Role of small and medium enterprises in tanzania

INTRODUCTION

It is now increasingly recognised that the Small and Medium Enterprises (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 evenutilities are not as demanding as it is the case for large enterprises. These enterprises can also be established in rural settings and thus add value to the agro products and at the same time facilitate the dispersal of enterprises. Indeed SMEs development is closely associated with more equitable distribution of income and thus important as regards poverty alleviation. At the same time, SMEs serve as a training ground for emerging entrepreneu (SME Policy, 2002).

Empirical studies find that the share of SMEs in GDP is significantly increasing in tanzania with average of 16%a and 18%. This reveals the importance of SME growth and employment generation. However, prevalence of credit market failure is an important constraint on the growth of SMEs. Since the closure rate of SMEs is higher than larger enterprises, the financial service providers tend to consider SME financing risky (Caves, 1998). Much as like in microfinance, SME financing also requires innovations in lending technology that could reduce the risk to the lender in ways that does not increase the overall transaction cost to the entrepreneur. With the aim of generating employment opportunities through SME growth, Akiba Commercial bank of Tanzania launched a special SME lending scheme in 2002. Akiba commercial bank is a private bank in which local ownership is 66% and foreign ownership is 36%.

As one of the core objectives of Akiba commercial Bank's SME lending is to support SME growth and employment generation. Research and Development Department of Akiba Commercial Bank was asked to carry out a research to assess the extent of SME growth before and after financing. The following section of the essay presents a brief review of SMEs growth, SME financing, SME and post loan changes and the loan disbursed size to determine contribution of microfinance on SME growth.

SMEs growth in Tanzania

The SMEs term inTanzania is used to mean micro, small and medium enterprises. It is

sometimes referred to as micro, small and medium enterprises (MSMEs). The SMEs cover non-farm economic activities mainly manufacturing, mining, commerce and services. There is no universally accepted definition of SME. Different countries use various measures of size depending on their level of development. The commonly used yardsticks are total number of employees, total investment and sales turnover. In the context of Tanzania, micro enterprises are those engaging up to 4 people, in most cases family members or employing capital amounting up to Tshs. 5. 0 million. The majority of micro enterprises fall under the informal sector. 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. This is illustrated in

the table below (SME policy, 2002)

CATEGORIES OF SMEs IN TANZANIA

Category	**Employees**	**Capital Investment in Machinery (Tshs.)**
Micro enterprise	1 – 4	Up to 5 mil.
Small enterprise	5 – 49	Above 5 mil. to 200 mil.
Medium enterprise	50 – 99	Above 200mil. to 800 mil.

Large enterprise

100 +

Above 800 mil.

SME growth means increase in size or improvement of the business development process. Various indicators both qualitative and quantitative are used to measure SME growth. They include;

-outcome indicators-profit

-output indicators-e. g sales volume, number of employee etc

-capacity based indicator-value of assets, capital invested

-Qualitative indicators-structure, management practice, degree of formalization etc

Therefore the measure of SME growth as result of microfinancing is done using above indictors as outlined in assessment below. However the objective of this essay is to explore on whether microfinancing to SMEs will contribute to growth for them.

Microfinancing SMEs in Tanzania:

It is a common understanding that SMEs in Tanzania are being, to some extent, excluded from the targeted clientele of both the formal and semi-formal sectors (e. g. Ahmed, 1999; Meagher, 1998). However, this is not a unique phenomenon particular to Tanzania. A large survey in 80 countries by Schiffer and Weder (2001) revealed that financing is the foremost obstacle for SMEs growth followed by taxes, regulation and inflation. Various factors are considered to be the hindrace for SMEs to be financed. They include lack of access to banking services due to unavailabity of identity document, birth certificates, proof of residence, education and distance and lack of transport infrastructure. Also there is lack of access to credit due to lack of collateral, education and lack of transaction history. Among the factors the major one is the lack of innovation by bankers and regulators.

Most SME ventures in Tanzania depend on personal savings, family or other informal credit sources. A few of the more established MFIs (Microfinance Institutions e. g SACCOS) are scaling up to tap this market. The main microfinance institutions can be categorized as non governmental organizations (NGOs), Cooperative based institutions namely SACCOS and SACCAs while the third category is banks. The major players in the NGOs category include PRIDE Tanzania, FINCA (Tanzania), Small Enterprise Development Agency (SEDA) and Presidential Trust for Self-Reliance (PTF). Others, which are relatively smaller in size, include Small Industries Development Organization (SIDO), YOSEFO, SELFINA, Tanzania Gatsby Trust, Poverty Africa and the Zanzibar based Women Development Trust Fund and Mfuko. There rest consists of very tiny programmes scattered throughout the country mainly in the form of community based organizations (CBOs). Banks that are actively involved in microfinance services delivery include the National Microfinance Bank (NMB), CRDB bank, Akiba Commercial Bank (ACB) and a few Community/regional banks namely, Dar es Salaam Community Bank, Mwanga Community Bank, Mufindi Community bank, Kilimanjaro Cooperative Bank, Mbinga Community Bank and Kagera Cooperative Ban

It is estimated that all the MFIs in Tanzania put together serve a combined client population of about 400, 000 SMEs, which is only around 5% of the total estimated demand. Commercial banks including community banks account for around 50, 000 while the NGO category accounts for the an estimated population of 220, 000 clients. PRIDE Tanzania being the largest single player accounts for about 29% of the market share in this category or 16% of the existing total market share.

Delivery systems of financial products

Almost all micro-finance institutions (MFIs) provide credit services. Some others also provide financial products such as savings, transfer payments and insurance. Some institutions like FINCA are in the process of developing a new product: micro-leasing. Since credit is the most common service, most of the delivery methods have been developed around credit. Savings and other products are relatively few and there has been less innovation on how to deliver these services. The following are common delivery methods.

Group Lending

This methodology is commonly used by most MFIs. Credit is delivered to groups that guarantee the loan. Peer pressure is used to enforce repayment. The loan can be disbursed to either an individual member of the group or to the group, which in turn provide loans to individual members.

Individual Lending

Under the methodology, credit is delivered to individuals according to their ability to provide the MFI with the assurance of repayment and some level of security.

Constraints and challenges facing the micro-finance industry in Tanzania

The constraints faced by the micro-finance industry in Tanzania include:

Ÿ Poor leadership and governance structures;

Ÿ Lack of operating systems, other than for loans i. e. accounting, internal controls;

Ÿ Lack of effective policies and operating procedures;

Ÿ Lack of qualified personnel to handle technical issues such as the appropriate investments of financial resources;

Ÿ Poor/low capital base;

Ÿ Poor infrastructure especially in the rural areas;

Ÿ Declining donor support;

Despite these constraints, the prospects are good for the following reasons:

Ÿ Government recognition and support of the micro-finance sector;

Ÿ The operationalization of the National Micro-finance Policy;

Ÿ The existence of a large portion of unmet demand;

Ÿ Entrance of commercial banks with innovative products and delivery methods such as CRDB Bank and Akiba Commercial Bank;

Ÿ Emphasis on the development of the rural infrastructure, i. e. under the Highly Indebted Poor Countries Initiative of the World Bank and the IMF.

That notwithstanding, the sector is faced with some challenges including:-

Ÿ Reaching the poorer communities;

Ÿ Balancing objectives of poverty alleviation and that of achieving sustainability;

Ÿ Provision of appropriate products to different categories of clients;

Ÿ Sources of capital since most of them are currently donor dependent.

Ÿ Improvement of the rural infrastructure to facilitate easy accessibility to remote areas;. The country is big and unfortunately and resources are limited;

Ÿ Capacities building as most of the MFIs are poorly managed. Capacity building in management and technical aspects is necessary to push the industry ahead;

Ÿ Creation of other incentives for private sector investment into the sector, i. e. tax treatment;

Ÿ Public education to facilitate a change of attitude

With the aim of fostering growth and to seize the opportunities of the unserved market various financial instutions are coming up with innovative lending approaches to tap the SMEs microfinancing needs. One of the approaches designed by one of them is explored hereunder and growth motives to SMEs is analysed;

Akiba commercial bank approach.

In pursuit of this goal, AKIBA pioneered many types of savings and microfinance

loan products, with which it has supported various micro enterprise activities such

as food vending, fish mongering, groceries, mitumbas (sale of second hand clothes),

small scale diary cattle keeping, retail and distribution, tailoring, carpentry, masonry

works, internet cafes, stationery shops, secretarial services, barber shops, hair salons,

and small scale agriculture etc

LOAN PRODUCTS

AKIBA currently offers several microfinance loan products each tailor-made to suit

every type of our customer. In broad terms, the features revolve around both the traditional group and individual loan methodologies. Besides these, and by virtue of

being a full-fledged commercial bank, it also able to offer consumer lending and

corporate loans and overdrafts.

Group micro loans

Under this scheme, customers are able to borrow as little as TZS 20, 000 and as much

as TZS 5 million with no tangible securities other than their savings and the

guarantees that members of the group give to each other. The total portfolio size

currently stands at TZS 800 million. Total of 4000 customers have been served under this approach.

Individual micro loans

This is the product that serves many micro entrepreneurs in this

country. Since its launch May 2001 in one branch, it has grown at a faster pace than

any other loan product over the past two years, from just above 700 active loans in

December 2001 to 4500 today. Out of the current outstanding total loans and advances portfolio of TZS 18 billion, TZS 4 billion is made up of individual

microfinance loans. AKIBA s individual micro loan is characterized by quick turn

around time and flexible loan terms more flexible than any of the products offered by

its direct competitors. The minimum loan amount is TZS 200, 000 and the maximum

currently stands at TZS 10 million. Beyond this, customers graduate to SME loans

and further to corporate loans and overdrafts depending on their working capital

requirements.

Consumer Loans

As with the individual micro finance lending, AKIBA was the pioneer of consumer

lending in Tanzania having introduced the product in December 2000. It was little

wonder that the portfolio and the total asset base of the bank grew very rapidly during

the early days of its launching. Competition has however since set in with all the mainstream banks now aggressively offering salary based loan products similar to

AKIBA s. In spite of this, and because of our constant innovations, flexibility, and

good market intelligence, rather than lose our market share, the number of borrowers

have continued to grow from 1200 in 2002, to 4300 today borrowing just over TZS 7

billion.

SME and post loan changes

In this section general profile is provided for the sample of enterprises that were provided credit by Akiba commercial bank in terms of some key variables and the post loan changes in these variables. Also the uses of the loans and how these have affected the enterprises is discussed.

Sectoral composition:

Sectoral composition of Akiba Commercial bank borrowers of the sample shows the high extent of concentration of Akiba Commercial Bank on traders (retail and wholesale). No clear pattern is visible among the different categories of borrowers, i. e. new, repeat and dropout, in their sectors of business except for a slightly higher share of manufacturing among the repeat borrowers than new , with which it has supported various micro enterprise activities such as food vending, fish mongering, groceries, mitumbas (sale of second hand clothes), small scale diary cattle keeping, retail and distribution, tailoring, carpentry, masonry

works, internet cafes, stationery shops, secretarial services, barber shops, hair salons,

and small scale agriculture etc

Business experience of entrepreneurs:

Akiba Commercial Bank SME borrowers have a fair degree of experience in their respective businesses. Majority of the borrowers are involved in the business for more than 10 years. This conforms to the fact that the Akiba commercial bank look for customers with some amount of experience. Though majority of the borrowers took SME credit for the 7 business already about 9 years old, some 17 percent of the borrowers received credit for the businesses they had been doing for not more than 3 years. This suggests that Akiba Comercial Bank is providing credit facility to new entrants on selective basis, because entry and exit in trading is relatively high. Average age of manufacturing units is significantly lower than trading units among the SME borrowers. Though these figures of years give the idea of length of operation of the businesses, the experience of the entrepreneurs might be higher. In fact, 30 percent of the borrowers have previous business experience of same sort or other. Not surprisingly, probability of having previous business experience in other enterprises is higher for those entrepreneurs who have been granted credit for relatively newly established enterprises compared to others. This suggests bias against start ups which is a common feature in SME lending. According to ownership pattern of the ventures, two third of the enterprises are proprietorships while the rest are family business.

Capital portfolio:

Personal and family savings account for more than three quarter of the capital in the surveyed SMEs. It is not surprising that enterprises with higher capital were granted larger amounts of loan1. It is interesting to note that before loans, the size of average capital was almost the same for trade, service and manufacturing sectors. Enterprises in trading sector have managed to increase the size of their capital, more rapidly than enterprises in other sectors. Only 3. 4 percent of all the enterprises reported capital erosion and over 40 percent managed to more than double their capital after taking loan. There is no clear difference among the three groups of enterprises. However, it is important to note that this increase in capital may not solely be driven by the SME loan. In the words of a client, “ SME loan only adds momentum to already expanding business.” On average, SME loans constitute 37 percent of the total capital of the borrowers. These figures for the new and repeat borrowers are 31 and 44 percent respectively.

Value of the business:

Average value of the businesses, measured by the amount for which the entrepreneur can sell the business, was Tsh 1. 84 million before taking loan. Presently, the average value of the business of these enterprises is Tsh 2. 49 million. Increase in value of enterprises has been higher for repeat borrowers than new borrowers, as expected, since they are operating for longer durations. However, value of enterprises of the dropout clients has also increased and their initial values were higher than others. Figures of average growth in values by types of enterprises show that manufacturing units have observed the highest growth and agro processing firms grew at the least pace. However, SME loan is not the only factor behind this growth of business. After all, SME loan constitutes only 24 percent of working capital on average.

Sales volume:

Average yearly gross sales of the new, repeat and dropouts were Tsh 4. 29, 5. 61 and Tsh 6. 47 million before taking loan. Since Akiba Commercial Bank is providing much needed working capital to these enterprises, volumes of sales have increased for almost every borrower. On average, present sales of these enterprises are respectively 40, 67 and 26 percent higher compared to pre-loan period.

Breakdown of expenses:

Since most of the enterprises are involved in trading, it is not surprising that cost of goods purchased as raw materials or for sale accounts for more than 90 percent of their expenditure. Wage payments came out as the second major expense. Rents, power and utilities, and other operating expenses constitute the rest. A prevalent idea about business in Bangladesh is that informal and contingency payments in terms of extortion and bribes are rampant. However, over 95 percent of the enterprises reported that they do not have to pay any sum under this heading. Although there are no significant differences between the enterprises that incur these expenses and those that do not in our sample, discussions with clients suggest that these expenses are prevalent only for larger enterprises.

Salary payment:

Wage bill reflects, to some extent, the labour intensity of a business organization. When a particular business firm expands, it is expected that its wage bill will also increase. On average, annual expenses in salaries and wages increased by Tk 16, 000 for the sample enterprises after taking SME loan. Since the volume of trade has also increased during this period, share of wage in total expenses have not increased. For the enterprises under consideration, wage constituted 4. 89 percent of their total expenses at pre-loan period. However, comparable present figure has declined marginally to 4. 63 percent. This signifies that wage bill increased at lower rate than their total expenditure. 55 percent of all the enterprises are spending same the amount as wage bill presently as they used to do before loan. However, about a quarter of these enterprises managed to increase their gross sales by at least one third. This indicates that there was some extent of underemployment in these enterprises and SME loan helped them, at least partly, to utilize this surplus labour.

Present loan size and future credit plans

Average size of the last loans of the repeat borrowers is understandably higher than that of the new borrowers and dropouts. On average, loan granted is about 85 percent of amount demanded by the borrowers, with enterprises in the service and trading sectors receiving relatively more (87-88% of amount requested) compared to those in manufacturing and agro processing sectors (82-83%). 80 percent of the total respondents (including dropouts) expressed their interest in taking future loans from Akiba commercial Bank. 17 percent of the existing borrowers, both new and repeat, are not keen about future loans. About 70 percent of the dropouts are still considering potential loans from Akiba Commercial bank. A fair level of eagerness among the dropouts indicates that they have not dropped out voluntarily. However, the fact remains that currently they have no outstanding loans with Akiba commercialBank. 23 percent of the dropouts claimed that they were refused repeat loans, 34 percent discontinued due to high interest rates, 13 percent switched to other banks/NGOs and 12 percent did not need further financing. In terms of growth plan, both new borrowers and dropouts are expecting bigger jumps in loan sizes compared to repeat borrowers. Repeat borrowers have, perhaps, adjusted their expectations from experience. Majority of new clients and dropouts would like to get their next loan increased by two thirds. It is interesting to note that fifty percent of the clients, who are considering next loans, think that they would have to apply for a greater amount of loan to get their desired size of loans. It was found that previous experience with amount applied for and amount granted is associated with their strategy of future application. The ratio of amount demanded and realized in the prior cycle is positively correlated with the ratio of future cycle plans.

Uses and impact of loan

SME enterprises in Tanzania chiefly require financing for three purposes – for start-up, for working capital, and for fixed capital. Unavailability of working capital from formal financial institutions is recognized as one of the major complaints of SMEs in Tanzania. The single most important use of Akiba Commercial bank SME loans is in the form of working capital. 89 percent of the clients reported that they used their loan for increasing working capital. Although the loan is used less for investment in fixed capital, discussions with clients revealed a demand for financing fixed investments, which will typically require a gestation period before the investment generates enough cash flow for repayment. According to the SME borrowers, given that the Akiba Commercial Bank installment scheme is not suitable for fixed capital investment, almost all of it is used for working capital. In increasingly competitive markets, SMEs are under pressure to grow and diversify in order to hold on to their share of the market. One client drew a comparison between his enterprise with a balloon saying that after receiving loan from akiba commercial Bank, his business expands like a balloon, but eventually shrinks down to its original size by the end of the loan tenure. Other uses of loan included buying vehicles, repairing shops, building houses and repaying previous loans.

When asked about the positive impacts of the loan on their businesses, clients in the SME loans came up with a list of areas. In order of importance, these were increased working capital, cash purchase, profits, sales, diversification of goods and services. Moreover, clients claimed that increased transactions facilitated by the loans have improved their status in the business community.

Clients claim that increased working capital has direct impact on the volume of sales. They are able to increase stocks and varieties and benefit from availing market opportunities. Many retailers expand business by starting up wholesale transactions. Transactions in credit are also facilitated due to the availability of cash. This allows entrepreneurs to purchase raw materials and goods for sale at lower prices, and also improve their relations with their buyers by offering sales on credit. Expansion of business and cash purchasing increases their status as businessmen, which facilitates future business deals. Interestingly, none of the clients mentioned having recruited new employees as an important impact of the loans. According to them, the labour hours is increased only by the entrepreneur himself, as he feels extra pressure for repaying the loan on time. As part of an exercise, clients were asked to rank the eight listed effects by order of importance. Increased efforts from the entrepreneur turned out to be the most important effect of the loan in almost all cases. Clients felt that they would not be putting in so much effort if they hadn’t taken the loan.

CONCLUSION:

Innovations in addressing the credit market failures faced by poor households through microfinance have been a major development breakthrough of recent times. Micro and small enterprises have been shown in several studies to be largely underserved, giving rise to the term ‘ missing middle’ in the literature. Yet, this is a critical market segment to support for both growth and poverty alleviation through employment generation. As a response to this demand and supply side changes in the traditional microfinance market, which has become significantly more ‘ crowded’ in recent times, many microfinance providers in Tanzania have started providing enterprise finance targeted at the small enterprises. Some formal banks have also started operating in this market. Akiba commercial bank established in 2001 with a view to support small and medium enterprises and since 2002 has been providing small and medium enterprises credit. This paper is an early assessment of Akiba microfinance institutions lending to small and medium enterprises with respect to foster growth.

A fairly comprehensive method was employed in order to capture the full extent of SME growth by breaking down enterprises into three groups – manufacturing, trading and agroprocessing employment. Percentage of enterprises graduating from microfinance into small enterprises increased by 20% in average but in varied percentage between manufacturing, trading and agro processing enterprises. Trading is significantly higher than that of manufacturing and agroprocessing. It is noteworthy that more than fifty percent of the new jobs are created by increased enterprises as result of borrowing. Thus the importance of sustained access to finance appears to be important from growth perspective of SMEs.

However growth of SME is not necessarily a function of microfinance other variable such as availability of market, government regulations, education and inflation could equally affect thegrowth of SMEs.

Financing SMEs as a core business is still relatively new for formal financial providers in Tanzania. This is fundamentally different to microfinance, which is essentially providing households with better money management facilities (Rutherford, 2001). Akiba commercial bank’s SME financing has quickly become its core product line and our analysis suggests that it is successfully financing growth of the SMEs supported, which in turn is generating employment. However, the product characteristics still appear to be more suitable for financing growth of relatively established trading based enterprises. Most of the investment being made is also in terms of increasing working capital. Future challenges of Akiba commercial bank SME lending operations would be to develop the right types of products to lend to manufacturing enterprises, and supporting fixed capital investments of SMEs. Such diversification would have greater potential of supporting growth and generating sustainable employment opportunities.