the Tanzania population. They are primarily facilitators rather than creators of the underlying economic opportunities that lead to widespread economic prosperity thereby contribute to reduction of poverty and improvement of income distribution hence higher standards of living. While focusing on contributing to economic growth and reduction of poverty, the policy outlines the following:

- Describing the roles of the implementing agencies and the tools to be applied to facilitate development
- Laying out the principles that will guide operations of the microfinance system;
- Establishing a framework within which microfinance system may operate.
- Serving as a guide for coordinated intervention by the respective participants in the system.

The government considers microfinance system as an integral part of the financial sector that falls within the general framework of its financial sector reform policy statement of 1991. The overall objective of the policy is to establish a basis for the evolution of an efficient and effective microfinance system in the country that serves the low-income segment of the society. The policy cove rs the provision of financial services to households, smallholder farmers, small and medium enterprises in rural areas as well as in the urban sector covering a range of financial services including savings, credit, payments and other services. In the end, the Government expects institutions that decide to become microfinance service providers to fulfill their responsibility to learn “Best Practices” and apply sound financial principles in the delivery of their services.

2.1.7.2. The Small and Medium Enterprises Development Policy

An assessment of the SME sector has shown that it is facing constraints, which need to be addressed adequately through this policy. Given the importance of the sector and the need to transform it to a vibrant and dynamic one, it is crucial to put in place strategies that will facilitate the removal of those constraints so that it can attain the desired vision and identified objectives. In the SME Development Policy, strategies have been identified

focusing on areas, which have maximum impact on the sector. The major areas of focus include creation of the enabling business environment, developing the infrastructure, strengthening financial and non-financial services, establishing, and strengthening institutions supportive to SME development. In this policy, problems are identified, Government statements are articulated and appropriate strategies are specified.
The policy addresses the following key areas namely:

- Enhancing the growth of the sector;
- Reviewing and reconsidering public policies and regulations that discriminate against or hinder the start-up, survival, formalization and growth of SME's;
- Developing and institutionalizing public-private partnerships for SME sector development;
- Identifying and assigning clear roles of key actors; and
- Developing strategies that will facilitate provision of financial and non-financial service to SME's.

The SME development policy seeks to further the objectives of the Tanzania Development Vision 2025. The implementation of the policy is based on the basic principles to include consensus- building through dialogue, active participation of all key stakeholders, capacity building to ensure effective utilization of all factors of production and periodic review to identify bottlenecks in the implementation process with view to finding their solutions along with best practices.

Policy Statement: The Government will enhance implementation of programmed aimed at simplification and rationalization of procedures and regulations so as to encourage compliance and minimize transaction cost.

2.1.8 SME's Constraints in Tanzania

Generally, SMEs are confronted with unique problems including heavy costs of compliance resulting from their size. Other constraints include insufficient working premises and limited access to finance. In addition, Business Development Services, namely 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. In addition, there is no umbrella association for SMEs. At the same time, the institutions and associations supporting SMEs are weak, fragmented and uncoordinated partly due to lack of clear guidance and policy for the development of the sector.

The poor services and infrastructure in Tanzania has been an obstacle in the promotion of rural industrialization. Major services and infrastructural challenges include:

- Roads;
- Warehouse facilities;
- Reliable power supply;
- Reliable communication services; and
- Serviced business premises in most of the cities and towns.

The lack of these services and infrastructure has affected the growth of SMEs, especially in rural areas. Even when these services are available, their supply has been quite unreliable. The poor state of infrastructure has made it difficult to induce even local investors to the rural areas where almost 80% of Tanzania lives.

The institutional framework supporting the SME sector is also weak, fragmented, un-coordinated and concentrated in urban areas rather than rural. Although the government has put in place a number of industrial support Organizations, including the SIDO, these institutions are ill equipped in terms of equipment, personnel and operational funds and therefore unable to discharge their expected responsibility.

Industrial Policy

In October 1996, the Government of Tanzania had launched a revised industrial policy namely the Sustainable Industrial Development Policy (SIDP) 1996-2020 to replace the Basic Industry Strategy (BIS) 1975-1995.

Under the new SIDP, SMEs and the informal sector were earmarked as a major vehicle for future industrial growth. To ensure their growth the emphasis will be put on creating a favorable environment.

Immediate promotional measures include:-

- Taxation and duties: -

  A reasonable and special taxation regime on income and sales will have to be introduced for the early stages of enterprises growth. In addition to that, imported machinery, start up raw materials, inputs and required tools for SMEs should be exempted from duties in order to facilitate investment growth.
- Market and trade incentives: -

  The Government, through Industrial Support Organizations (ISO's), will provide market services, training, market information, and export consultancy to ensure that the stakeholders meet market standards for their products on both local and foreign markets.
- Business and financial infrastructure:-

  Preferential treatment in development plans and financial services will be provided to ensure that potential entrepreneurs find a conducive environment with respect to finance and credit.
- Credits: -

  The SME sub-sector will be provided attractive credit terms and conditions. For example, the financial restructuring taking place aims at splitting the National Bank of Commerce into two banks, namely Trade Bank and Micro Finance Bank. This is a step ahead towards solving SMEs' credit problems.
- Promotion: -

  Existing promotional institutions and new ones will be supported, through their strengthening or restructuring in order to enable them address the current economic requirements.
- Licensing and registration: -

  The policy stipulated the need of Government to assist SMEs and the informal sector by removing bottlenecks which hinder the development of the sector. This includes, i.e., the simplifying of the licensing and registration procedures.

- Entrepreneurship development: -
  Measures recommended to foster entrepreneurship development include the provision of techno-economic information on product profiles, and the establishment of a business advisory service facility.

Small Industries Development Organization (SIDO) Act, 1973

Following the Party Directive on Small Industries Development of 1973, an Act was enacted that led to the establishment of the Small Industries Development Organization (SIDO). This is a parastatal organization in charge of the development of small industries in Tanzania.

Up to this point, SIDO remains a government arm for implementing SME promotion activities in the country. Its main functions are:-

- the promotion of SME activities in the form of technical advice, training in management, book-keeping and marketing etc.;
- the provision of credits for working tools and start-up capital;
- the provision of common facilities through industrial support programmes, i.e. foundry workshops as well as common facility workshops;
- Industrial extension services. *[Page-number of print edition: 78]*

SIDO Support Programmes for SME Development

Hire Purchase Programme

SIDO introduced urban, rural, women and micro credit schemes aimed at the provision of a meaningful assistance to the small and micro enterprises sectors. Under the Urban Hire Purchase Programme, the entrepreneur is assisted with machinery and working tools. Credit terms include a down-payment of between 10 and 25%, and a grace period of up to five years. These loans attract an interest rate of about 30% (i.e. marginally above the inflation rate) and amounts disbursed range from 100,000 to 6,000,000 Tanzanian shillings.

Extension and Advisory Programme

SIDO has 20 regional offices, one in each region which caters for SME support. Services offered by these offices include technical support in machinery, installation maintenance, repairs and parts fabrication. Also these offices give advisory services in management aspects. Regional offices are administrative centers and are empowered to make decisions on SME support programmes in a particular region.

Technology Acquisition and Transfer

SIDO is also involved in technology development through improvement of locally available technologies as well as acquisition of technology from abroad which suites Tanzania's environment. The Sister Industry Programme and the Sister Daughter Programme are typical examples of SIDO involvement in technology acquisition and transfer.

Role of Stakeholders in SME Development

The roles of different actors in the SME sector change according to political and economic environment changes in the country at a particular time. In Tanzania the Government has changed its role from economy controlling to facilitation, while private sector is encouraged to participate actively in economic ventures. *[Page-number of print edition: 79]*

Government Role

The government has recognized its role in creating an enabling environment for the emergence of the private sector and its participation in economic activities. It has committed itself to reduce its direct involvement in productive activities. Instead, the private sector is encouraged to invest into these areas.

The main Government role with respect to SME development includes:-

- to provide necessary infrastructure for SME development;

- to set up institutions which support SME activities and to strengthen the existing ones, e.g. SIDO, CARMATEC, TEMDO, through the national budget;
- To ensure equal access to employment for women, youth, and the disabled.

NGOs' Role

Between 1954 and 1997 about 8,837 NGOs have been registered in Tanzania in different areas including SME support. In recent years, the country witnessed a mushrooming of NGOs. From 1995 to 1997 more than 1,000 NGOs were registered thus indicating that the economic reform taking place in Tanzania has a great impact. NGOs promoting the SME sector include MEDA, PRIDE Africa, Business Care Ltd., CDTF, Presidential Trust Fund, Gasby Trust, SERO, SWISS CONTACT, AMKA, FAIDA Oxfam, and Plan International.

The NGOs which are involved in SME support are operating without co-ordination which resulted in a low impact on the sector. Other factors which contributed to the poor performance include:-

- poor management;
- too broad objectives;
- lack of experience;
- duplication of efforts and outright competition among the NGOs;
- Piece-meal programmes that fail to meet the full range of social and economic needs.

2.2 Empirical Literature Review

The ILO(1998) report of a "National workshop on Promoting Demand oriented Research in the area of Micro and Small Enterprise Development in Kenya" realized that microfinance is no doubt making substantial impact on incomes and the welfare of the most disadvantaged groups. Poverty reduction estimates based on micro-credit shows that about 5% of programmed participants lift their families each year by participating in and borrowing from microfinance programmed as Khandler (1998) once revealed on the work on fighting poverty with micro-credit".

As Maria Otero (1997) observed in her article "Three Golden Rules, Keys to success for micro financiers and their clients" those tiny / small economic units that are operating at the margin of the modern, sector or outside it are the major sources of employment in urban areas throughout the developing world. In some cities, more than half of the economically active people are employed in these "microenterprises". This group provides most job/ employment in many developing countries varying from 40%-90%. In Tanzania, for instance, about 75% of the households depend very much on the informal business and earn their living through this type of economic activity. The informal business is playing an important role in accelerating and broadening economic base, ownership, employment and at the same time reducing disparities among the people particularly the disadvantaged group in the society (Omari, 1991).

Nchimbi (2004) conducted a study on assessment of the performance of credit schemes in promoting economic empowerment of SME's owners in Arusha Municipality who were provided loans by the National Microfinance Bank (NMB). The study looked at performance, effectiveness and impact of micro financing programs/ credit schemes on development along with contribution to economic empowerment for owners of small and medium business enterprises as a means to eradicate poverty. The study considered some indicators of the impact of microfinance interventions to include ability to finance education, employment creation, business growth, and food sufficiency, construction of houses, household furniture / equipment, savings and standard of living. Findings based on interviews, questionnaires and observation confirm that 64% of the respondents used loans to expand their business activities as well as funding education for their children. 86% of loan beneficiaries have improved/ expanded their business ventures and 60% have improved household consumption in terms of food shelter, clothing, health services and their life standards.

In Tanzania, for instance, out of 1.8 million enterprises in the informal sector only 0.4 %(8000 enterprises) obtained their credit from formal sources Malima, (1997). Similarly, Dondo, (1997) estimates that fewer than 10% on the people who operate SMEs in Kenya have access to financial services.

This serious lack of access to credit by micro entrepreneurs has become even more acute with the liberalization of banks and financial institutions. Providing appropriate financial services to low income micro-entrepreneurs is important because such an intervention may well be the single most effective means to tackle poverty and create broad-based economic growth. This is because financial services give poor people the means to increase their assets, income, living standards and their roles in shaping the society.

Pitt, Khandler and Carturight (2003) observed that government and non-governmental organization in many low-income countries have introduced credit programs targeted to the poor. Many of these programs specifically target women based on the view that they are more likely to be credit constrained, have restricted access to the wage Labour market and an inequitable share of power in household- decision making than men.

The Gramen Bank of Bangladesh is perhaps the best-known example of these small-scale production credit programs for the poor and findings revealed that over 90% of its clients are women. The studies found, interlaid, that credit provided to women importantly improves measures of health and nutrition for both boys and girls than credit provided to their counterparts.

Yunus, M (1999), singled out the way on how to fulfill the micro-credit summits goal of reaching 100 million of the world's poorest families especially, the women with micro-credit for self-employment and other financial and business services by the year 2005. It was agreed that the summit should ensure not only more resources are dedicated to promoting micro-credit but also that resources are provided to the institutions in cost-effective ways.

Donor agencies generally provide funds as grants or low interest loans to micro-credit programs, often with government involved as a guarantor. The administrative cost of providing these funds is often unacceptably high and the amount that reaches the poor as loans is probably quite low. It is strongly suggested that donors should increase the percentage of funds up to at list 70% that can be used for micro-credit that reaches the poor.

Several limitations exist in the current methods of funds distribution by donor agencies. Firstly, an over-reliance on consultants, many of whom do not have skills necessary to successfully advice and assist micro-credit donors and practitioners. In order to strengthen their capacity to reach the poorest, donor agencies should declare what percentage of funds going to the microfinance sector will be committed to loans to the poorest and require each local office to produce annual reports on its contribution to achieving its country's goal. A clear policy should be established to ensure that funds go to the poorest.

The micro-credit summit estimated that US$ 11.6 billion would be needed as grant and soft loan to reach 100 million poor families. According to Yunus, (1999), the consultative Group to Assist the poorest has a critical role to play as a catalyst given the fact that it is uniquely positioned to assist and with its commitment to reaching the poorest and as an agency of which all leading donors are constituted. The percentage of money going to the poorest as loans will be quite low, probably less than 25% and that the amount of funds going to the groups as loans in the first cycle is low. Also it has been argued that in some cases funds used for institution building is more than that given to the small entrepreneurs and hence the bank funds have not been used in cost effective ways in terms of meeting the credit needs of the poorest, said Prof Yunus.

Through this mechanism, more donor money can go into the hands of the poorest as loans, rather than in the pockets of officials and the consultants as salaries, fees and international travel. The paper by Greuning, Gallado and Randhawa (1998) singled out that Banks in developing countries typically serve no more than 20% of the population leaving the rest with little, if any, access to financial services. The unnerved majority, which employs as much as 60% of the economically active population, depends on informal and semi-informal sources of finance. Most of the entities providing microfinance services are non-formal and semi-formal institutions not subject to prudential regulations, which apply to banks and other formal-sector institutions. Microfinance services further seeks to provide a framework for addressing regulatory issues, which affect operations and institutional development of and focuses on risk taking activities that need to be managed and regulated. MFI's can be classified into three broad categories namely: MFI is which depend on: on other people's money, on member's money and which leverage the public money to fund microfinance loans.

A report by PREM Network(1998) prepared for world Bank on " Using micro-credit to Advance women" asserts that providing the poor with financial services increase their income, productivity and self-employment, there-by reducing poverty. It states categorically that many countries traditional financial institutions have failed to reach the poor due to collateral requirements, which the poor do not have. Therefore, micro-credit programs have been developed to fill this gap. Banks and other donors, microfinance is emerging as a powerful tool for reducing poverty and improving access to financial services in low-income countries.

Findings from the report revealed that micro-credit programs are more attractive to poor women than to poor men. The programs have learned that women are better credit risks than men are. Again reaching out to more women than men promotes social development and gender equality.

2.3 Conceptual model

Due to the research topic aim is to see how some of my chosen independent variables (x) have an impact on the dependent variable (y =development of small and medium enterprises). Therefore the following independent variables will have effect on the dependent variable as follows

- Formation of group lending; is the method of providing small credits to the poor, most used by microfinance that provides loans without collateral. This has impact on increase individual savings opportunity, broaden the range of products and services example clinic and pharmacy and increase the number of customers

- Capital budgeting; is the process in which a business determines whether projects such as building a new plant or investing in a long-term venture, are worth pursuing. MFIs Contributions towards increase in SMEs market share, assist on coordinate the activities of the various parts of the organization and to ensure that the parts are in harmony with each other, help to motivate managers to strive to achieve the organizational goals, Effective evaluates the performance of managers.

- Payment period; Payment period is period over which the borrower is obliged to make payments. On most mortgages, the payment period is a month but on some it is twice a week. The impact of payment period on the development of SME's, appropriate loan size, sell of substitute products and a way to speed up money circulation

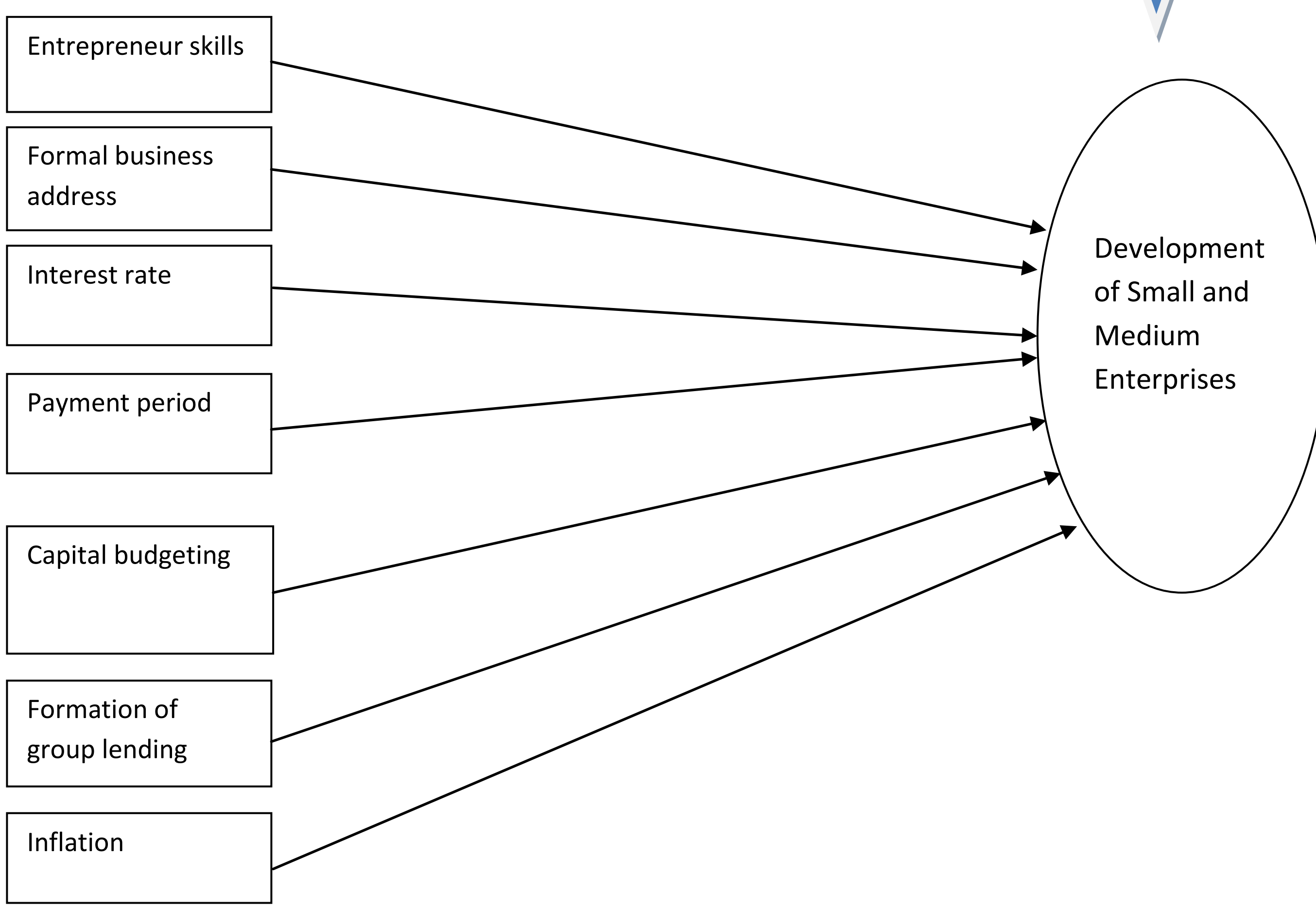
- Entrepreneur skills; These enterprises play a crucial role in driving economic growth in both developing and developed countries. SMEs typically generate the most new jobs; introduce locally (and sometimes globally) relevant innovative ideas, products, and business methods; and can push economic reform and the modernization of uncompetitive economies.

- Formal business address, this has been one among the factors that the financial institutions use as a condition of proving loan. When one has a formal business address is easy for them to have permanent customers and it will develop their business

2.3 Conceptual Framework and Research Model

Independent Variables **Dependent**

Variable



Source: Researcher 2013

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter outlines the methods and procedures, which were used by the researcher in the study in collecting, coding, analyzing, and interpreting data. The methodology was based on primary and secondary data collection, data analysis and data presentation both qualitatively and quantitatively in order to meet the research objectives**.** The focal point of the study was at NMB Bank Ngarenaro branchon the assessment of microfinance services on the development of small and medium enterprises.

3.1 Research approach and design (Type of the study)

In this study, the deductive approach was used where theoretical and conceptual structures are developed. While the researcher use the case study design because this design helps to secure a wealth of information about the unit of study, which may provide clues and ideas for further research, all methods of data collection such as observation, interview and questionnaire are useful to case studies (Krishnaswami 2006).

This method of study places more emphasis on the full analysis of a limited number of events or conditions and their interrelation. It is essentially and intensive investigation of a particular unit under consideration. The objective of the case study method is to identify the factors that account for the behavior or patterns of a given unit as an integrated totality. In addition, it will be concerned with discovering and testing whether collateral, entrepreneur skills, payment period, operating costs, interest rate, and items and conditions of loans set by the NMB bank has any impact on the development of Small and Medium Enterprises.

In brief I can say that a case study method helped me to form of qualitative analysis where carefully and complete observation of an individual or situation or an institution was done. In addition, an intensive investigation was useful for testing hypotheses about structural and procedural characteristics of specific social unit.

3.2 Research Area

The study was conducted mainly in Arusha region with focus on both existing small and potential client of the National Microfinance Bank (NMB). The area cover will be Arusha municipal area only

3.3 Population Sample and Sampling

The target population was the customers of NMB Bank Ngarenaro branch who have obtained personal loans from the bank as well as bank staff. In number, the population targeted will be approximately 150 customers who have been financed by the bank and 10 bank staff.

3.4 Sampling Techniques and Procedures

In this part I was interested in examining and assessing the effectiveness of Microfinance Service to Small and Medium Enterprises [SME's] in Arusha municipality, the sample was composed of farmers, retailers, wholesalers and other small and medium enterprises. The population being heterogonous, I classify them into groups of homogenous and then being able to obtain a sample from each group so that they can be examined to have a good representative of the population and well statistical result.

3.4.1 Random Sampling

I used both the simple random sampling and stratified random sampling. In simple random sampling, this enabled all customers from a list to have the equal chances to be in the sample. I was able to select the sample out of the homogenous group and being able to collect data from them. In addition, stratified random sampling also was used to ensure that specific groups (strata) are included proportionately in the sample, (as their proportions in the population are) and being able to randomly select more of a certain stratum that is not very frequent in the population. Each group of customers will be considering from the ones taking loan of Tshs 50,000 to Tshs 7.5 millions as provided by the bank.

3.5 Data Collection Techniques and Instruments

In collecting the primary data, the researcher used observation, questionnaire, and interviews both closed ended and open-ended questions were used in questionnaire. Customer telephone numbers were obtained, so that interviews can be conducted over the telephone. The language of communication was both English and Kiswahili as a way of making customers feel comfortable responding to the questions asked.

3.5.1 Observation

Data was also collected through observation; the researcher participated in daily activities of NMB bank especially those related to account analysis and credit in order to obtain the information by interacting with both customers and staff. The researcher also uses this method because with this method the observer can understand the emotional reactions of the observed group and get a deeper insight of their experiences. In addition, the observer was able to record context, which gives meaning to the observed behavior and hard statement

3.5.2 Questionnaires

The researcher also use open and closed ended questions in a well standardized questionnaire to solicit data from staffs of NMB bank and their credit customers. Questionnaires can be used contacting persons such as senior business executives who are difficult to reach in any other way, the respondents can complete the questionnaires at their conveniences and certain personal and economic data may be given more accurately in an unsigned mail questionnaire. Hence, the questionnaire was sent to some of the NMB credit clients who were not reached through telephone or face to face interview.

3.5.3 Interview

Interview was conducted to some customers who were coming to the loan office and for those who were reached through telephone and through visiting the customers in their areas of business. The researcher also use telephone interview, as it is possible due to the fact the bank keep customers profiles such as telephone number and postal boxes can be obtained from the bank. Replies were recorded so that they can be played back later to ensure that they have been properly captured.

3.5.4 Secondary data

The secondary data are those which have been already been collected by someone else and which have already been passed through the statistical process (Kothari, 2006) documentary data was used to obtain information on the problem under research. This was obtained from the customer's record and their files of loans that they have attach information when obtaining loans, and research done by the NMB loan officers on how to meet the demand of their customers in need.

3.6 Data analysis methods

Raw data obtained from the field was obtained and then single entry was done followed by data cleaning and lastly data analysis. For presentation of the study findings I used charts and tables. These include frequencies, total scores, means and percentages. Spreadsheets were also in use in order to come up with appropriate charts and tables for data presentation, while total scores were used to rank the responses**.**

CHAPTER FOUR

PRESENTATION OF FINDINGS

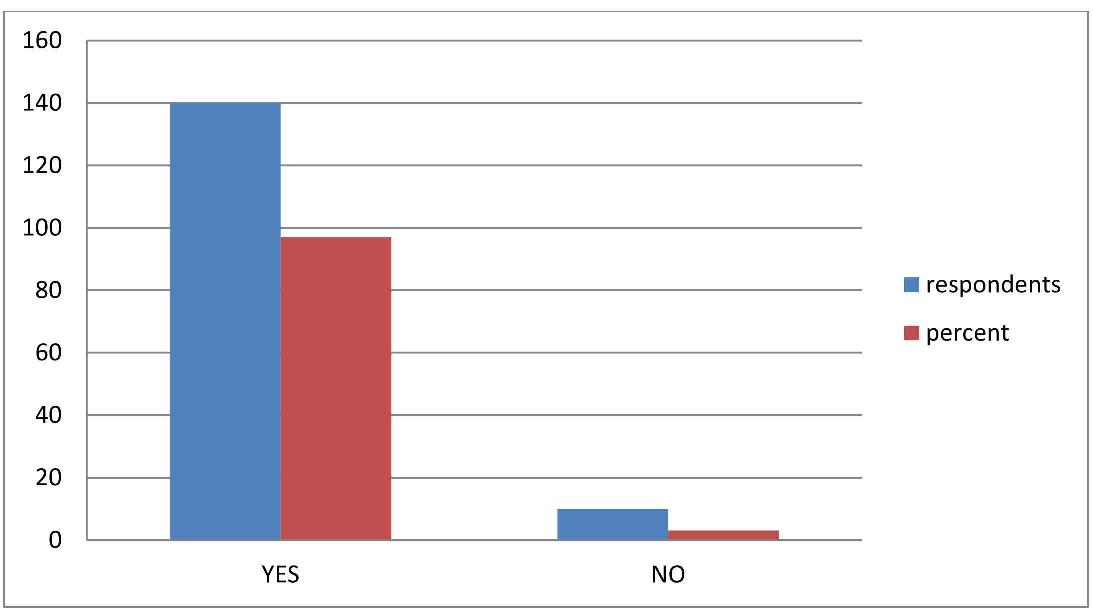
4.0 Introduction.

In this chapter, analyzed data and research findings have been interpreted in relation to the objectives of the study and with respect to the research questions developed to guide the study. In analyzing the data collected, the researcher used both quantitative and qualitative techniques. Quantitative data analysis involved computation of some mathematical measures such as totals and percentages, and qualitative data analysis on the other hand involved factual and logical interpretation, comparison and explanations of study findings. The characteristics of respondents was 63% women and 37% men.

4.1 Accessibility to MFIs loans

Access to loans is one of the major problems facing SMEs in Arusha. The idea of creating MFIs is to provide an easy accessibility to SMEs particularly those who cannot access formal banks loans

Figure 4.1 Respondents' Opinion about their Accessibility to MFIs Loans



Source: Research findings 2013

In Figure 4.1, to determine SMEs accessibility to MFIs loans, this question was asked "sourcing capital is one of the major problems facing SMEs in Arusha, does your firm have any access to MFIs loans?" and the result depicts that 140 of the respondents which represents 93% claim they have an access to MFIs, and 10 respondents which represents 7%, a minute and insignificant number of the respondents disclosed that they have no access to MFIs loans. What this implies is that the federal government of Tanzania's efforts through its ministry of finance on May 2000 in to issue a microfinance policy i.e. the Regulatory and supervisory Framework, whereby licenses of operation were issued out to over eight hundred microfinance banks was a right decision. Moreover, most of the community banks which used to operate only within their local environment were required to raise their capital base and operate as microfinance within their states and interstate, thereby given them the opportunity to reach more SMEs. Also, many SMEs were able to approach MFIs for finance because MFIs do not request collateral before they issue out loans to the SMEs.

There are some of the elements/independent variables that have come on hand on my research finding that leads to the development of SME's through the credit services provided by the microfinance institutions, such as;-

4.2. Formation of group landing

4.2.1 Group lending

Group lending is the method of providing small credits to the poor, most used by microfinance that provides loans without collateral. The interest charge is not much different from that of commercial banks but far lower than interest charge by individual by money lenders. The Opportunity bank is a typical example of microfinance institution using this method. The repayment rate is very high since each member is liable for the debt of a group member. Loans are not granted to individuals on their own but to individuals belonging to a group; and the group acts as a collateral which is term social collateral. This is to avoid the problems of adverse selection and also to reduce costs of monitoring loans to the members who must make sure the loan is paid or they become liable for it. On the other hand individual lending is the lending of loans to individuals with collateral. Besley and Coate (1995) say despite the advantages of lending to groups, some members of the group may fail to repay their loan. Montgomery (1996) stresses that this method of lending avoids the social costs of repayment pressure that is exerted to some group members. And it has been noticed that members in group lending bear high risk because they are not only liable for their loans but to that number of the group members. Hence, it is important for the loan officers to have routine visits to the clients to make sure the loan is use for the project intended for. These monitoring is vital but at the same time increases the cost of the microfinance institution.

4.2.2The Impact of Group Lending in the Development of SME’s in Arusha

In this study, I have realized there are some group formations which are made by members who know themselves very well or have some social ties. This is through the agreement between parties and nothing formal as true partnership. In the case of NMB bank there is no provision of loan to groups hence people go and borrow personally due to the aim of what they want to open, they decide to form a collective business so as to be able to support their enterprise. Behind this, the bank has no idea of their partnership and so the court of law.

The following are the impacts of group lending on the development of SME’s in Arusha;-

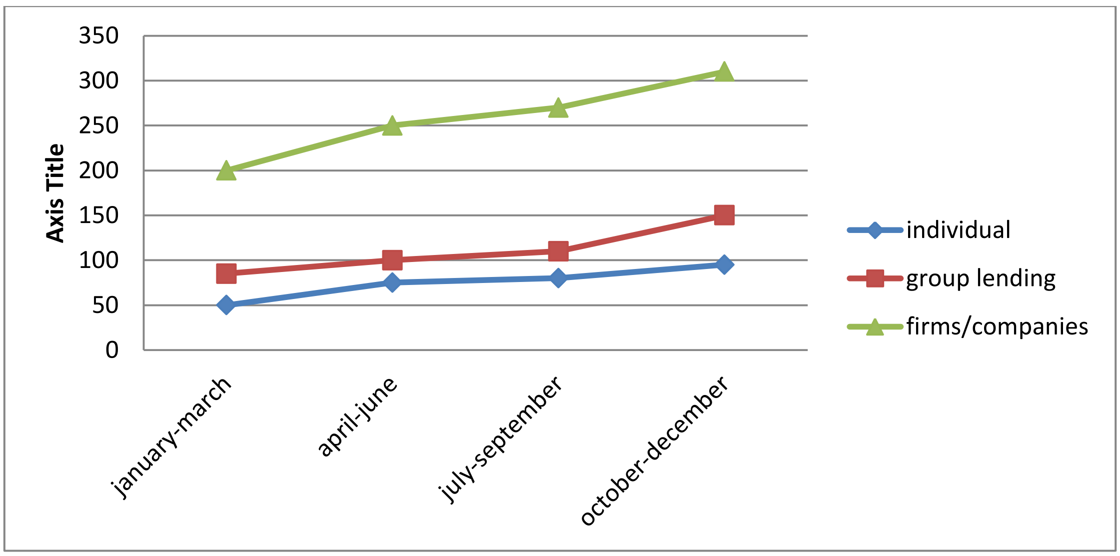
4.2.2.1 Increase Individual savings Opportunities

It has been a major problem to small entrepreneurs to make more savings individually as it’s on a group. This is due to the fact that the amount of loan may not meet all the personal needs and enable him to make more profit that will facilitate to enlarge the amount of savings. Hence the forming a group is inevitable, as it has enabled them to make more savings and this enlarge the size of the firm. Due to the size of the firm being large it has facilitated the increase of more job opportunities to the people around them. The increase of savings it help the SMEs being able meet their individuals needs such as make payments of loans in time, building houses and schooling their children.

Table 4.1 Results on increase in savings

Months	individual	group lending	firms/companies
January-March	50	85	200
April- June	75	100	250
July- September	80	110	270
October-December	95	150	310

Figure 4.2 Results on increase in savings



Source: Research findings 2013

4.2.2.2 Broaden the Range of Products and Services

Many of the credit customers ask for loan and find that they have based on one type of product or service that they provide. It has come to many of the people attention that the formation of group landing will increase and broaden the range of products and services that together they can provide. Example if there is one providing the pharmacy business and another has clinic but has no access to medicine then together they can work and increase the size of their services as they will be sharing the number of customers.

Also when there is a chance that the firm could handle more than one product or service but the amount of fund is not enough, it's possible for the 3 or more people to form a group and work together and this will increase the efficient of the firm and being able to make more customers and maximize their profits.

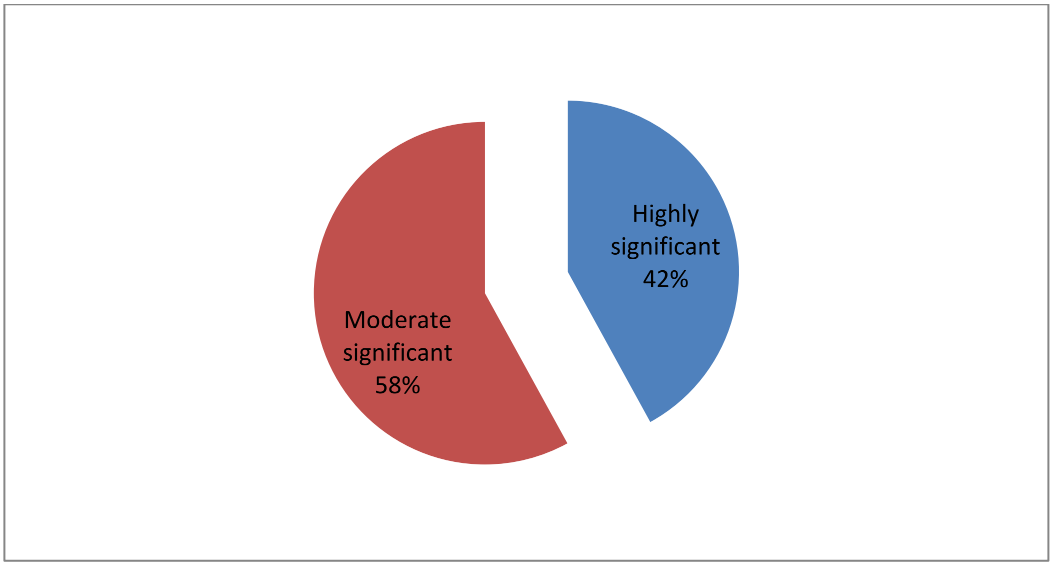
4.2.2.3 Increase the number of customers

Another challenge that face many SME is the number of customers that they can have due to the reasons like being known in that firm area, lack of information and awareness of information on what people like in that area. As most of the firms are small hence they are unable to match products to customers needs. This has challenged many to develop products that respond to the needs of their customers. So as to do so, they form a group to combine their capital and make a bigger firm so as to meet their customer's needs. This has make them get more customers as they share them and has helped them to get more profit as compared to when the operate individually

4.2.2.4 Increase Business competition

The formation of group lending has enable many of the credits customers to beat their competition on the businesses that the conduct. As the loan they obtain from MFI's has helped them in many ways on increasing their capital which helped them in business competition

Figure 4.3 Contribution of MFI'S on Increasing Business Competition



Source: Research findings 2013

In Figure above, the question raised was "Competition generally requires the need to exploit financial resources; to what significant level does the MFI contribute to the overall competitiveness of your company?" 42% of the respondents who have access to the loans believe that MFIs loans contribute to their company's competition at a highly significant level. 58% of the respondents believe that the loans granted to them contribute at a moderate significant level to their competition. None of the respondents claim that MFIs loans do not contribute to their competition

4.2.2 Limitation/Effects of group lending on credits provided by the microfinance institutions.

Through the research there are several effects that has hindered the development of SME's such as;

Many businesses have collapse due to one or more people in the team taking their share or leave the group. Many of the groups lending has this problem that makes for them impossible to meet their goals, as when one individual has the role of performing an objective moves away from the consideration it becomes impossible to make it happen. Also sometimes every person has the name and their number of customers so when one with the high number of customers starts his/her own market away from the group, hence the group loss all the customers and hence it's likely to generate loss.

Lack of entrepreneur skills. This is another reason as to why group lending in Arusha fail to last to use the microfinance credit and develop in their societies. Most of the groups are formed with no aim as to what they need to obtain at a certain period of time. This is due to the reason that many use the guessing theory on how to do business without knowing how they will use the obtained money to make profit and also to get the amount of money to pay back their instalment. Hence at the end of the time they find themselves with no capital, no profit also no development that has arise from the loan they ask from the bank.

4.3 Capital Budgeting

Capital budgeting is the process in which a business determines whether projects such as building a new plant or investing in a long-term venture, are worth pursuing. Oftentimes, a prospective project's lifetime cash inflows and outflows are assessed in order to determine whether the returns generated meet a sufficient target benchmark

Small and medium-sized enterprises have distinct capital budgeting best practices, distinct because they result from top management's intimate knowledge of the business. The search for investment opportunities depends on effective communication of strategy. Best practice in capital investment analysis starts with strategic importance, followed by profitability and risk assessment. Funding decisions must consider cost, control, flexibility, and risk. Monitoring capital investments is the essential, but frequently neglected. There are four best practices phases of managing capital budgets for small and medium-sized businesses (SMEs);-a) Create proposals; b) Select investments; c) Fund investments and d)Monitor results.

Ideally, businesses should pursue all projects and opportunities that enhance shareholder value. However, because the amount of capital available at any given time for new projects is limited, management needs to use capital budgeting techniques to determine which projects will yield the most return over an applicable period of time. Popular methods of capital budgeting include net present value (NPV), internal rate of return (IRR), discounted cash flow (DCF) and payback period (PBP).

4.3.1 How to make the best use of capital budgeting

There is a big need of more attention to client preferences in relation to loan size, repayment cycles, flexible loan products, and transaction costs in the design of products and delivery mechanisms could further improve program outreach and retention by reducing the risk of borrowing for clients. This challenge means looking more closely at the match between household financial and investment flows and loan and repayment cycles.

Introduction Capital budgeting irrevocably shapes the direction of a business, and our collective capital budgeting decisions. Also it determines the kind of society that we and our children will live in, not just this year but many years from now as well. Decisions of such magnitude must be made correctly. Choose investments with positive net present values. The NPV rule is important, but it is only one element of best practice.

4.3.1.1 Net Present Value

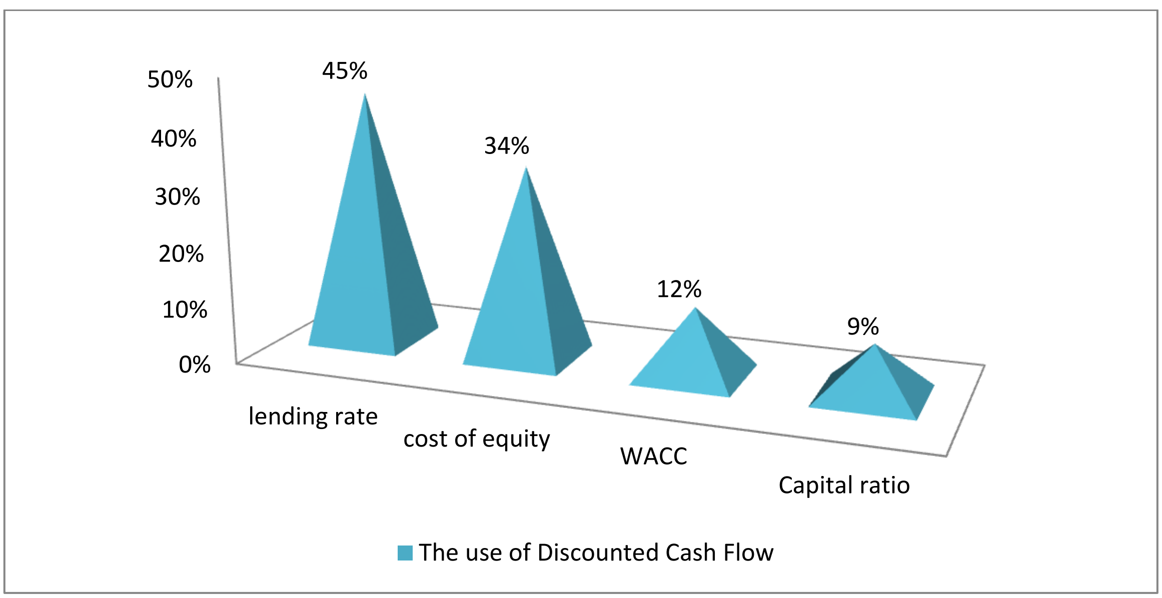
Net present value (NPV) is the present value of cash inflows minus the present value of cash outflows. The present value of the future returns discounted at the firms cost of capital minus the cost of investment. Thus is the PV of the expected cash flows is estimated and from this is deducted the initial cash outlay required for the investment. If the NPV is positive, the project should be accepted; if the NPV is negative the project should be rejected. In case the two projects are mutual exclusive, the one with the higher NPV should be chosen. This method is generally preferred for ranking investment proposals as it recognize the time value of money.

Respondents were asked for details of the evaluation methods for their investment projects. The respond was 49% and 51% of firms never used net present value (NPV) nor internal rate of return (IRR) techniques respectively. 77% of firms always or usually used “intuition/gut feel”: The intuition part of the decision making process refers to the market knowledge, experience, gut feel or managerial knowledge that the decision maker uses to influence the determination. The high level of nonfinancial reliance in the decision making process indicates the low level of quantitative sophistication in small businesses.

4.3.1.2 Discounted Cash Flow

In looking into their approaches for evaluating the merits of proposed capital investments, I learned that only 17% of the firms used any form of a discounted-cash-flow (DCF) technique; 72% indicated they used no DCF approach at all; and 11% used no formal analysis of any form.

Figure 4.4 The use of discounted cash flow



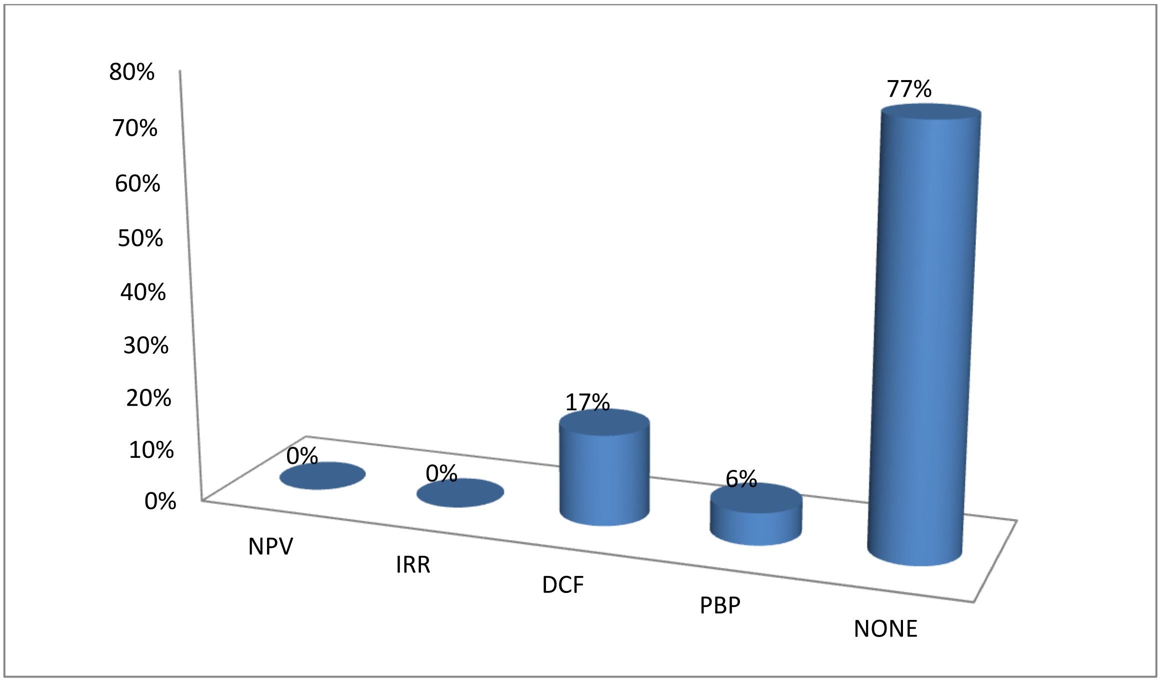
Source: Research findings 2013

The few companies (25 of respondents) which claimed to use DCF techniques were asked what was used as a discount rate. The leading rate was a 'judgment-based target return' used by 45% of firms. The 34% of companies which made estimates of the cost of equity based this upon a historical accounting return on equity or historical risk premium. Only 12% of the users of DCF estimated a weighted average cost of capital (WACC). 9% of firms responded that they either always or usually or sometimes were constrained by capital rationing.

4.3.1.3 Payback Period

The payback period (PBP) method is used to estimate the time taken for the investment outlay of a project to be "recouped" from the cash flows it generates for the firm. Essentially, the emphasis is liquidity—'how quickly will we get the money back?' The user tends to compare the estimate to a desired target period. In its bare form PBP shows no concern for changing the value of a firm. It overlooks the time value of money and cash flows received after any target period may be ignored. On my findings I obtain that only 6% of the firms uses the payback period. And most of them have been given loan of long term such as 3 to 5 Years.

Figure 4.5 Overall use of Methods of Capital Budgeting



Source: Research findings 2013

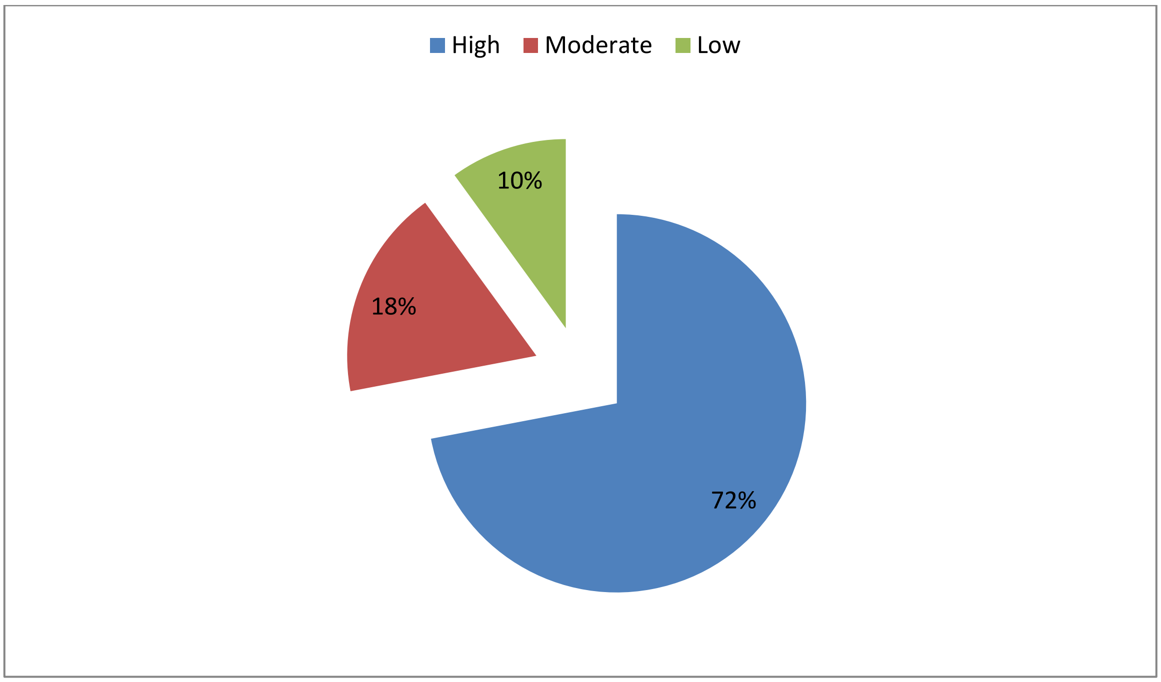
As shown above most of the SME's business doesn't use capital budgeting and many prefer guessing and this has caused most of them not use fully the resources that have on hand and make more profit. As when one conduct the NPV method will be able to know if their project should be accepted or rejected and this will help most of them not to start a business and come crushing at the end of the day. Also the use of payback period would make them meet more of the unexpected goals as this will establish a ground that could tell them this amount of loan will be beneficial to them at a certain period of time so as its interest that comes with the loan. Hence, it mostly important for the firms to put in consideration the use of capital budgeting as this will enable them meet their goal with positive results

4.3.2 Impact of capital budgeting in development of SME's in Arusha

4.3.2.1 MFIs Contributions toward SMEs Sales and Marketing Activities

The opinions of the respondents about the MFIs contribution to SMEs sales and marketing as the question asked was; - "Has the loan secured from the MFI contributed to the sales and marketing activities of your company?" In their view, 72% of the respondents assert that MFIs loans contribute high to their sales and marketing, 18% posit that these loans contribute moderate and 10% of the respondents assert that MFI's loans contributed low to their sales and marketing. However, none of the respondents claim that MFIs loans did not contribute at all to their sales and marketing activities. This implies that access to MFIs loans have contributed to SMEs, no matter how little.

Figure 4.6 Contribution of MFI's on SME's sales and marketing



Source: Research findings 2013

4.3.2.2 MFIs Contributions towards increase in SMEs Market Share

For SMEs to survive in Arusha there is a need to achieve a substantial market share. Moreover, for them to gain a portion of the market, competitions have to take place between them and other companies. MFIs contributions towards SMEs market share, the question that was asked was “Does the loan actually help your company to standardize your product/service to the extent that you achieved substantial market share?” All the respondents agree that MFIs loans contribute to their market share.

4.3.2.3 Assist on coordinate the activities of the various parts of the organization and to ensure that the parts are in harmony with each other

The use of capital budgeting has help a lot of small firms meet their goals as there are several department that has to work together to meet the firms goal. Example manufactory firms there is division of powers and work so that each department can do what they are good at doing (specialization), with this the time and resources can be utilized efficiently. By the use of capital budget the firm will have a better place of making decision by setting their objectives, determine the measurements that they will use to measure their achievements against the set organization goals, and being able to determine the difference and take corrective measures against the variance obtain. With a good knowledge of corporate management the management should be able to know the significance of the variation and take the corrective measure. By doing so the firm will have a better chance of making more profit and this will lead to the development of the firm

4.3.2.4 Help to motivate managers to strive to achieve the organizational goals.

According to Abraham Maslow on one model of motivation theory which argues that individuals are motivated to satisfy a number of different kinds of needs some of which are more powerfully than others. Which means that when a manager has the organization goals in mind as the most pressing needs then the organization goal will be attained before any other needs as other needs has little effect on individual. Therefore, when the manager has the motive to strive organization goal this will enable the organization and individual meet their goals

4.3.2.5 Effective evaluates the performance of managers.

So as the firm meets its goals/objectives it needs to have a powerfully measure that can be used to evaluate the performance of managers. A good evaluation will provide the firm with the right results and enable them to develop. The overwhelming response from the participants was the performance review is conducted on an annual basis (74%). In the case that the factory bosses has make it as their traditional to keep the assemble line workers productive during time when work was routine and predictable. This is in hand the incentive that the annual reviews were usually tied to annual pay increase as a reward for good performance

Over poll showed that 14% of the respondents conduct the performance review on 6 months terms. The bi-annual review breaks the review period into two shorter parts and allows the employees and his/her manager to focus on the performance issues and goal management for shorter period of time

4.3.3 How to Make It Happen

It is important to determine who will be responsible for managing the capital budgeting process (typically the CFO). In addition to managing the process, the CFO will recommend financing. Also communicate business strategy clearly to everyone involved and establish and publish hurdle rates. Then create standards with regard to what must be in capital investment proposals, including general description, strategic impact, NPV, and risk analysis.

Establish responsibility for capital investment decisions. Managers at various levels may be given authority to decide on smaller investments, while large strategic investments are decided by top management. A capital investment committee is frequently used, with membership including the CEO, CFO, and other senior managers. In addition establish a time schedule and process for monitoring. The monitoring process may be done as often as once a week during implementation, and may be part of the annual review thereafter.

4.4 Payment Period

Payment period is period over which the borrower is obliged to make payments. On most mortgages, the payment period is a month but on some it is twice a week. It is not necessarily the same as the **Interest Accrual Period**. The payment period indicates the average period for paying debts related to inventory purchases. The payment period ratio is included in the financial statement ratio analysis spreadsheets.

Formula to calculate payment period:-

Payment Period = (365 days x supplies payable) / inventory.

Also there is another thing that comes with the payment period known as the payment grace period. A **payment grace period** is the amount of time you have to make a payment after the due date and still be considered on time. For example, if your payment is due on the 5th of the month and you have an 8-day payment grace period, then you have until the 13th to make payment. On the 14th, you'll be considered past due and will face late payment penalties. Payment grace periods most often apply to installment loans rather than credit cards.

4.4.1 Repayment of loan

According to the interview conducted to the employees (loan officers) at the loan department, it shows that, repayment of loans has become a critical problem that has been facing banks particularly a credit department. Borrowers are frequently unable to fulfill their debt obligations. To the banks, this problem has been increasing from time to time whereby in some cases the borrowers are not paying at all the loans issued. Therefore in regards to this, it is very important for banks to consider the factors affecting the repayment of the loan, this is to be done due to the reason that sometimes a bank may lose the loan issued by ignoring such factors.

4.4.1.1 Criteria Adapted to Ensure the Repayment terms of the Loan

NMB intends to provide loans to those borrowers who are skilled, competent, and financially reliable. Timely loans installments payments trend is the first sign of financial reliability of the borrower. When a borrower has been late in paying three installments on the previous loan, he or she is not eligible for borrowing again.

If a borrower has been late in paying two installments on the previous loan, but paid the other installments on time, he/she will not be eligible for a repeat loan unless one of the failures was due to circumstances which could not have been foreseen.

A borrower who has been late in paying one installment on time may be considered for a repeat loan, but he/she should be cautioned not to repeat the delinquency and reminded that one installment missed forfeits the incentives and therefore the cost of borrowing for the borrower. Therefore this is what NMB has been doing to ensure that the repayment risk of the loan is reduced by the application of the above measures.

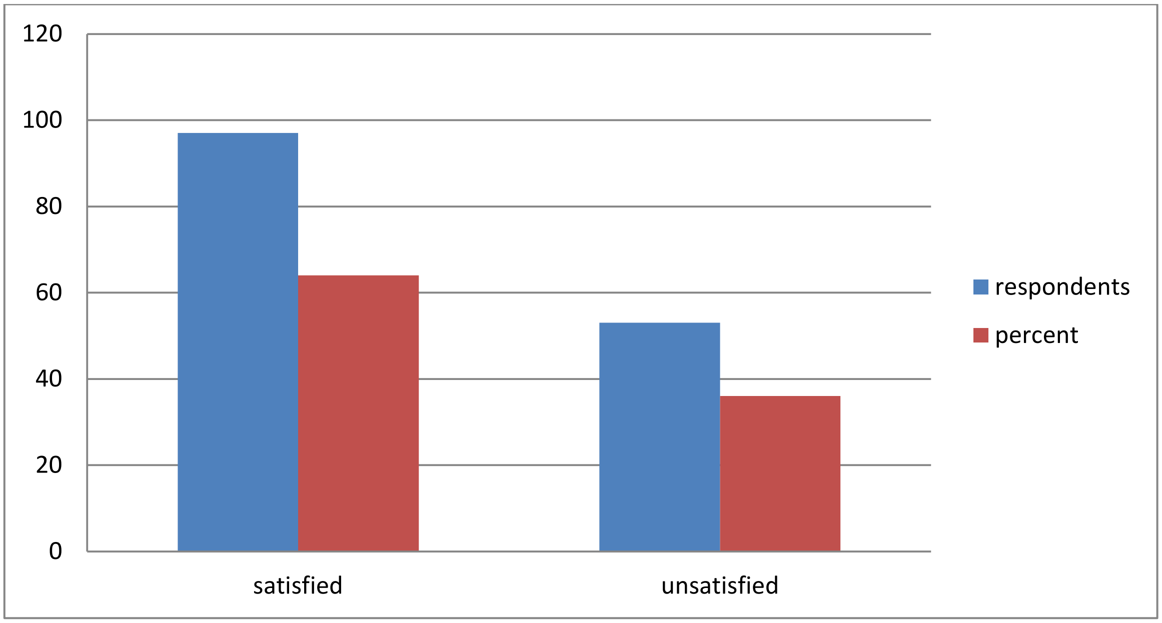
However, from the research done, it shows that most of the customers are satisfied with the loan repayment period given by NMB. The table below shows the answers to the guided questionnaire in percentage according to the number of people who answered the guided questionnaire.

Table 4.2 Assessment of the level of satisfaction of repayment period to respondents

CRITERIA USED	NO. OF RESPONDENTS	PERCENTAGE (%)
Satisfactory	97	64
Unsatisfactory	53	36
Total	150	100

Source: Research own 2013

Figure 4.7 Level of Satisfaction on Payment Period



Source; Research findings 2013

From the graph above; it shows that NMB has set repayment periods in such away they favor customers and meet the needs of the targeted customers. 64% of the questioned customers indicated that they are satisfied with the repayment period versus the 36% of the questioned customers who were not satisfied. The big percentage positive difference between the satisfied and unsatisfied customers shows that is very competitive in providing attractive repayment periods to customers. Therefore the following are the criteria adopted to ensure the repayment terms of the loan

4.4.2 The Impact of Payment Period on the Development of SME's

For poorer households, the risk of taking a loan could be reduced if repayment amounts and cycles corresponded to income flows and the repayment capacity of borrowers. For poorer households, smaller and more frequent installments stretched out over a longer repayment period may be more appropriate. Matching the variable nature of clients multiple income streams with appropriate repayments amounts and cycles may improve a client's capacity to repay and borrow over the long term and thereby reduce the risk of borrowing for them, as well as reduce the risk of lending to microfinance banks.

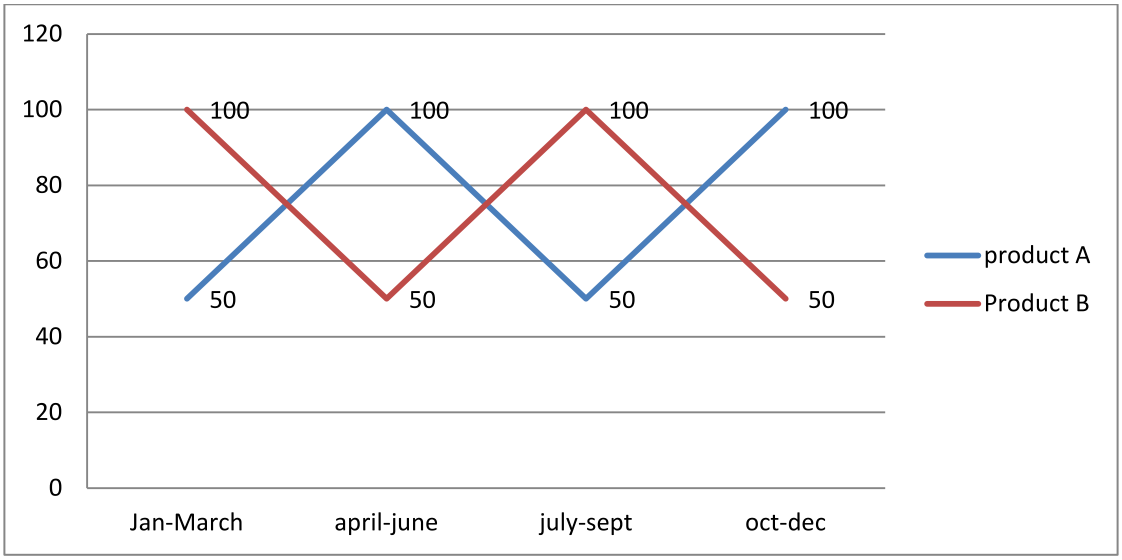
4.4.2.1Appropriate Loan Size

This is the important aspect to look at when determining the repayment period of a client. As the amount of loan size has to match the ability of borrower repayment. For example, some group systems automatically increase loan size for all members after each cycle, regardless of their needs or repayment capacity. The pressure of large loan repayment can force them to leave programs. Poorer borrowers need flexible and timely products with small-size, manageable repayments. For better-off households, larger loan sizes could enable them to take advantage of investment opportunities with potentially higher returns.

4.4.2.2 Sell of Substitute Products

The payment period has provided a range of many borrowers to make up goods/services that they provide being substitutable due to the fact that the payment of loan is in every month. Hence many firms operate on selling of goods and services which can be obtained and needed all year through. As many of the products are seasonal, this will have effect on their profit and payment period. So they need goods that are on high sell on every month and the less sell of one product can be covered by another product and remove the risk as shown below

Figure 4.8 Sell of Substitute Product to cover Risk and Losses



Source: Research findings 2013

4.4.2.3 Speed up Money Circulation

The payment period set by the bank is commonly a year or less than a year. Normally 6 months and 9 months to 12 months, and this make many entrepreneurs to speed up their money circulation so that they can meet their payment period. This has enabled many to meet unexpected goals as to meet their payment due they need to be more creative and speed up their money circulation and make more profit.

On the other hand this has made some of the firms obtain some losses due to the fact that they sell their goods at low prices just to be able meet the payment period

4.4.2.4 Economic Cycle

Economic cycle is the natural fluctuation of the economy between period of expansion (growth) and contraction (recession). And there are different factors that can be used to determine the current state such as Gross Domestic Product (GDP), interest rates, level of employment, and consumer spending. This is another factor that needs to be looked closely as it has the impact on SME's development. The payment period that has been set by the bank for the customer to repay the loan given to him/her as far as the economic cycle is concern it tend to have impact on the development of their business. This is mainly because the time for instalment is as soon as the first month is complete. This has effect on business as the money is not yet in the business cycle and at the same time you need to take the profit and payback the loan. This has caused much business to decline as far as the season of the product is low and the interest rate that the firm is being charged by the government is high.

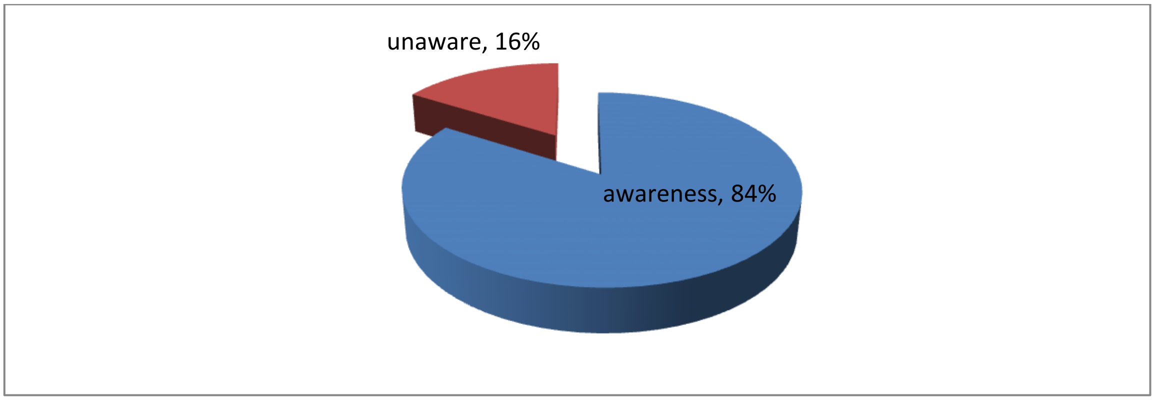
Apart from that there is a glory(growth) period that the business is booming and the firm is able to attain a lot of profit that will enable the firm to pay back the loan instalment, obtain profit for social development such as improve the business, improve the infrastructure and also been able to obtain school fees for the children. This has helped a lot of people to obtain employment and raise the government revenue. As when there is employment also it supports the consuming behaviour though one may have option either to save or consume the amount of income they obtain.

4.5 Other Factors

(a) Knowledge and awareness on business management

On knowledge and awareness 84% of the respondents were aware of business management and have acquired knowledge on business management while only 16% are unaware about business management as shown on the graph below;-

Figure 4.9 Knowledge and awareness on business management



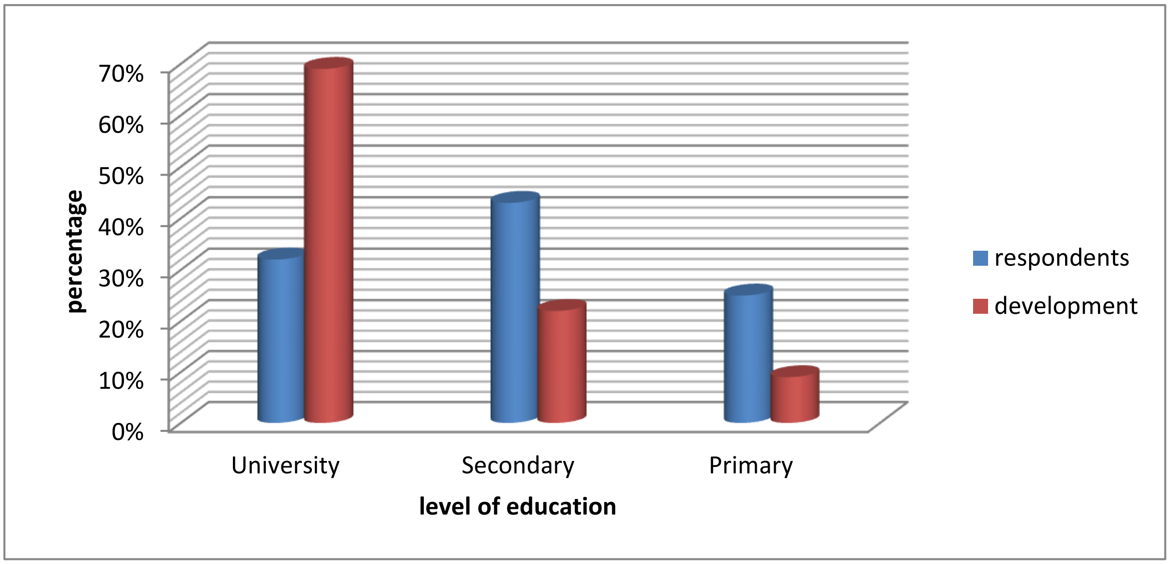
Source: Research findings 2013

However it has been seen that many SME's do not practice business management even though they have good knowledge. This study showed that 84% had knowledge of BM methods but its only 50% that make a proper use of it. There for many emphasis should be given to them during seminars that are conducted by both the MFI's and different NGO's.

(b) Education level

The results shows that those who have university education are the ones who have been more developed on their business more compared to other groups. 32% of the respondent had university education and the level of development is 69%, 43% of the respondents have secondary education and 22% level of development and 25% of the respondents have primary education and the level of development is 9% .

Figure 4.10: Percent showing education level and the level of SME's development



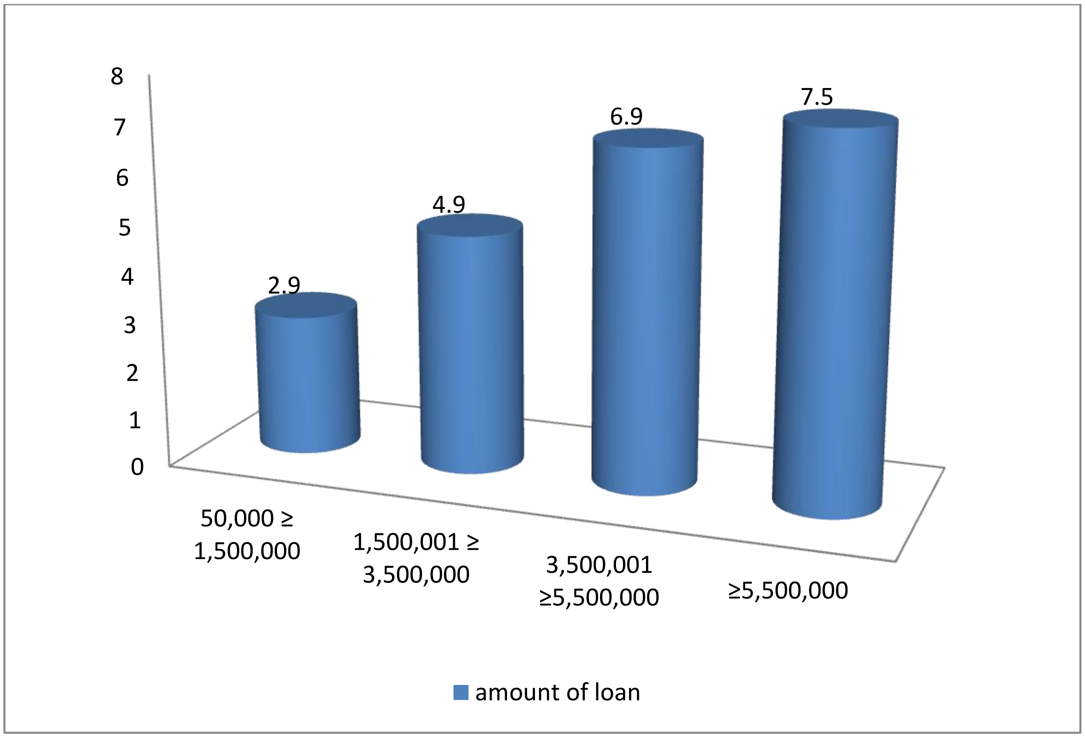
Source: Research findings 2013

This has shown that the ones with more education have more advantage on their business as they have more methods of making their business grow. But those with lower level of education they make less profit/ they are less developed due to the sense that they have less knowledge of how to make their business grow. They need help of loan officer's visions, seminars and advice they can get to help them meet their goals

(c) Level of income

The results show that those with income from 50,000 ≥ 1,500,000 are the ones with high low loan amount of Tsh.100, 000 to Tsh.2.9m. Income earners from 1,500,001 ≥ 3,500,000 are more advantageous as they can obtain loan of Tshs. 3m to 4.9m, and those with income of 3,500,001 ≥5,500,000 have access of loan amount to Tshs 5m to 6.9m. And those firms with income of more than 5,500,000 can obtain loan amounting to Tshs. 7m and above

Figure 4.11 Level of income against the amount of loan obtained



Source: Research findings 2013

The results make sense because as the process of borrowing is a risk game, the MFI's want to be assured that their credit clients will be able to pay their settlement when due. And one among the things that the loan officers take in consideration before providing loan is checking ones income through personal bank statement and evaluates the money circulation in their accounts.

(d) Age

Also another factor that comes on hand is the age of the credit clients. As the age is another factor that is considered very close to provide loan as the normal age is above 18. My findings has show that the women and youth are the most common borrowers of loans in MFI's as shown below

Table 4.3 Age of the respondents against frequency of using loan for SME's development

Age	18 – 27	28 – 37	38 - 47	48 – 57
Respondents	29%	45%	19%	7%

Source: Research findings 2013

The results shows that those with age from 28 to 37 are the ones with higher frequency (45%) of asking for loan and conduct business than other age groups.

CHAPTER FIVE

DISCUSION OF FINDINGS

The findings showed that the SME's have played a great role on the improvement of the living standard of the people and improve the state of economy of the country. As the data shows in chapter four, it has shown clear on how the formation of group lending can facilitate the reduction of poverty and also being one among the rules that some of the customers can use to obtain the loan where individually seemed impossible. Moreover, the use of capital budgeting is necessary as obtaining capital is one thing and make the best use of it is another thing. The study showed that only 23% use elements of capital budgeting in helping them set their objectives, plan, control and even determine the best way to evaluated their results all in to make sure that the set goals are being attained in time and as planned, while 77% of the respondents use none of the methods of capital budgeting.

Most of the respondents said that the payment period seems fair as before they obtain the contract they area asked if they think the payment period is favourable to them. As shown above a high percentage of the respondents said the payment period is fair though those asking loan for the first time they have limited time as they have to repay the loan for the first six months. That being the case some of the SME's has fail to make payment when due cause by the reasons below;

a) Change in the economy cycle,
b) Sell of seasonal products,
c) The distance/interval between obtaining loan and 1st payment being too short
d) Profit that obtain does not match the repayment amount
e) Natural disasters

All those being at hand they have enable others taking them as challenge towards individual goals as when they keep borrowing, the amount of loan keeps on increasing after they finish the previous contract. This has helped most of the SME's meet their development goals and being able to expand their business and also meet their family needs and wants. Some suggested that it will help more of them grow and meet their goals if the payment period would be increased to at list 18 months. This will call the attention of many SME's to come and ask for credit services in many MFI's as it will facilitate many to work independently and avoid the problem of loans diversion.

Through the study there has been some factors that has effect on the improvement of the competitiveness of all the SME's and make them unable to meet their set goals in time and as planned. The following are the factors affecting the SME's competitiveness such as;-

a) climate impediments,
b) shortage/insufficient supply of factors of production,
c) inadequate innovation,
d) poor infrastructure,
e) high transaction costs,
f) information asymmetry and
g) Poor economies of scale.

There are many advantages that the Small and Medium Enterprises gets which facilitate them in developing their firms such as;-

Close customers contact

Most of the micro and small firms operate at home areas where the owner of the firm is well known by the customers and this is one among the best advantage of permanent customers, a good example of these firms being such as retail shop and bars.

Continuing innovation

Many SME's expands as time goes on as many starts from one product supply or production to two and more. This gives a room for the expansion of business as it allow further innovation and even allow expansion of other branches in different areas as to cover more supply of their products. High market demand and competition of products this will challenge the entrepreneurs to innovate and improve the quality of their products so as to win/remain in the market.

There are also disadvantages that Small and Medium Enterprises face such as;-

Difficult to get capital

Many small firms fail to get capital from different sources of microfinance credits institutions due to have less of the required conditions of obtaining loan such as insufficient/lack of security or collateral for the loan asked. Lack of collateral has caused most of the micro entrepreneurs fail to support their business as they have no fund to meet their customers demand

High fixed costs

High fixed cost is another problem that face small and medium enterprises as they are always there no matter the state of the economy is. This has effect on many firms as in low seasons they make less profit and still they have to cover the same amount of fixed costs such as rent, storage facilities, transportation cost and also salaries for worker

Missing resources

This is another disadvantage of SME's as there is insufficient amount of resources such as raw material for their product as this can be due to the difficulties of obtaining them as they can be far from the industry area and they need high transportation costs or not available at the moment, poor infrastructures, poor information systems and also skilled labour. It is difficult for the small firms to hire good personal as they are expensive and the firm cant be able to pay them as they require due to the amount of profit they make

CHAPTER SIX

SUMMARY, CONCLUSION AND POLICY IMPLICATION

6.1 Summary of the study

Across developing countries, micro, small and medium enterprises (SMEs) are turning to Microfinance Institutions (MFIs) for an array of financial services; this is because microfinance is acknowledged as one of the prime strategies to achieve the Millennium Development Goals (MDGs) which are: poverty and hunger reduction, universal primary education, reduction of child mortality, combating diseases such as malaria and environmental sustainability. The reason is because access to sustainable financial services enables owners of micro enterprises to finance income, build assets, and reduce their vulnerability to external shocks. The primary objective of microfinance institutions (MFIs) is to provide financial services (credit and savings) to the poor in order to release financial constraints and help alleviate poverty. According to the provision of credit to the poor serves two purposes;-

First, as borrowed capital is invested in small enterprises, it often results in significant short-term increase in household expenditure and welfare.

Secondly, microenterprises credit spurs economic growth in the informal sector through fostering increase capitalization of business, employment creation, and long-term income growth. This study was attempted to examine and assess the impact of microfinance institutions (MFIs) on SMEs development in Arusha.

These enterprises play a crucial role in driving economic growth in both developing and developed countries. SMEs typically generate the most new jobs; introduce locally (and sometimes globally) relevant innovative ideas, products, and business methods; and can push economic reform and the modernization of uncompetitive economies.

SME development is also often seen as a critical component of pro-poor growth strategies such as:-

a) Generate many of the new jobs in the economy, since many of these jobs are suitable for semi-skilled or unskilled workers, they can be taken up by the poor.

b) SMEs introduce business methods, products, and services that help restructure weak agricultural sectors or other uncompetitive transition economies, thereby absorbing labor that would otherwise drop into the ranks of the poor.

c) SMEs help spread the benefits of economic growth by engaging low-income groups in national development. They form dynamic supply-chain linkages between small-scale producers and lucrative urban, national, or export markets. In the reverse direction, they link large urban businesses with mass consumer markets in remote areas

6.2 Conclusion

There is a need of the financial institutions to be given a range of credit products as field studies (sampled) have demonstrated the importance of the support given to contribute to the potential for developing housing and education loans or savings products. With housing viewed by the poor as a productive investment and one of the few appreciating assets they can acquire, client demand for housing loans is high. With both the size of school fees and their timing and frequency predictable, financial vehicles, either savings or credit,' should be useful for responding to this financial need. More accessible and private savings that are not linked to borrowing and that can be used to deal with anticipated and unanticipated risks and day-to-day economic stresses. Again, it is important that such financial products be structured to reflect the financial and investment cycles of the client and to be accessible when they are needed.

6.3 Policy implementation

Through the study there are many limitation that I have face such as lack of awareness, importance of standards for Small and Medium Enterprises and also comprehension this based on the technical content, language and information systems. The following are my policy implementation such as;-

- **Match the size of Loan and Collateral**

Many small and medium enterprises fail to borrow money from microfinance banks due to the fact that the amount of loan and the demand of collateral do not match. This is due to the fact that things needed as security/collateral are such a as house, plots and cars. Not all of them can meet this security demand, which cause most of them unable to ask for loan. Also there is fear among the SME's as when they see others collaterals are taken away and the amount of loan in balance does not match the amount of security settled. This has made more borrowers remain poorer as they need to start from the start to build their financials and meet their social needs. Hence the microfinance institutions should have a closer look on their policy of collateral in question against the amount of loan asked

- **Employing low skilled workers**

The effect of employing relatively more low-skilled workers;- Since it is likely that both SMEs and their suppliers, on average, employ a greater share of local, low-skilled workers than do large firms or the suppliers to large firms, and since to the extent that SMEs hire less skilled workers, these workers plausibly spend a larger share of their income on other products produced by less skilled workers, there is more likely to be a positive multiplier effect on the alleviation of poverty through SME support than through development projects that lack this focus.

- **Increase Product Flexibility**

To help clients manage and recover from losses associated with unanticipated crises or economic stress events after they occur, MFBs are challenged to provide more flexible loan and savings products. For example, emergency loans could play an important role in helping clients recover lost stock, make repairs on premises or equipment, start a new business activity, or cover health bills. Emergency loans could help clients recover from such events more quickly as they continue to pay their loans and stay in programs. By avoiding the use of negative coping mechanisms, such as selling off productive assets or taking children out of school, and maintaining access to credit, clients reduce their vulnerability to future risks

The key to success for emergency loan products is their timeliness. The money must be readily available when clients need it. For clients who are in the middle of a loan cycle, emergency loans may enable them to continue to repay their loans and stay in programs when they face an unanticipated crisis, for non-clients, these types of loans could be an important enticement to enter a program. While the capacity of borrowers to carry debt needs to be weighed carefully, emergency loans are proving themselves effective in crisis situations, big and small.

- **Provide Insurance Products**

To help clients mitigate anticipated, but unpredictable, risks, MFBs are challenged to provide products and services beyond credit. A great majority of the studies suggests a potential role for insurance products to help clients cope with frequent, idiosyncratic risks such as ill health or death of a family income earner. All are potentially insurable risks. Some MFBs and credit unions include loan insurance, usually as a fee. While loan insurance protects the MFB, it does little to protect clients from emergencies that lead to default. Providing these services is not easy. Yet for MFBs, the direct or indirect provision of insurance services to protect clients against these risks is a win-win proposition for both MFBs and their clients.

Areas for further study

a) Why there are many rising new microfinance credits institutions?
b) What cause more working people fail to come and ask for loans?
c) How microfinance institutions are affected with few/less +customers on credits?

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APPENDIXES

Appendix I

Questionnaire for Loan Officers

1. What is your name?

   ____

2. For how long have you been in this department?

   a) 2 years b) 3 years c) more than 4 years

3. What type of loan do you provide?

   a) start up loan b) working capital c) working expansion

4. What is the limited size of loan that the bank provides?

   ____

5. What are the qualities of the customer deem feet to obtain loan?

   ____

   ____

   ____

   ____

6. What are the things that you consider as collateral or security?

   ____

   ____

   ____

7. Is the collateral match the rate of loan asked?

   a) yes b) no

8. What is your judgment on the percentage of those asking for loan and the amount that you provide?

____

9. Are there any lending group's client?

   a) yes b) no

   Why?

10. What should be considered to motivate others to come and ask for loan?

____

____

____

____

11. What should be done to improve credit services?

____

____

12. Is the existing strategies has some loopholes that may be considered as weakness in the bank?

____

____

____

13. What do you think off that could be added in the bank strategy so that to improve its performance?

DODOSO LA WATEJA

MASWALI

TIKI JIBU SAHIHI

1. Jina la biashara na aina ya biashara

   ____

2. Je nimahali gani biashara yako ilipo?

   ____

3. Jinsia

   a) mwanamke b) mwanaume

4. Je, huu ni mwaka wangapi kwenye biashara unayofanya?

   ____

5. Kiwango cha elimu

   a) shule ya msingi b) secondary c) chuo

6. Ni aina gani ya mikopo unayoichukua hapa NMB banki?

   ____

   ____

7. Ni marangapi umesharudia mkataba wako wa mkopo na banki?

   a) Chini ya mara moja b) kati ya moja na nne c) zaidi ya mara nne

8. Vigezo na masharti ya mkopo unaweza kuviweka katika kipegele gani?

   a) magumu b) wastani c) nafuu

9. Unakiongeleaje kiasi cha riba yamkopo?

   a) kubwa b) wastani c) nafuu

   Ninikifanyike?

   ____

   ____

   _

10. Je muda wamarejesho ni nafuu kwa biashara yako?

11. Je nifaida gani umenufaika na mkopo katika biashara yako na jamii kwa ujumla?

12. Je umewahi kupata mafunzo yoyote ya ujasiriamali?

    a) ndio b) hapana

13. Banki inahitaji kufanya nini cha ziada ili iwezekupanua huduma zake nakuwafikia na wale wasio na ujumbe juu ya swala zima la mikopo?

Appendix II

INTERVIEW QUESTIONS FOR CUSTOMERS

1. What are you dealing with in your business?
2. Where did you get the information that motivated you to come at NMB bank and ask for loan?
3. Are you comfortable with the conditions and processes of obtaining loan?
4. Are there any difficulties/problems that you face in obtaining loan?
5. How are you planning to use the amount of loan provided to you by the bank, to make profit and be able to repay the loan as per schedule?
6. On what extent does the formation of group lending facilitate the development of small and medium entrepreneurs?
7. How does capital budgeting have an impact on the development of Small and Medium Enterprises?
8. What is the impact of payment period on credits provided by the microfinance on the development of small entrepreneurs?
9. Is the payment period favorable for your business?
10. What should be done to motivate others like you to come and ask for loan?
11. What do you think is a threat that makes others unable to come and ask for loan?
12. How far has the loan provided to you by the bank helped you in meeting your goals?
13. Sourcing capital is one of the major problems facing SMEs in Arusha, does your firm have any access to MFIs loans?
14. Competition generally requires the need to exploit financial resources; to what significant level does the MFI contribute to the overall competitiveness of your company?”
15. Respondents were asked for details of the evaluation methods for their investment projects

16. Competition generally requires the need to exploit financial resources; to what significant level does the MFI contribute to the overall competitiveness of your company?
17. Respondents were asked for details of the evaluation methods for their investment projects.
18. Has the loan secured from the MFI contributed to the sales and marketing activities of your company?
19. Does the loan actually help your company to standardize your product/service to the extent that you achieved substantial market share

INTERVIEW FOR THE LOAN OFFICERS

1. How long have you been in this department?
2. What kind of customers are you dealing with?
3. What is the limited size/rate of loans that the bank provides?
4. What are the qualities that deemed feet for the person to obtain loan?
5. What kind of things you consider as collateral/security?
6. What can you say on the percentage of those asking and obtaining loans?
7. Is there a lending group client?
   If yes, are there any special treats for them?
8. What group of customers asks for more loans?
9. Are there any difficulties that you face dealing with these groups?
10. What measures should be taken to improve credit services?
11. What should be considered to motivate more customers to ask for loan?
12. Is the existing strategy has some loopholes that you think they should be considered as weakness?
13. What should be added in the existing strategies to increase efficiency and effectiveness on loan department?