

Constraints of Accessing Debt Financing from Commercial Banks among Small and Medium Enterprises in Tanzania: A Literature Review

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Abstract

Elsewhere in the world including Tanzania, Small and Medium Enterprises (SMEs) have been constrained with difficulties to access debt finance from commercial banks (CBs). This paper examines the critical constraints facing SMEs to access debt finance from FIs in Tanzania. Variables such as lack of collateral, low value of collateral, high interest rate, unavailability of loan information, low risk taking propensity, poor saving habits, bureaucratic loan procedures, business informality, poor repayment habits and corruption among CBs' employees were measured using quantitative approach. Twelve (12) up-to-date related literatures (2011-2015) were intensively reviewed to extract the constraints which appear most frequently. Percentages and frequencies of ten (10) studied variables were computed and presented using a table and bar chart. The findings indicate that lack of collateral, low value of collateral, low risk-taking propensity, poor saving habits and high interest rates are significant constraints for ease access of debt finance from CBs. The study recommends that such challenges need to be curbed by policy makers by harmonizing lending schemes of all CBs and re-engineering training programmes in order to enable SMEs to access credit.

Key Words: *Debt Financing, Small and Medium Enterprises, Commercial Banks, Challenges, Tanzania*

1. Introduction

The role of SMEs in the development process continues to be in the forefront of policy debates not only in developing countries but also in developed countries. The potential of SMEs in promoting economic growth and poverty alleviation elsewhere in the world is widely recognized and documented by both academicians and policy makers. In Tanzania, small and medium enterprises (MSMEs) is used to mean micro, small and medium enterprises engaging up to four people or employing a capital of up to TZS five million, between five and 49 employees or with a capital from TZS 5 to TZS 200 million and between 50 and 99 employees or with a capital from TZS 200 to TZS 800 million respectively (URT, 2003). In Tanzania, it is estimated that about 2.75 million MSME owners own and manage about 3.16 million MSMEs and the sector is estimated to contribute TZS 6.9 Trillion or about 27% of the country's GDP (Mashenene and Rumanyika, 2014; URT, 2012).

Elsewhere in the world including Tanzania, SMEs have been constrained with difficulties to access debt finance from CBs (Mashenene and Rumanyika, 2014; Mashenene *et al.*, 2014^b; URT, 2012). Most SME owners (91%) raise their own start-up capital compared to only 9% who take a loan to start the businesses (URT, 2012). Accordingly, the same study argues that those who take loans mostly rely on family and friends (39%), microfinance institutions (MFIs) (26%), SACCOs (13%) but very few take loans from CBs (10%). The small proportion of borrowers who take loans from CBs poses a question of interest which needs investigation. Most of the previous studies regarding to debt financing have tended to group together the constraints regarding debt financing whether from MFIs or CBs (Mashenene and Rumanyika, 2014; Mashenene *et al.*, 2014^a; Maziku *et al.*, 2014; Mashenene *et al.*, 2014^b). In reality, the conditions and requirements for debt financing from MFIs and CBs differ markedly. This study intends to assess the constraints facing SMEs when accessing debt financing from CBs in Tanzania.

2. Literature Review

2.1 Theoretical Perspective

2.1.1 Resource-based Perspectives (RBP)

RBP emphasizes the role of resources that the firm owns, acquires or develops. RBP differ according to whether the resources being referred to belong to the entrepreneur or the firm. According to this view, competitive advantages (and hence growth) emerges through resource accumulation and deployment, leading to idiosyncratic endowments of proprietary assets. Success is seen to stem from unique, valuable, not easily purchased, stolen, imitated or substituted resources. Such assets can include unique technology, products, brands, markets or business networks (Majenga, 2013). The relevance of RBP to the current study is that

SMEs should be enabled to access debt financing from CBs in order to achieve their goals through growing working capital and grabbing emerging investment opportunities.

2.2 Empirical Literature Review

2.2.1 Constraints of Accessing Debt Financing from Money Lenders

Worldwide, business inadequate capital has been noted to be the stumbling blocks of potential growth of SMEs (Mashenene and Rumanyika, 2014). Kwaning *et al.* (2015) in Ghana identified the following constraints encountered by SMEs in accessing credit from CBs in Ghana, high interest rates on loans, short repayment periods, poor understanding of interest calculations, inability to meet the loan approval criteria/bank requirements and default payment loans. The same paper points out difficulties faced by banks in providing loans to SMEs, history of high default rate, false information's about business, poor record keeping, use of loans obtained for unintended purposes, uninsured collateral, collateral with no names of the business bearer and false documents of collateral.

2.2.2 Studies from Tanzania Addressing Constraints of Accessing Debt Financing from CBs

In order to measure the constraints facing SMEs in accessing debt financing from CBs in Tanzania, the following previous studies (**Table 1**) were reviewed and from which the variables for the study were extracted and measured.

Table 1: Selected Previous Studies in Tanzania and Major Findings

Author(s) and Title	Major Findings
Maziku, M. (2012): Credit Rationing for Small and Medium Scale Enterprises in Commercial Bank Loan Market	(i) lack of collateral, (ii) unregistered collateral, (iii) geographical distance between collateral location and business location, (iv) use of third part collateral, (v) inadequate collateral and type of collateral, (vi) reluctance of CBs to accept movable property as collateral, (vii) lack of track record, (viii) lack of credit history, (ix) poor cash flow
Mashenene, R. G., Macha, J. G. L., and Donge, L: Socio-Cultural Determinants and Enterprise Financial Sources among the Chagga and Sukuma Small and Medium Enterprises in Tanzania	(i) high interest rates, (ii) low risk-taking propensity, (iii) poor saving habits, (IV) lack of collateral, (iv) low value of collateral, (iv) lack of adequate of loan information
URT (2012): National Baseline Survey Report. Micro, Small and Medium Enterprises in Tanzania	i) Poor saving habits, (ii) poor usage of financial services, (iii) high cost of credit, (iv) corruption
Petro Maziku, Annastazia Majenga and Robert Galan Mashenene (2014): The Effects of Socio-Cultural Factors on the Performance of Women SMEs in Tanzania	i) low risk-taking propensity, (ii) poor saving habits, (iii) high interest rates, (iv) unregistered collateral, (v) unavailability of business information, (vi) lack of collateral, (vii) business informality
Robert Galan Mashenene, Joyce G. Lyimo Macha and Leo Donge (2014): Socio-Cultural Determinants of Entrepreneurial Capabilities among the Chagga and Sukuma SMEs in Tanzania	i) low risk-taking propensity, (ii) poor saving habits, (iii) high interest rates
Kira, A. R. (2013). The Evaluation of the Factors Influence the Access to Debt Financing by Tanzanian SMEs	(i) firm location, (ii) size, (iii) age, (iv) incorporation, (v) availability of collateral, (vi) availability of business information
Majenga, A. and Mashenene, R.G. (2014): Socio-Cultural Factors and Financial Performance among Women Small and Medium Enterprises in Tanzania	(i) poor loan information, (ii) poor saving habits, (iii) low risk-taking propensity, (iv) unregistered collateral, (v) lack of collateral, (vi) high interest rate, (vii) bureaucratic loan procedures, (viii) business informality, (ix) poor repayment habits, (x0) corruption among CBs' employees

Calice, P., Chando, V. M., and Sekioua, S. (2012). Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia.	(i) Unavailability of reliable information provided by SMEs, (ii) high interest rates, (iii) lack of third-party guarantees
Hawa Petro Tundui (2012): Gender and Small Business Growth in Tanzania: The Role of Habitus	(i) lack of collateral, (ii) cumbersome loan procedures, (iii) high interest rate, (iv) inability to write business plan
Patricia Lindelwa Makoni (2014): Finance and firm characteristics in Tanzania	Lack of assets to put up as collateral
Martijn Boermans and Daan Willebrands (2012): Financial constraints, risk taking and firm performance: Recent evidence from microfinance clients in Tanzania	Somewhat unlikely to take risk
Atsede Woldie and John Isaac Mwitwa (2012): Challenges of Microfinance Accessibility by SMEs in Tanzania	i) lack of collateral, ii) high transaction costs

Source: Literature Review (2015)

3. Research Methodology

3.1 Research Methodology

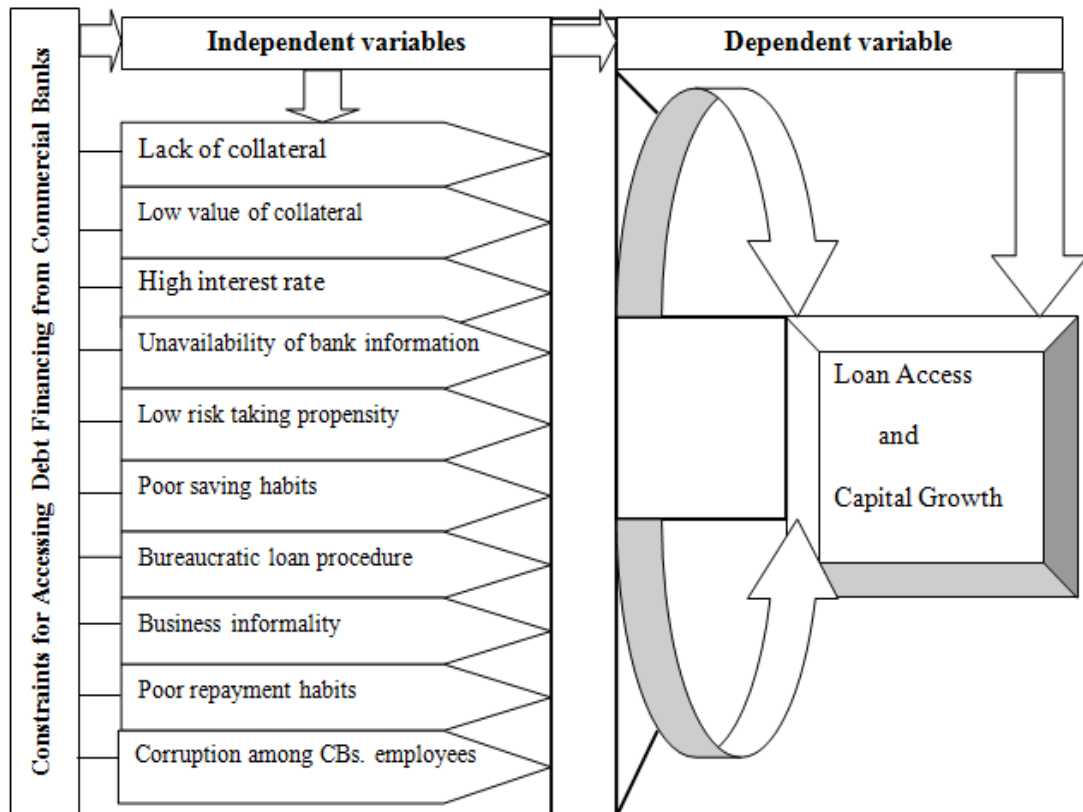
This paper uses a quantitative approach in which descriptive analysis was adopted. An intensive literature review was conducted in order to extract the most frequent identified constraints facing SMEs when accessing debt financing from CBs in Tanzania. Constraints of the study were extracted from twelve (12) selected literatures in Tanzania in which the selection of these literatures was based on their relevance to the topic under study and timeliness in which the literature was restricted within 5 current years (2011-2015). A sample size of 12 literatures was viewed adequate for statistical analysis since Mohammed *et al.* (2013) used a sample of 12 literatures to draw up the conclusion. From the literatures, ten (10) variables were identified and analyzed descriptively in which frequencies and percentages were computed and tabulated. The choice of 10 variables for analysis was due to the facts that Rumanyika (2015), Mashenene and Rumanyika, 2014; and Mohammed *et al.* (2013) used 10 variables for statistical analysis. These variables are (i) lack of collateral, (ii) low value of collateral, (iii) high interest rate, (iv) unavailability of loan information, (v) low risk taking propensity, (vi) poor saving habits, (vii) bureaucratic loan procedures, (viii) business informality, (ix) poor repayment habits and (x) corruption among CBs' employees. In this study, the decision for the constraints to be critical was limited to only variables with scores at least 50% (Rumanyika, 2015; Mohammed *et al.*, 2013).

3.2 Conceptual Framework

Based on the literature review several constraints affecting the potential growth of SMEs in Tanzania were identified. The constraints for this study are as follows: The dependent variable for this paper is the access to debt financing from CBs in Tanzania. It is expected in this study that dependent variable is affected by independent variables (lack of collateral, low value of collateral, high interest rate, unavailability of loan information, low risk-taking

propensity, poor saving habits, bureaucratic loan procedures, business informality, poor repayment habits and corruption among CBs' employees).

Figure 1: Conceptual Framework



3.3 Hypotheses

Based on the theoretical conceptual framework, the relationship between business constraints and potential growth of SMEs can be hypothesized as follows:

H₁: There is a negative relationship between lack of collateral and access to debt financing from CBs.

H₂: There is a negative relationship between low value of collateral and access to debt financing from CBs.

H₃: There is a negative relationship between high interest rate and access to debt financing from CBs.

H₄: There is a negative relationship between unavailability of loan information and access to debt financing from CBs.

H₅: There is a negative relationship between low risk-taking propensity and access to debt financing from CBs.

H₆: There is a negative relationship between poor saving habits and access to debt financing from CBs.

H₇: There is a negative relationship between bureaucratic loan procedures and access to debt financing from CBs.

H₈: There is a negative relationship between business informality and access to debt financing from CBs.

H₉: There is a negative relationship between poor repayment habits and access to debt financing from CBs.

H₁₀: There is a negative relationship between corruption among CBs' employees and access to debt financing from CBs.

4. Findings and Discussions

Based on the intensive literature review carried out, the most extracted constraints are presented in **Table 2**. The sign (√) indicates that the variables have been identified to be the critical constraints in the articles reviewed in this study.

Table 2: Constraints Affecting Debt Financing from CBs among SMEs in Tanzania

Article/Researcher	[1] LC	[2] LVC	[3] HIR	[4] ULI	[5] LRP	[6] PSH	[7] BLP	[8] BI	[9] PRH	[10] COR
Maziku, M. (2012)	√	√				√		√		
Mashenene, R. G., Macha, J. G. L., and Donge, L. (2014)	√	√	√	√	√	√				
URT (2012)			√		√	√				√
Petro Maziku, Annastazia Majenga and Robert Galan Mashenene (2014)	√	√	√	√	√	√		√		
Robert Galan Mashenene, Joyce G. Lyimo Macha and Leo Donge (2014)		√	√	√	√	√				
Kira, A. R. (2013)	√			√						
Majenga, A. and Mashenene, R.G. (2014)	√	√	√	√	√	√	√	√	√	√
Calice, P., Chando, V. M., and Sekioua, S. (2012)		√	√	√						
Hawa Petro Tundui (2012)	√		√		√		√			
Patricia Lindelwa Makoni (2014)	√									
Martijn Boermans and Daan Willebrands (2012)					√					
Atsede Woldie and John Isaac Mwita (2012)	√		√							

Source: Literature Review (2015)

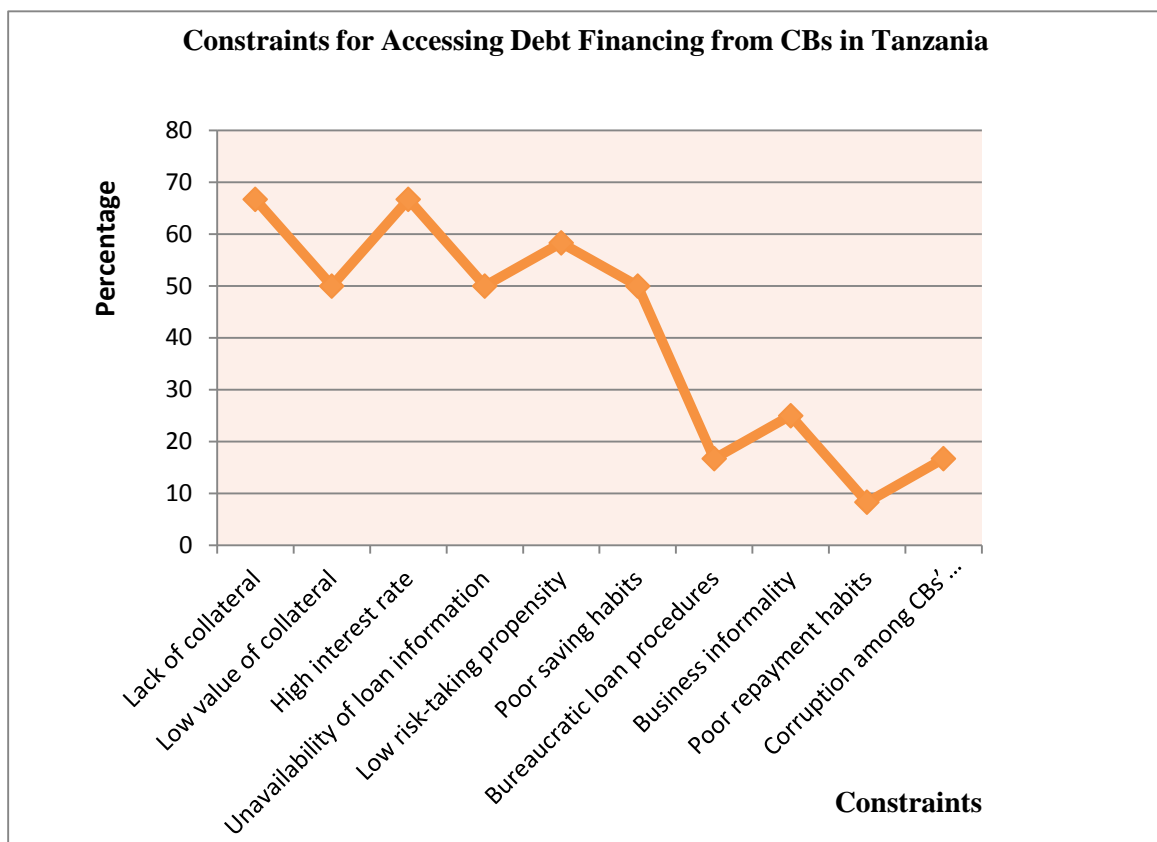
Key: [1] LC=Lack of collateral, [2] LVC=Low value of collateral, [3] HIR=High interest rate, [4] ULI=Unavailability of loan information, [5] LRP=Low risk-taking propensity, [6] PSH=Poor saving habits, [7] BLP=Bureaucratic loan procedures, [8] BI=Business informality, [9] PRH=Poor repayment habits, [10] COR=Corruption among CBs' employees.

Based on **Table 2**, the most extracted variables are presented in **Table 3.0** to show the frequency and percent.

Table 3: Constraints of Accessing Debt Financing from CBs among SMEs in Tanzania

Variables	Frequency	Percent
Lack of collateral	8	66.7***
Low value of collateral	6	50.0*
High interest rate	8	66.7***
Unavailability of loan information	6	50.0*
Low risk-taking propensity	7	58.3**
Poor saving habits	6	50.0*
Bureaucratic loan procedures	2	16.7
Business informality	3	25.0
Poor repayment habits	1	8.3
Corruption among CBs' employees	2	16.7

Source: Literature Review (2015) (Significant constraints with a trend ***> **> *)



Findings (Table 3) indicates that lack of collateral, low value of collateral, high interest rates, unavailability of loan information, low risk-taking propensity of SMEs and poor saving habits of SMEs are significant constraints of accessing debt financing from CBs among SMEs in Tanzania. On the other hand, bureaucratic loan procedures, business informality, poor repayment habits and corruption among CBs' employees were found to be insignificant constraints for accessing debt financing from CBs among SMEs. These constraints have resulted SMEs to operate in undercapitalization environment as the majority remains solely depending on personal saving for their start-ups and additional capital (Mashene *et al.*, 2014^b; Tundui, 2012; URT, 2012). According to this study, high interest rate and

unavailability of loan information termed as constraints encountered by SMEs in accessing credit from CBs in Tanzania. These findings imply that high interest rate discourage SMEs from accessing loan from CBs as borrowers get fear on how to repay the borrowed fund at such high interest rate. Similarly, unavailability of loan information makes SMEs blind on where to get loan, how to apply for the loan and requirements for the loan. It is evident that, if information regarding loan is not disseminated to reach potential borrowers, the number of borrowers will hardly increase and this tendency has negative effect to both borrowers and lenders. On the other hand, lack of collateral, low value of collateral including unregistered collateral, poor saving habits and low-risk taking propensity are termed as constraints faced by banks in providing loan to SMEs in Tanzania. This categorization of constraints for accessing debt financing from CBs among SMEs is in consistence with that in Kwaning *et al.* (2015). Regarding collateral and low value of collateral is greatly caused by most of land and human settlement is not surveyed and lack title deed; as the result, the CBs perceive such collateral as low valued assets to act as security during loan application. Moreover, the findings regarding poor saving habits suggest that most of SMEs are denied from accessing loans from CBs as their businesses show poor cash flows associated with poor usage of financial services. According to CBs' evaluation procedures for loan applicants, the issue of cash flow is considered among the key factor for SMEs to qualify for the loan. In this view therefore, SMEs are advised to route their business fund into their bank accounts and make frequent withdrawing when they want to meet day to day business obligations. These findings are supported by Mashenene *et al.* (2014) and URT (2012) which argue that the majority of SMEs in Tanzania have poor saving habits. Regarding low risk-taking propensity, the findings suggest that the efforts of the government and CBs to ensure that credits are available to SMEs will not be fruitful unless SMEs are transformed and acquire high risk-taking propensity which will trigger borrowing behavior among them. Generally, the findings of this study conflict with the RBP in a sense that SMEs are being constrained with these constraints, as the result they hardly achieve their goals through growing working capital and exploiting emerging business opportunities

5. Conclusion and Recommendations

This paper concludes that lack of collateral, low value of collateral, high interest rates, unavailability of loan information, low risk-taking propensity of SMEs and poor saving habits of SMEs are significant constraints of accessing debt financing from CBs among SMEs in Tanzania. However, high interest rate and unavailability of loan information are constraints from the CBs' side which hinder SMEs in accessing loan from CBs while lack of collateral, low value of collateral including unregistered collateral, poor saving habits and low-risk taking propensity of SMEs are constraints limiting the CBs in proving debt financing to the

SMEs. This recommends that the Ministry of Land, Housing and Settlements Development in collaboration with other development partners should make sure land for human settlements is surveyed and individuals are provided with title deed which can minimize or eliminate the constraints of lack of collateral and low valued or unregistered collateral. Similarly, policy makers and institutions supporting entrepreneurship and business training to SMEs should design strategic training programmes aiming at encouraging them to access loan from CBs. Mashenene and Rumanyika (2014) points out that well designed training programme instill confidence to SMEs; as the result they can build a sense of daring to access loan from financial institutions. In the same view, poor saving habits can be corrected through entrepreneurship and business training programmes in which financial aspect among SMEs need to focus on good saving practices. As the matter of fact, CBs are highly concerned with the SMEs' cash flow when evaluating loan applicants. Regarding high interest rate, the Bank of Tanzania, Ministry of Finance and Planning, CBs and other development partners should consider lowering of interest rate as the national agendum with the aim of creating enabling environment for SMEs to access credit from CBs. As of now, the majority of SMEs in Tanzania are undercapitalized with poor access to credit being cited as the critical challenge (Mashenene and Rumanyika, 2014; URT, 2012). Accordingly, CBs should make sure information regarding loan reach SMEs timely and as convenient as possible. This will encourage high usage of financial services among SMEs as of now the majority (69%) of MSME owners do not use any financial service and one the reasons to this inadequate loan information available to them (URT, 2012).

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