FINANCIAL CONSTRAINTS AND STRUCTURAL CHARACTERISTICS OF SMALL AND MEDIUM SIZED ENTERPRISES (SMEs): THE CASE OF TANZANIA.

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Abstract

Title: Financial Constraints and Structural Characteristics of Small and Medium Sized Enterprises (SMEs): The Case of Tanzania.

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Keywords: Small and Medium Enterprises, Characteristics of Small Firms, Nature of Small Firms, Financial Constraints.

Purpose: The main focus of this thesis is to explore the nature and the characteristics of SMEs together with the financial constraints facing the SMEs. Basically the research focuses Tanzania as the main area of study, but it will also cover the facts of SMEs for the neighbouring countries such as Uganda and Kenya. In some parts of Asia, such as India and Bangladesh will also be discussed under the same main purpose of this research.

Methodology: The study is based on the library research. The research follow phenomenology since it is more suitable because it is not a scientific testing or study rather it is a social study. Moreover the nature of data collected for this project will be basically qualitative. Journals and articles were the main tools for collecting data and analyse them.

Conclusion: The author has concluded that many studies have shown most of the SMEs lack access to finance for starting, operating and expanding their businesses, therefore access to finance is always quoted as a major constraint for all SMEs and can seriously affect their ability to survive, upgrade the technology in their business, increase their capacity and even in many cases, expand their market, improve management system or increase productivity as well as profitability.

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Chapter 1: Introduction

It is now increasingly recognised that the Small and Medium Enterprises (SMEs) play an important role in income generation as well as employment creation around the globe.

> Small and medium-sized enterprises (SMEs) are considered to be one of the principal driving forces in economic development. They stimulate private ownership and entrepreneurial skills, they are flexible and can adapt quickly to changing market demand and supply situations. They also generate employment, help in diversifying economic activities and make a significant contribution to exports and trade. (Szabo, 1996)

SME are the core or basis for the future of developing countries as well as developed countries in creating jobs and competitiveness. As in the case of Europe, those enterprises which employ less than 250 employees, the so called SMEs have been the main source of employment growth within the non financial sector in the European economy. This means that the SME in Europe represent about 99.8% of all EU-25 enterprises in 2003, in which the SMEs employs about two third of the workforce in Europe and generate more than a half (57.3%) of its value added. (Schmiemann, 2006). Due to the Globalization, most of the SMEs nowadays are involved in the face of Globalization especially in this 21st century, whether they operate locally or internationally. It has become increasingly difficult over the past few years to discuss the development of SMEs without making a link to the Globalisation of the markets and thus of the economy. This means that Globalization involves exchange of goods and services of all kinds, but most of the exchanges results from the formations of new alliances or agreements between businesses, as it may be seen in the computer industries, fine chemistry industries or automotive industries. Therefore due to this globalisation effect, we are now witnessing the extension of direct or indirect foreign investment, whereby the consequence of this Globalization on consumer markets cause the variety of the products to increase rapidly across the world. Also due to the international competition which is caused by Globalisation, most of the SME are availing themselves by purchasing technologies in a great many countries, as well as the semi finished products and raw materials so as to increase their productivity. The SMEs must also seek new outside markets for their products in order to increase their profitability and be very innovative so as to compete in this world of Globalisation. (Julien, 1996)

Thus the importance of the SMEs in the market economies is worldwide. If we see the case of Asian Pacific economies, the SMEs accounts about 90% of the enterprises in which they constitute the backbone of this region. This means that between 32 and 48% of the SMEs contribute for the employment and between 60 and 80% contribute for the gross domestic product (GDP) in individual Asia Pacific economies. In Switzerland and the European Economic Area (EEA), the enterprises are more than 16 million, this means that less than 1% constitute of large enterprises while the remaining are the SMEs. Therefore in this region, two third of all jobs are created by the SMEs while one third of all jobs are provided by large firms. Also the United States economic performance has of been stimulated by the creation of the SMEs in which they accounted for 43% of the job creation between 1990 and 1994. (UN/ECE Secretariat, 1997)

In Africa, the SME sector accounts for almost 90% of all the enterprises, in which they are located in both the rural and urban areas, whereby they provide more equitable distribution of income in all areas of the countries. This means that the SMEs are the main source of providing employment to the people and stimulate the development of the countries by promoting the entrepreneurship and the business skills amongst communities and strengthen the local production sector as well as the industrial base. Therefore the SMEs in Africa have been considered to be a very important engine for obtaining national development goals, such as poverty alleviation and economic growth. (Mokaddem, 2006). For example, in South Africa, the SMEs accounting for about 46% of the total economic activities and 84% of private employment. It is also estimated that about 80% of the formal business sector and 95% of the total business sector are considered to be the SMEs. (International Institute for Sustainable Development, Canada, 2004)

However, in the case of Tanzania, the SMEs contribute significantly in the income generations, stimulating development growth in both rural and urban areas as well as creating employment. (Ministry of Industry and Trade, Tanzania, 2002)

The main purpose of conducting this research is to explore the nature and the characteristics of SMEs together with the financial constraints facing the SMEs in the chosen areas of the whole study. Basically the research focuses Tanzania as the main area of study, but it will also cover the facts of SMEs for the neighbouring countries such as Uganda and Kenya; where all three countries form an important Economic integration within the Eastern part of Africa. In

some parts of Asia, such as India and Bangladesh will also be discussed under the same main purpose of this research.

Therefore this will be discussed under the following categories:

- ❖ Determining the SMEs structural characteristics.
- ❖ Identifying financing constraints facing SMEs.
- ❖ Explaining the problems faced in accessing the capital in SMEs.
- ❖ Finding out the reasons of low performance and growth of SMEs
- ❖ Identifying ways to overcome the financing constraints of SMEs.
- ❖ Finding suggestions or recommendations on how to access good financing methods for SMEs.

Outline of the thesis is as follows. In Chapter two, the research will look on the introduction of this research or study, defining the SMEs, determining their structural characteristics as well as explaining their roles and significance in Tanzania. Chapter three will identify the financing constraints facing the SMEs, i.e. by looking on the financial conditions of the SMEs in Tanzania. The same chapter will also explain the problems faced in accessing the capital in the SMEs of Tanzania, i.e. by looking at the effecting factors of the financing structure as well as their low financial performance and growth. Chapter four aims at identifying the barriers to financing in SMEs and the efforts made to empower them as well as the ways to overcome these financing constraints i.e. finding the measures to alleviate some of the challenges encountered by small firms in accessing credit to support the growth of their firms. The last chapter of the research will look on the conclusions and recommendations on how to access good financing methods for SMEs.

Chapter 2: The SME sector in Tanzania

2.1 Introduction

It is now increasingly recognised that the small and medium enterprise (SMEs) play a crucial role in employment creation and income generation in Tanzania. SMEs all over the world and in Tanzania in particular, can be easily established since their requirements in terms of capital, technology, management and even utilities are not as demanding as it is the case for large enterprises. (Ministry of Industry and Trade, Tanzania, 2002)

In this chapter the author will review the financial performance of Tanzanian SMEs in particular and some other developing countries such as Kenya, Uganda, India and Bangladesh. The review investigates the structural characteristics and the financial constraints of SMEs development in different growth stages of the business.

In this research, the review touches on different areas such as the definition, characteristics and nature of the small firms. This has been discussed by looking on the contents of small firms and what makes them different from other firms. The access to financial services by small firms or SMEs has seen to be one of the major constraints which limit their benefits from credit facilities. In most cases, the access to financial services problems, are mainly created by the formal financial institutions through their lending policies. This is described in the form of minimum amount of loans which are given to the entrepreneurs, complicated applications procedures in applying for a loan as well as the restrictions on credit for specific purposes. For example in developing countries many micro-financing institutions provide training to the entrepreneurs as one of the precondition for obtaining credit, whereby credit and training are now considered to be as a joint product. This means that in Tanzania almost all micro finance institutions such as SIDO (Small Industrial Development Organization), FAIDA (Finance and Advice in Development Assistance), PRIDE-Tanzania (Promotion of Rural Industries and Development Enterprises), Poverty Africa Credit Shops, as well as NEDF (National Entrepreneurship Development Fund) have adopted this joint product. Therefore training has been considered to be one of the major preconditions for qualifying for a loan or credit; hence the lack of access to finance is mainly caused by these policies from the financial institutions. (Kuzilwa, 2005)

In Tanzania banks are discouraged and not willing to lend to SMEs due to inadequate information and insufficient competition on the credit markets. (Ministry of Industry and Trade, Tanzania, 2002).

Another constraint is the behaviour of the small firm owners, since many small firms owners are reluctant to take risks and to welcome other investors/partners or financiers due to the fear of dilution of control. The strong desire of many small business owners is to retain personal control and business independence which has also been recognised as a key factor limiting the growth of many potentially successful small enterprises.

Therefore in accessing financial services by small firms or SMEs, the recommendations have been made to reduce or alleviate such problems which are the challenges to the small firms to grow or expand their enterprises.

2.2 Definition of SMEs

There are several reasons which make the firm small and make it different from other firms. Although the identification of these firms may be problematic, therefore in this study we shall have to understand the reasons why small firms are created and which are the small firms. There is no precise and universally accepted single definition of SMEs. (Aikaeli, 2007). Different countries use various measures in defining the SMEs according to their level of development. The commonly used measures are the total number of employees, sales turnover, size of the premises as well as the profitability of the firm. This means that each organisation has their own definition of SMEs to suit their work or according to their work, which cause inconsistence from one business sector to the other. For example, the firm of 70 lawyers or accountants would be considered to be large than the electrical goods manufacturing firm which have the same number of employees, i.e. 70 employees. (Bolton Committee Report, 1971)

2.2.1 Definition of SMEs in Tanzania

In the context of Tanzania, micro enterprises are those engaging up to 4 people, in most cases family members or employing capital amounting up to Tanzanian Shillings (Tshs) 5 million. The majority of micro enterprises fall under the informal sector. Small enterprises are mostly formalised undertakings engaging between 5 and 49 employees or with capital investment from Tshs 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. (Ministry of Industry and Trade, Tanzania, 2002)

This has been illustrated from the table below:

Table 1

Categories of SMEs in Tanzania with Capital Investments

Category	Employee	Capital Investment in Machinery (Million Tshs)
Micro enterprise	1–4	Up to 5
Small enterprise	5–49	Above 5 ≤ 200
Medium enterprise	50–99	Above 200 ≤ 800
Large enterprise	100 $^+$	> 800

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

The following are the Definitions of the Small Business as advanced by the number of sources such as the Bolton Committee of 1971, Department of Trade and Industry (DTI), European Commission and the Companies Act of 1985.

2.2.2 The Bolton Committee Report (1971)

In defining the Small Businesses, The Bolton Committee's Report (1971) on Small Business within the UK economy, has attempted to overcome the problem of defining the small business sector as there is no uniformly acceptable definition of small firms. Therefore they formed a definition that had both a quantitative (statistical) and a qualitative (economic) element.

The Quantitative (Statistical) Definition of Bolton Report regarding Small Businesses was defined as follows:

They defined small business in terms of size by observing the number of employees in some sectors and by the turnover in other sectors. Therefore all quantitative or statistical definitions include reference to both the number of employees as well as the turnover. The main issue

was to quantify the current size of the small firms and their contribution to the economy such as in the GDP, export, employment and innovation.

The Qualitative (Economical) Definition of Bolton Report regarding Small Businesses or SME must fulfil the following criteria:

> They have a relatively small market share within the industry.
> They are mainly managed by their owners or part owners in a personalised way and not by an organised structural management.
> They are independent with the owners or managers having control of the activities of the business, and should only be limited by outside elements in matters of financial obligation.

2.2.3 Department of Trade and Industry (DTI)

The Department of Trade and Industry (DTI) in UK defined the small business by using the number of employees as one of the determinant of the size of the firm and the turnover. This means that a clear description of the major characteristics of the SME comes from the Report of the Bolton Committee on Small Firms of 1971. Therefore according to the DTI statistical definition, they still maintain the statistical definition of the Bolton Committee on small businesses. (Tonge, 2001)

According to the **European Commission (EC)**, in 1996 they adopted a single definition for SME that to be applied across all the Community proposals and programs from December 1997 onwards. This definition is the same as that of the DTI. (Tonge, 2001)

However, for statistical purpose, the definition which was used by the DTI is as follows:

> Micro firm, 0 – 9 employees
> Small firm, 0 – 49 employees (includes micro)
> Medium firm, 50 – 249 employees
> Large firm, over 250 employees.

2.2.4 The Companies Act of the United Kingdom

According to the Companies Act, 1985 of the United Kingdom, section 248. Some more quantitative definitions have been included.

This elaborate that for a firm to be considered small, at least two of the following criteria must be satisfied:

- ➢ A turnover of not more than £2.8 Million
- ➢ A balance sheet total of not more that £1.4 million
- ➢ Not more than 50 employees.

And for the medium-sized company, the firm must at least satisfy two of the following criteria:

- ➢ A turnover of not more than £11.2 million
- ➢ A balance sheet total of not more than £5.6 million
- ➢ Not more than 250 employees.

2.3 Characteristics and Nature of Small Firms

The characteristics of the small firms can be said as follows:

- ❖ The small firms mainly focus on a small range of products or services and mainly sell their product or services on the local domestic market.
- ❖ In small firms, the owner is the only person in a managerial position, thus no organised structural management or board of directors.
- ❖ The small firms operate their business on trust, rather than on contracts and systems.
- ❖ In small firms the pressures of day-to-day management and resource constraints cause their vision and outlook to be bounded by the horizons, skills and experience of the owner or founder
- ❖ The small firms likes to operate independently of other businesses and institutions or work on their own i.e. they prefer more self help rather than seeking advices.
- ❖ The small firms face a fierce competition due to their small range of products and small market share; therefore they tend to be simply price takers.
- ❖ Small firms also do not have any preparations for the future plans.
- ❖ Maximum small firms are not publicly owned companies; they are either partnership firms or privately owned companies, i.e. most of them are not quoted on a stock exchange – they are "unquoted"
- ❖ Small firms have limited resources in terms of assets, manpower, as well as finance. (Small and Medium Business, New Zealand, 2004)

2.4 The Role and Significance of SMEs sectors in Tanzania

The importance of SMEs within the industrialization period is understood again since 1970's. (Financing of SMEs in Turkey, 2008). Perhaps now, SMEs are the seed from which economy in many developing countries is grown. This means that the role of the SMEs in developing

the economy of a country varies from economy to economy, depending upon the political system of the country, industrial climate within the country and the material resources available.

> The implication of this is that in a particular economy, we would expect more entrepreneurial activities and faster business growth during a regime with more opportunities and freedom for private business than in a restrictionist regime. This is an interesting context for transition economies in Africa and indeed Tanzania during its reforms phase since 1986. (Kuzilwa, 2005)

This means that the Tanzanian government had to move to a more market oriented economy from the centrally planned economy so as to allow private sector development as well as the economy in general. Therefore the government introduced several far-reaching economic reforms so as to stimulate the economy. (Calcopietro and Massawe, 1999)

In Tanzania, approximately one third of the GDP is originated from the SME sector. It is also estimated about 20% of the labour force in Tanzania which is almost 3 million people is engaged in small businesses, in which these are micro enterprises consisted of 1.7 million businesses which are operating in the informal sector alone. Though the data are not reliable and rather sketchy, it is therefore reflected from the available data that the SME sector play a major role in economic development. (Ministry of Industry and Trade, Tanzania, 2002)

Since SMEs create employment to majority, therefore they are considered to be labour intensive; this is because they are operated at a relatively low level of investment. At present, the significant problem that is faced in Tanzania is unemployment, in which the government has to deal with. It is estimated that there are approximately about 700,000 new entrants who enter the labour force every year, whereby about 500,000 of them are school leavers with very little marketable skills. This means that out of 700,000 new entrants, the public sector can only employ 40,000 into the labour market, whereby the remaining 660,000 are left out to join the underemployed reserve or to remain unemployed. Therefore most of these people who remain unemployed end up in the SME sector, in which they establish their own employment, mostly in the form of informal sector. This is due to the fact that SMEs require a low rate of capital formation that is why the SMEs are the best option for those who are unemployed in the public sectors .(Ministry of Industry and Trade, Tanzania, 2002)

In the case of Kenya, the small scale enterprise sector plays a crucial role in the Kenyan national economy. This means that the focus on SMEs is very important due to the fact that they contribute a lot in employment, whereby about 5.1 million people are engaged in this

sector, representing 74% of the total national employment and contribute about 88% of the total job creation at any one time. They also contribute in the Gross Domestic Product of the country, whereby they contribute about 24.5% to the GDP. (Maina, 2006). While in Uganda, the SMEs represent the backbone of the economy. This means that there are special linkage promotion programme that are used to promote SMEs sector, in which these programmes are seen to be as a fast-track vehicle for creating a dynamic SME sector. In Uganda the SMEs comprise over 90% of the private sector and are considered to be very important in stimulating the economic growth of the country. Therefore the SMEs create productive jobs to the people, provide a good source of the tax revenues for social as well as economic development and they also increase the export revenues vis-à-vis import substitution and thus balancing the terms of trade. (Outline of Business Linkage Opportunities in Uganda, 2008) This means that the SMEs contribute about 75% of the GDP and employment of approximately 2.5 million people in Uganda. (Hatega, 2007)

> This means that the structure of employment in East Africa, i.e. Kenya, Uganda and Tanzania, is such that the majority of the population depend on small business. Today, small enterprises are found in every corner of the three countries and have great potential to create a variety of jobs, while generating widespread economic benefits. (Kelly *et al.*, 2006)

As in the case of India, where the SMEs as referred to as Small Scale Industries (SSIs). They contribute approximately 40% of the total production within the industry and over 34% of the national export, thus the SMEs emerged to be a very important sector within the economy of India. According to the website of the Ministry of Small Scale Industries in India, indicate that in the year 2005, about 30 million people where employed in the sector of SME. (Kelly *et al.*, 2006). This means that in India the SME sector is considered to be the second largest manpower employer, whereby the majority of the people are employed in this sector after the agriculture and output sector. Approximately 40% of the value added in the manufacturing sector and one third of the national exports are contributed by the SMEs. (Chopra, 2004). Also according to the most recent private sector survey in Bangladesh, it is estimated that, nearly 20-25% of the GDP is contributed by the SMEs. This means that in terms of output, private sector activities as well as employment opportunities, the SME undoubtedly play a very crucial role within the economy of Bangladesh. They also comprise over 90% of all enterprises in the industry, whereby they are quite predominant within the industrial structure of Bangladesh. Therefore the contributions of the SMEs are reported to be between 80-85% of

the industrial employment and 23% of the total civilian employment. In the value added contribution, the SMEs seen to contribute between 45-50% of the total manufacturing value added. (Ahmed *et al*., 2004)

In short, small and medium-sized enterprises are contributing to employment growth at a higher rate than larger firms, also the private sector and in particular SMEs form the backbone of a market economy and for the transition economies in the long-term might provide most of the employment. (Szabo, 1996)

Chapter 3: Financial Conditions, Structure and Performance of the SMEs in Tanzania

3.1 Financial conditions of SMEs in Tanzania

Many studies have shown that most of the SMEs lack access to finance for starting, operating and expanding their businesses. In Tanzania, the demand for credit is so high, whereby it is estimated that about 2.5 million borrowers are demanding for loans or credits compared to only 50,000 borrowers who are served recently. Also, the range of the credit which is largely demanded by the SME is between Tshs 50,000 to 500,000. There are mostly small and short term credits that are available from several MFIs, such as MEDA (Mennonite Development Associates), PRIDE-Tanzania and Poverty Africa Credit Shops, in which these institutions are mostly prominent and widely spread. They typically raise credits in stages from Tshs 50,000 to 500,000 per SME recipient or group, with the repayment period of about 6 to 12 months which is a very short time. This means that in this situation, only the micro enterprises benefit from these loans such as those primarily engaged in trade, food vending as well as agriculture. Another condition is that most of the loans from the MFIs attract an interest rate of between 25 and 40% per year, which is over and above the commercial lending rates of 20-25%. Therefore due to these high interest rates from the MFIs, the SMEs are discouraged not to take long term borrowing even if they were available. (UDEC, 2002)

In Tanzania, there are also some Government departments or agencies which provide credit to the SMEs such as the District Community Development Officers that manage the Youth Development Fund (YDF) and the Women Development Fund (WDF), in which they provide micro credits in rural areas and mostly to the economic groups. SIDO remains to be the main government arm for promoting SMEs within the country, whereby it manages National Entrepreneurship Development Fund (NEDF), which also provide micro credits to the SME operators in the regions. In addition to MFIs and NGO, there are also informal moneylenders in which the SME operators also rely on them. However these moneylenders charge extremely high interest (as high as 130% per year). Therefore these informal moneylenders are considered to have extremely high lending rates. (UDEC, 2002)

According to the MFIs there is another condition for the entrepreneurs in accessing the small credits or loans, whereby it is now easy for these entrepreneurs or SMEs to access small loans (up to Tshs. 2,000,000) from MFIs as long as they are ready to follow the group lending requirements. This model of group lending requires the borrowers to formulate a group and

meet every week so as to obtain this type of a loan. The loan in which the group will be given to start the business with is so small (Tshs 50,000) and gradually the loan will be increasing as the business proceeds. (UDEC, 2002)

In Uganda, the cost of finance or debt is still an issue, because the high cost of finance or debt and the limited access to credit remain to be the key barriers to the private sector growth. This means that large and successful enterprises can obtain the loan at relatively low interest rates and easily while the small businesses are charged high interest rates and yet the loans tend to be of short-term. The commercial banks in Uganda charge high interest rates on credit of over 23% for the past three years, which is unfavourable if compared with those of East African partner states, i.e. Tanzania and Kenya. Indeed, very few private businesses in Uganda can achieve an internal rate of return as high as 25% to justify borrowing from the Uganda's commercial banking sector. Also due to the inherent risks perceived by banks, cause the cost of finance or debt to become very expensive, as a result the SME operators prefer to obtain a more readily available short-term loan to cater for medium to long term investment for their expansion. Another condition is that most of the banks especially the transnational ones, do not accept the collateral which are outside of the city centre by 5 kilometre radius, thus this condition is also a severe constraint to the SMEs. (UNCTAD, 2002). Moreover, in Kenya most of the SMEs lack access to finance for starting and operating their businesses due to the lending terms and conditions of the formal sector as well as the loan rationing in the informal credit markets, which is attributed to the limited resources base. This means that the informal sector do not have enough fund to give out the large amount of loans to the small firms, therefore it offers a small amount of loan but caters the large number of SMEs. Therefore in Kenya the terms and conditions affects the borrowers decision when choosing the credit source, such as formal credit market or informal credit market due to the fact that the application fees, collateral values, application period as well as the repayment periods are higher in formal credit markets than in informal credit market. Therefore this makes the borrowers not to get the adequate funds they need for the expansion of their business due to these terms and conditions of the credit markets. Also in Kenya, there is a specific credit package in which each lender offer to its borrowers who meet specific conditions, such as in the group based credit programmes supported by the NGOs, whereby the NGOs give loans to the group at the market interest rates and then the group lends to the members at the higher interest rates. Therefore due to these lending terms and conditions, the formal financial institutions, created the myth that the poor or small enterprises are not bankable, this is due to

the failure of providing the required collateral, and thus they are considered to be uncreditworthy. (Atieno, 2001)

According to the Report of the Internal Group to Review Guidelines on Credit Flow to SME sector in India (2005), even when the debt financing is available to the SMEs or the small-scale sector, but the main problem with these loans is the maturity period. This means that the maturity period to repay the loan in most cases is too short, thus cause the small scale sector not to be able to finance the sizable investments.

> In India the surveys conducted by Reserve Bank revealed that majority of the bank branches are adhering to the time frame prescribed by Reserve Bank for disposal of loan proposals. They are also adopting simplified method of computation of working capital requirement of SSI units, based on minimum 20% of the projected annual turnover of the borrowing unit for limits up to Rs.5 crore, except in a few cases where banks are adopting actual turnover. (Report of the Internal Group to Review Guidelines on Credit Flow to SME sector in India, 2005)

Furthermore, in Bangladesh, lack of institutional or formal credit seems to be a major bottleneck to SME growth. In most cases, the banks and non bank financial institutions are requesting for collateral in the form of land and buildings so as to advance loans to the SMEs or their clients. This means that the value of the collateral which is the real-estate security is usually set to be as twice of the amount of the loan which is actually granted. Due to this condition or lending policy of the financial institution cause most of the SMEs not to obtain the loan because they fail to provide such collateral. In Bangladesh, the SMEs are also considered to be high risky borrowers because in most cases they are subjected to high mortality rates, have insufficient assets as well as low capital income, therefore do not offer any attractive deal to the financial institutions in terms of interest rates and in terms of the loan itself. Furthermore, the application forms for a loan or credit from the banks are very long and tedious. (Razzaque, 2003)

3.2 Financing structure of SMEs in Tanzania

As it was explained by Calcopietro and Massawe (1999). In Tanzania, adequate finance is still not provided to the SMEs, so as to allow growth in this sector, even though there is a financial system which comprises of both formal and informal organisation. In both the 1991 and 1995

Informal Sector Surveys, revealed that the lack of capital is the most pressing need of the SME operators. This means that the main problem which was faced by the SMEs was lack of investment capital to start up a new business and lack of working capital for business growth or expansion. Therefore the access to finance is limited by the number of reasons as follows:

- ❖ Tanzania lacks an adequate financial system, this means that the financial system is not composed of the appropriate financial services institutions to cater for SME needs. Most of the banks restructure their institutions but still they do not operate an SME financing window. The National Micro-finance Bank in Tanzania has great potential of financing the SME but it is practically not operational as yet. The other problem related to the financial system is the inexperienced bank staffs that are still not well educated in the issues concerned small credits and micro finance. Apart from these problems, there is also another related issue of insufficient development of the capital market in Tanzania. This means that in the capital market there is no enough liquidity to absorb outstanding shares and still there is a lack of institutional investors.

- ❖ Some of the banks mostly operate in limited geographical areas, while some regions are left without banks or are located in towns, in which it is not convenient to those investors who are leaving far away from town. Therefore the SME operators are discouraged and thus forgo these loans; after all they include a lot of procedures.

- ❖ The use of appropriate collateral is the most common mechanism which is used by the financial institutions so as to reduce the informational problems in financing the SMEs. In Tanzania there is also lack of guarantee system or scheme to back up those banks which will finance the SMEs in case they fail to repay their loans. This means that due to lack of guarantee system from the government and the entrepreneurs are unable to fulfil the collateral requirement, thus banks shy away from giving loans to the SMEs. This is a reflection of the inflexibility of the banks and other financial institutions. Where this requirement has been relaxed (e.g. Pride Tanzania Ltd) successes have been recorded. But in general the SMEs in developing countries lack appropriate collateral to support their repayment ability according to banks.

- ❖ In most cases the financial structure of private firms in Tanzania are opaque. This means that there is lack of transparency in their financial records and most of them are not audited. Therefore investors fail to fulfil the bank requirements in obtaining loans

due to the fact that the borrowers have low capabilities of preparing business proposals and applications which suits the bank requirements, and thus it is too expensive to hire a professional to do this service for the SMEs.

❖ In Tanzania, there is also lack of credit rating system for the SMEs. This means that the SME are not rated according to their performance and thus makes it difficult for banks to grant them loans, since there are perceived to be of a high risk of business failure. This is typically a reflection of the lack of financial information or the perceived high cost of collecting this information on SMEs. Therefore in Tanzania, the majority of commercial banks have in recent years denied SMEs credits because of a higher defaulting rate. (Calcopietro and Massawe, 1999)

However in Uganda, the awareness of the capital market is still low, where by capital market is the good source of funding among the business community. This means that in the stock exchange, the traders or investors are not yet sensitive to the price changes and thus they tend to hold onto the shares they buy as one of the means of investment, in which this result into a low level of activity in the stock exchange. In Uganda there is also lack of financial information from the SMEs which increases the transaction costs of the banks or even makes it impossible to evaluate the chance of getting back their money. The bankers commonly state that most of the SMEs, even in the formal sector under declare their sales income or profits and only do the tax accounting. As a result banks and the venture capitalists lack the reliable financial information of the SMEs which would indicate a track record. Also due to lack of good credit rating system in Uganda, the SME are perceived to be highly risky, this is proven from the default rates for Ugandan SMEs which was approximately 78%. The SMEs apart from being of high risk, they also have little or no collateral at all to ensure themselves against these risks, and this is mainly because they suffer from high mortality rates, low capitalization as well as vulnerability to market fluctuations. (UNCTAD, 2002). In the case of Kenya there are number of institutions which provide credits to the SMEs such as the commercial banks, NGOs, non-bank financial institutions, multilateral organisations, business associations, rotating savings and credit associations and credit associations. Despite having many financial institutions in Kenya, still most of the commercial banks, rarely give loans to the SMEs. This is because the commercial banks emphasize mostly on the collateral or security, in which most of the SMEs lack, only few firms are able to provide the guarantee requirements and the collateral to the commercial banks. Also most of the enterprises had not

used credit before, this is not because they are wealthy or had relatively higher wealth values, but it is because of the type of loans they require do not exist in the capital market. This implies that the credit markets do not serve those SME or enterprises who seek to expand their business. Another reason for these SMEs not seeking credit was lack of information about credits. Formal or informal credit sources were justified as the only source of credits; this means that there is a limited range of options to the SMEs. (Atieno, 2001)

According to the Basu (2004) and the Report of the Internal Group to Review Guidelines on Credit Flow to SME sector in India (2005), due to the institutional weaknesses in India, such as absence of good credit appraisal system and monitoring tools or risk management system, cause the banks' transaction costs to increase when dealing with the SMEs. This means that due to the small amounts of loans which are given to the SMEs, makes the aggregate cost of collecting these information, loan processing, due diligence and monitoring costs to be much higher. This is because there is lack of reliable credit information on SMEs to the financial institutions or lenders, which are mainly, caused by the asymmetry of information as well as the moral hazard issues. This means that the SME hide some of the information about their business prospects due to the fact that they do not have a well-documented credit history. And in the case of moral hazard problems, most of the SME are associated with the possibility of diverting funds to alternative projects or develop the propensity to take excessive risks so as to get higher profits as we know that the higher the risk, the higher the return. Therefore due to the problems of information asymmetry and high risk perception of the SMEs forces banks to prefer the collateral based lending rather than the cash flow analysis when serving the SMEs. Even though there is a threshold up to which the financial institutions should not ask or insist on collateral but they still do that on the assumption that the risk involved on the non collateralized lending is high. Another problem in the financing structure of India is also rooted in the legal and regulatory framework, due to the fact that there is lack of bankruptcy and contract enforcement, in which makes it difficult for the lenders to recover their bad loans from the SMEs once they fail to repay their loans. Furthermore in the case of Bangladesh, Cookson (1999) reported that, there is lack of an adequate financial system, this is because the impact of the central bank's and Ministry of Finance's intervention in interest rates and insistence on collateral is to ration available saving heavily to large enterprises which provide low return and high default rates. The overall impact of the rationing of credit leads to a misallocation of capital and insolvency in the financial system. Ironically, rather than try to encourage lending to small enterprises the action of the regulatory authorities supports

continued rationing against small enterprises. There is also poor flow of credit information for permitting a better choice of borrowers and reducing the rationing effects. However most of the credits which are given to the SMEs tend to be ineffective due to poor flow of credit information. In Bangladesh, there is also lack of credit rating; they consider that provision of a credit rating is a more difficult task than simply relaying the loan balances. The rating is based on the company's credit history. To provide credit ratings requires a staff able to review data and make prompt decisions, in which this will add significantly to the costs.

3.3 Financial Performance of SMEs in Tanzania

Access to Finance

According to the Oyen and Levitsky (1999). In Tanzania, it is well known that access to finance is a major problem for all SMEs; they seriously hinder the ability of the small firms to increase their capacity, survive as well as upgrading of their technology in businesses. However, lack of access to formal finance is still a major element crippling the ability of a business to operate effectively, to purchase materials and services most economically, to modernise or expand business as well as maintaining or replacing machinery. When starting a new business, most of the small enterprises begin as the micro businesses and are unable to obtain loans from the formal institution, thus they decide to begin or start their businesses by investing their own savings or use funds from friends and relatives.

> Therefore as far as financing at the beginning of activities are concerned, only 6.7% of SMEs had the benefit of receiving funds from a bank in Tanzania. In most cases, however, the main source of financing at the beginning of business was personal savings (63.3%) followed by loans or gift from family (23.3%), and profit from another business (16.7%), bank loan (6.7), SIDO loan and gift from friends (1.7% each). (Mutalemwa, 2005)

Interweaving of the finance of the owner, his family and that of the business is another problem of the SMEs in accessing finance to the banks. This means that it is often very difficult for these elements to be separated and hence SMEs fail to present a clear justification for the sum of money requested to the financial institution based on the accounts available to the business operation. Moreover, most of the SMEs in Tanzania have the tendency of extracting more funds for the personal use of the family members than what is actually generated in the business. Therefore this may reduce the business funds which might be

needed to cover for operating expenses and thus may impedes the building up of resources. It also obstruct the creation of the contingency funds in case of any emergency that may arise within the business an makes it impossible to set aside a portion of funds as a reserve for future investment and growth of the business. (Oyen and Levitsky, 1999)

Apart from the loans which are made available through the banking system, there are also other forms of finance for the SMEs. This means that part of the working capital can sometimes be finance through a trade credit or in some situations through advances from the customers. Therefore in most cases, the working capital of the SMEs is financed by the bank overdraft facilities. All these methods of financing the SMEs current needs may be acceptable under the condition that the SME operators must be under control and it is important that the owners of these businesses know exactly their cash flows and how they intend to cover these overdrafts. As in the case of fixed assets, most of the entrepreneurs overestimate their business proposals for investments in their business premises as well as in the business equipments, in which it results into poor utilization of facilities. In addition to that, another problem hinders the access to finance for the SMEs is the inexperienced staff in banks, where they accept the data submitted by the SMEs when applying for a loan without questioning. This means that the advisory services needed to reduce this problem by demonstrating to the SME operators on how to prepare a realist business plan or proposal so as to meet the needed requirement in order to obtain a credit. (Oyen and Levitsky, 1999)

In Uganda, the access to finance in formal sources is also a major problem for the SMEs, as we know that these businesses form an important part of the Ugandan economy. This means that due to this constraint of access to finance, most of the SME operator tend to rely on the informal sources of funds such as family, friends, suppliers credits, customer advances as well as credit cards. Most of the commercial banks prefer to grant loans or credits to selected customers such as large enterprises and government, thus excluding the SMEs. Another problem in finance for smaller firms in Uganda is when the SME owners and managers do not have the information they need for management purposes. They sometimes hide some of the needed information by setting three sets of accounting books, one for themselves, one for taxman and the other for their ex-wives. As a result, at the end of the day they do not know where their profit centres are, therefore this is mainly because there is no good accounting system in Uganda. This means that due to the poor accounting system in Uganda, cause most of the SMEs not able to present the clear justification of the total fund needed to the financial institutions. Most of the SMEs in Uganda are privately owned or family operated business in

which they mix business and personal or family finance together, thus they do not treat business as a legal entity. When the family problem arises, such as school fees for a relative's child or in case of any emergency, inevitably the fund from the business will be used. This means that after solving the family problems, the potential future cash flows of the business tend to be interrupted. In Uganda, there are also other forms of finance such as bank overdraft to the SMEs. Through these overdrafts facilities, the SMEs have been using these facilities to purchase the fixed assets whereby this has robbed the business of much-needed working capital and led to its ultimate demise. (UNCTAD, 2002). However, in Kenya access to credit by the SMEs is still one of the major constraints, despite the emphasis which is made to increase the availability of the credits to the SMEs. A survey which was conducted in 1995 on small firms, found that up to 32.7% of the entrepreneurs mentioned that they lack capital, which is the main problem, while only 10% of the entrepreneurs had ever received loans. The main credit source in Kenya is the informal credit market, which provides easier access to credit for SMEs, rather than in the formal credit market which have the lending terms and conditions, such as collateral, application procedures as well as the repayments periods. Therefore due to these factors, most of the SMEs obtain their initial capital for starting their business as well as their operating capital from the informal sources. As a result, most of the SMEs accumulate their personal savings and use them both as initial and operating capital. For the initial capital, this was obtained through the loans form the parents, close relatives and the sale of properties, while for the operating income; the funds were obtained through the sale of properties and the supplier's credits. (Antieno, 2001)

As per the Report of the Internal Group to Review Guidelines on Credit Flow to SME sector in India (2005). It is well know that without the adequate finance, the small business cannot acquire or absorb new technologies nor can they expand their business so as to be able to compete in the global market or even strike business linkages with larger firms. This means that the most significant barriers in which the SMEs faces in India is the formal or institutional finance so as to meet their working capital need as well as their fixed capital. According to the third census of SMEs conducted in India, about 4.55% of the units (478,404 units) had obtained outstanding loans as on March 31, 2002 with institutional sources. Therefore according to this small percentage, the SMEs consequently are forced to rely on their retained earnings as well as the financial support from the family and friends so as to expand their businesses. Also Razzaque (2003), has reported that in Bangladesh, most important problems affecting SMEs is the access to finance, where SMEs need finance to

enable them undertake productive investment in order to expand their business as well as introducing new products and be able to market them. For example, in the most recent private enterprise survey, about 58% of the surveyed businesses, report the problem of lack of investment funds and approximately 35% of the surveyed businesses also report the problem of lack of funds for their business operations. Therefore financial institutions are shy to grant loans to the SMEs since they are not considered to be attractive and profitable.

Chapter 4: Barriers, Efforts made to Empower SMEs and Countermeasures to the SMEs Financing Constrains

4.1 Barriers to Financing in SMEs

According to Wang (2003), the following are the main issues regarding the constraints of the SME financing in general:

1. Financial institutions assess the SMEs as being inherently high-risk borrowers which are owing to their low capitalization and limited assets, they are vulnerable to market the fluctuations and have high mortality rates.

2. Financial institutions charge higher interest rates to SMEs than to larger companies in order to compensate for the higher costs of information collection, the smaller volume of external financing and the greater risk of failure.

3. While large firms comply to a large extent with high standards of disclosure requirements, most SMEs do not.

4. Lending to SMEs is more likely to be backed by collateral than lending to larger firms so as to reduce moral hazard and adverse selection. This may lead to situations in which the decision to extend loans is based not on expected returns but rather on access to the necessary collateral. Many SMEs lacking access to "good collateral" suffer from credit rationing.

5. In the case of new enterprises, experienced bankers or other specialized financial intermediaries can, in many cases, assess the risks involved with the activities proposed better than the relatively inexperienced SME owners. A specific disadvantage of young firms is that they cannot point to credit histories that provide important signals and help to facilitate access to debt financing.

6. The significant administrative and transactions costs associated with lending or investing small amounts do not make SME financing a profitable business for private commercial banks.

7. External financial institutions usually do not possess better information about the expected profits of established SMEs than the entrepreneurs or managers connected with those enterprises. This lack of information leads to higher market rates to compensate for risk, which may crowd out low-risk, low return borrowers, leaving a relatively greater number of high-risk, high-return borrowers in the market. Charging higher interest rates may not, however, be in the interests of the banks because low-risk borrowers, who are most likely to repay loans, are driven from the market. (Wang, 2003)

Therefore due to these constraints which are faced by the SMEs, hence many SME operators rely on their personal savings or those of their family members and friends, as well as on the leasing, factoring and their private equity, in addition to bank credits to finance their business activities.

4.2 Efforts made to empower SMEs in Tanzania

According to Calcopietro and Massawe (1999), in order to overcome the barriers facing the SMEs, a number of initiatives have been taken by government, donors as well as the NGOs. Some of which are aimed specifically at empowering the SMEs so as to stimulate the economy since they are considered to be very important in the economic development. Although in Tanzania there is still a weak supportive business environment for SMEs, whereby most of the micro-finance institutions (MFIs) cater for those firms with the low credit requirements which are below Tshs 2 million and crowd out those firms with higher credit requirements of about 3 million to 10 million. This means that the credit beyond 10 million can only be accessed by those SME with adequate collateral, even though these credits tend to be of short period and conservatively managed. In Tanzania the proper risk management system and project lending are virtually not available from the commercial banks. Also in Tanzania, the established venture capital and private equity funds are very few and only concentrate on the expansion of the established firms where by few of them paying attention to the fast-growing SMEs. Therefore the following are the main institutions and programs that constitute the current support framework of financial services to the SMEs.

4.2.1 Government Departments

The Tanzanian Government has tried to support the SMEs programmes in different areas such as areas of education, credits or loans as well as training, and it has also attempted policy and regulatory framework reforms. (UDEC, 2002). The roles of different government units in supporting SMEs are assessed and described below:

Table 10: Assessment of the Roles of Different Government Units in Supporting SMEs

GOVERNMENT DEPARTMENT	ROLE	ASSESSMENT
Ministry of Community Development, Women and Children (MCDWC)	• Administration of the Women Development Fund (micro-finance for rural women) for mainland Tanzania and Women Entrepreneurship Trust Fund (WEDTF) for Zanzibar. • Administration of the Credit for Rural Women (CREW) project.	• This fund is administered by local government at district level. It has been politicised, with politicians aspiring for office using it to gain votes. • Repayment rates are very low (in some cases, less than 30%).
Ministry of Industry and Trade (MIT)	• Responsible for policy and strategy development for micro, small and medium sized enterprises.	• MSE is just a section under the Industry Department with only 4 members of staff. • MIT does not have a focal point for women entrepreneurs.
Ministry of Justice and Constitutional Affairs (MJCA)	• Responsible for establishing and reviewing laws.	• It has no special initiative to deal with laws and regulations that discriminate against women, such as property laws. • It takes a very long time (years) to review a law.
Ministry of Regional Administration and Local Government (MRALG)	• Responsible for establishment of the legal and administrative framework for local government to operate. The Ministry is implementing the Local Government Reform Programme.	• There are no deliberate measures in place to create a better environment for women entrepreneurs in particular at the district/municipal level.

Local authorities (municipal, town and district councils)	• Responsible for issuing by-laws, licensing and in general creating a conducive environment for business.	• Most local authorities still harass MSE operators. • There is corruption and unnecessary delays in licensing MSEs. • There are no initiatives to address the special problems of women entrepreneurs

Source: UDEC, 2002

4.2.2 Donor Support

There are other related programmes that were established through Government or donor joint efforts including the Small Entrepreneurs Loan Facility (SELF), National Income Generating Programme (NIGP), Presidential Trust Fund and Community Development Trust Fund. (Ministry of Industry and Trade, Tanzania, 2002)

Most of the support from the donors to the SME sector is that, they support the policy and regulatory reforms, they provide credit facilities to the SMEs, help them in capacity building in meso-level organizations as well as subsidizing the business development services (BDS) to the SMEs. Recently The Royal Netherlands Embassy in Tanzania (RNE-TZ) has carried out a survey concerning the donor's involvement in helping the SME sector. All donors currently targeted their funds to the lowest levels of the poor, whereby women and the youth (vulnerable groups) are their main focus. As a result those who are poorer and found to be predominantly in the informal micro enterprises segment have been the main beneficiaries from these donors. (UDEC, 2002)

4.2.3 Non-Governmental Organizations (NGOs)

In the recent past, the number of institutions providing services to SMEs has mushroomed in Tanzania. The majority are in the form of NGOs, most of which offer credit to the SMEs. There is a significant number of the NGOs provide the financial services to the low income earners and the poor households in Tanzania. Therefore due to the support of the NGOs to the SME sector, none of the NGOs are subject to any regulation with respect to the financing activities they carry out. The two largest microfinance NGOs in terms of client base and outreach in Tanzania are PRIDE-Tanzania (affiliated with the Kenya- based PRIDE Africa) which uses union or group lending as its base lending methodology and the other one is

Mennonite Economic Development Association (MEDA) which utilizes the individual lending methodology in catering about 4,000 micro entrepreneurs. (Randhawa and Gallardo, 2003)

4.2.4 Formal Financial Institutions

According to Randhawa and Gallardo (2003) and Integrating Financial Services into Poverty Reduction Strategies in Tanzania (2008). In Tanzania, the principal providers of financial services to the SMEs in the rural and urban areas consist of licensed commercial banks, regional and rural unit banks as well as savings and credit cooperative societies.

- The Commercial banks available are National Microfinance Bank (NMB), Akiba Commercial Bank, CRDB Bank and Tanzania Postal Bank (TPB).

- Regional and rural unit banks are Kilimanjaro Cooperative Bank, Kagera Farmers Cooperative Bank, Mwanga Community Bank, Mufindi Community Bank, Dar es Salaam Community Bank and Mbinga Community Bank.

- Savings and Credit Cooperatives Societies: SACCOS are seen to dominate the industry especially in the rural areas. Records by Bank of Tanzania (BOT) indicate that by 2005 Tanzania have a total of 1899 microfinance institutions out of which 1635 are SACCOS.

4.2.5 Informal Financial Institutions

Lack of access to formal finance from the banks or financial institutions in rural areas has forced majority of the SME operators to resort into informal financial sources of funds. This means that in Tanzania the informal financial system continue to dominate the financial sector particularly among the poor such as Accumulated Savings and Credit Associations (ASCAS), Rotating Savings and Credit Associations (ROSCAs) or "UPATU", Credit Societies, funeral associations, families as well as friends. (Integrating Financial Services into Poverty Reduction Strategies in Tanzania, 2008)

4.3 Countermeasures to the SMEs financing constraints

According to the Stevenson and St-Onge (2005), the following are the measures to alleviate some of the challenges encountered by the SMEs in accessing credit to support the growth of

their enterprises in Tanzania. These measures are presented in three levels of intermediaries, i.e. micro financing operators, government as well as financial institutions.

4.3.1. Micro-financing

Raise ceilings on micro-finance lending limits:

Due to the low lending limits to the SMEs which is currently in place tend to undercapitalize these firms at the start up level, thus cause the performance of the SMEs to be low in terms of expansion or growth. At present, it is reported that most of the micro-finance institutions (MFIs) cater for those firms with low credit requirement of about 2 million. Therefore for those SMEs requiring a credit or loan in excess of this limit, are referred to the financial institutions having the lending policies and conditions which cannot be met by the SMEs in most cases.

Improve the level of information among SMEs regarding financing programmes and services:

A Guide to financing for SMEs should be produced and designed to disclose the important information to the SMEs on sources of financing, preparing financing proposals, terms and conditions as well as negotiating for credit. The guide should be in both languages English and Swahili and distributed widely throughout the country, so as for all SMEs to be aware of any information available concerning the financing services.

4.3.2. Government policy

The Government should implement the SME loan guarantee programme proposed in the SME Development Policy. This is because the loan guarantee fund would serve to reduce the risk to banks in cases of limited collateral, often the situation facing SMEs. The Government should also undertake dialogue with lending institutions on SME access to credit with a view to making more credit available to the SME sector. Moreover the government should also examine the take-up of government financial assistance to female versus male-owned enterprises and take steps to address any gaps.

4.3.3. Financial institutions

Develop financing programmes tailored to the needs of growth firms; where SMEs require different levels of financing interventions at various periods during the growth of their businesses, such as receivables financing, working capital loans and quasi-equity products.

Apart from developing financing programmes, a reserve for SMEs can be established, i.e. financial institutions should set a corporate portfolio targets and establish individual account manager loan writing objectives for SMEs. The financial institutions should also be more proactive in developing the SMEs market to ensure that the marketing materials are sensitive. Seek opportunities to partner in firm-focused initiatives. They should also help SMEs develop business plans for bank financing and negotiate better. The onus is not only on lending institutions; firms also have to be oriented in the art of dealing with banks and packaging their loan requests for financing. SMEs need to learn how to approach and negotiate with financial institutions, know the lender's information requirements and how to prepare financing project proposals.

Chapter 5: Conclusions and Recommendations

5.1 Conclusion

Many studies have shown that most of the SMEs lack access to finance for starting, operating and expanding their businesses, therefore access to finance is always quoted as a major constraint for all SMEs and can seriously affect their ability to survive, upgrade the technology in their business, increase their capacity and even in many cases, expand their market, improve management system or increase productivity as well as profitability.

The study has shown that most of the SMEs suffer from inadequate control and poor planning. This means that the SMEs did not have any long-term business plans and they were just focusing on the near future. Also the majority of the people enter into the business due to lack of adequate education and difficulty of finding employment from the public sectors or a formal employment. The study shows that most of the people enter into SME sector because they do not have adequate education, thus it is difficult for them to find alternative paid job. This implies that SMEs are seemed to be the last resort to the majority due to the above reasons. The study also shows that most of the financial institutions' policies and lending requirements are not firm friendly in a way that would facilitate SMEs in obtaining credit easily and sufficiently. Furthermore the banking services to SMEs are limited; most of the commercial banks are not geared to service the SMEs, particularly the private ones, due to perception of a high risk of business failure. Other banks have limited coverage and limited financial products and thus depend heavily on collateral. On the credit guarantee schemes which aim to share the risks with the financial institutions so that the lenders will be compensated for all or part of the loss on loan defaulters. Therefore the schemes are intended to assist those firms which have sound viable projects but cannot offer satisfactory collateral to meet the bank requirements in order to obtain a loan. The experience shows that the guarantee schemes are poorly performing in terms of repayment, this means that the guarantee system must be designed and implemented so that claims can be made and settled against any default which may arise without bureaucracy or delay in payment.

5.2 Recommendation

The purpose of this study is to find ways that will increase the understanding of how SMEs can change their characteristics or their behaviour and be able to the access to finance easily and sufficiently without any constraints. Therefore there are several important recommendations emerge from this study. First of all, improving their business conditions,

this means that proper financial records should be kept and clear accounting standards should be adopted, setting up independent, competent and reputable accounting firms and creating more credit bureaux supplying data on the solvency or insolvency of the firms. Furthermore an impartial legal system, commercial law reforms and bankruptcy procedures that can help settle disputes are very important for growth of the SME sector. The use of credit guarantee is also another important recommendation in improving the business condition of the SME. This means that credit guarantee may help to increase bank lending for SMEs if the financial sector as a whole and banking institution are in a sound state to use such schemes properly. Therefore credit guarantees schemes can only solve the problem of lack of suitable collateral on the part of SME borrower with potential business projects. Second, SMEs should be assisted in meeting the requirements of the formal financing. This can be done by removing the barriers to access finance for the SMEs which requires the micro-credit institutions, commercial banks, community groups and business development bank work closely together so as to help SMEs obtaining credit according to the need of their businesses. Third, increasing the supply of finance through the non-financial private sector. This means that wealthy firms or big firms can also help the SMEs in obtaining finance and not necessarily the financial institutions. This can be practiced by transferring the resources such as money or factors of production and guaranteeing SME solvency with the financial institutions in case they want credit. The links with these major companies can also help the SMEs get credit from other suppliers such as trade credit since the commercial partner or major companies are better informed than other creditors (financial institutions) about the capacity of the firms to repay the loans.

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