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# The Challenges Confronting Small Scale Businesses in accessing Microfinance Services from MFIs Case Study: Rural Tanzania

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**Abstract**
Microfinance services from microfinance institutions assist small scale businesses in the development and expansion of their businesses especially in rural areas. This study was carried out to evaluate the accessibility of microfinance services together with the challenges that small scale businesses are facing when accessing microfinance services from the main stream of MFIs in Mvomero district in Tanzania. The data collected through questionnaire were administered to 195 small scale businesses and analyzed with Statistical Package for Social Scientists (SPSS) version 21. The study shows that small scale businesses have access and also have benefited in microfinance services from different MFIs. Nevertheless, there are many challenges confronting small scale businesses when accessing microfinance services. Therefore, the researchers recommend that microfinance institution should set up more flexible, reasonable and attractive requirements in financing small scale businesses. Also, the government and other stakeholders should set a good financial structures and legal systems which will allow the financial institutions especially microfinance institutions to provide finance startups to newly establish businesses.

**Key words:** Small scale businesses, microfinance institutions, challenges and rural Tanzania

**Introduction**
Small scale businesses in rural areas play a vital role in employment creation and income generation in most developing countries such as Tanzania. The establishment of small scale businesses all over developing countries is easy in terms of capital; technology, administration even utilities relative to large businesses (Acs, 1992). Definitely, small scale businesses development is directly connected with more fair distribution of fund and thus important as regards to poverty alleviation. The accessibility to finance in small scale businesses in rural areas depends on external or internal sources. Notably, the internal sources of fund are obtained from business operations which usually are not enough for small scale businesses. Therefore, the demanding need for externals sources of fund arises. The externals sources of funds are from friends, relatives and financial institutions like microfinance institutions (Woldie,

Isaac Mwita, & Saidimu, 2012). The access to financial services by small scale businesses is usually seen as one of the limitation to their benefit from credits and other services (Mashenene & Rumanyika, 2014). Most of the cases based on access to finance problem is mostly in the formal financial institution. Among the factors that hamper accessibility include lending policies, complicated application procedures and other restriction based on credit for specific purpose. Small scale businesses depend on access to short-term credit, thus resulting to the fundamental aim of microfinance programmes at such entrepreneurs (Ledgerwood, 1999). The methods of loan payment are normally fast and easy making the terms of the microfinance services flexible (Rahman & Rahim, 2007). Therefore, the reason of providing microfinance services to small scale businesses is for businesses expansion.

In Tanzania, there are many microfinance institutions providing financial services in both urban and rural areas. The accessibility of these services to small scale businesses has been discovered as a major element for a successful capacity building in order to compete in business and support in poverty alleviation (Christopher, 2008). Also, MFIs were founded to be in control of small-scale business in the earlier years and of medium and large scale business in the later years (Makorere, 2014). Tanzania government has tried to design different plans that will help to sustain small scale businesses in the global economic competitiveness of business atmosphere. Most small scale businesses are the borrowers of microfinance institutions services and have engaged themselves in different employment activities. Most of them are mainly self-employed small scale businesses. Moreover, others are food processing, hand agriculture, housing and livestock. It is difficult for small scale businesses to access microfinance services based on heavy collateral requirement that MFIs and other financial institutions request.

There are number of challenges confronting small business on the way of microfinance services accessibility. There are some requirements that microfinance institutions provides to small business to meet in order to obtain micro credit (Olu, 2009). The requirements are physical collateral and some amount of money as savings to secure the loan. Insufficient collateral and reasonable interest rate charges make it difficult for small business to accessing financial services (Woldie et al., 2012). Even lack of training related to business is mentioned as a challenge facing small scale businesses in accessing microfinance. This was reported in a study conducted in Pakistan for women starting new businesses from the microfinance credit. Owing to the reason that these women lack training on how to generate profit from microfinance institution, lead them fail to control and manage the loan (Ashe, Treanor, & Mahmood, 2011). Furthermore, included among the challenges is the reluctant of microfinance institutions to provide loan for starting up new businesses (Blanchflower, Levine, & Zimmerman, 2003). Besides, recent study on the supply and demand for financial services in Tanzania showed that 9% has a formal bank account, 2% has access to semi-formal finance and 35% has access to informal finance like Rotating Savings and Credit Association (ROSCAs), Accumulating Savings & Credit Associations (ASCAs) and moneylenders. Only 20% of the population has access to formal bank within 1 hour walking distance (Facet, 2011). Thus, this study examines the microfinance accessibility to small scale businesses in Mvomero district. Specifically, this work identifies the challenges that small scale businesses undergo when accessing microfinance products and services from the main stream microfinance institutions.

## 2. Small Business and Microfinance accessibility in rural Tanzania

As aforementioned, accessibility of finance by small scale businesses in the formal conventional banks is still a problem. This is because terms and condition from formal banks is cumbersome and not conducive for small scale businesses (Hishigsuren, Spahr, Estevez, & Magnoni, 2014). Nowadays, most small scale businesses population shifted to microfinance institutions as their main sources of financial services, due to the fact that most of the developing countries take microfinance program as a tool to achieve their strategies on development. Accessibility to finance by small entrepreneurs facilitate economic growth in the informal sector by increasing funds for business, job creation and increase long term income generation. In addition, the borrowed capital by small entrepreneurs results in increase households social welfare and spending (Dunn & Arbuckle, 2001; Kevane & Wydick, 2001). But unfortunately, inaccessibility of microfinance credit to small business that are living above or below poverty line can lead to a lot of consequences in social welfare (Morduch & Haley, 2002). Therefore, it is important that microfinance services are near to small scale businesses to facilitate business activities (Okpukpara, 2009).

In Tanzania, government also implemented some conditions for financial sector which also targeted farmers and small scale businesses after independent (Facet, 2011). Some economic reforms and financial restructurings were done by government in 1990 to encourage and increase the number of private institutions in order to provide microcredit to small scale businesses. A number of private and public institutions as well as banks are reported to deliver microfinance services. A report shows that most of them concentrate and provide microcredit services more in the urban areas (Facet, 2011). However, another study also revealed that despite the financial reforms in 1990, poor population in rural areas has little access to microfinance services (Wangwe & Lwakatare, 2004). In Tanzania, banks and other financial institutions are mostly located in town and big cities that results in difficulty in accessing microfinance service by small scale businesses in rural areas. The current evidence shows that more than 70% of population in Tanzania are excluded from reliable bank services (Facet, 2011). But still in urban area small scale businesses fail to access financial credit from the banks and financial institutions due to several factors largely related to the nature of business they are operating (Mfaume & Leonard, 2004; Nyamsogoro, 2010). Most small scale businesses are operating their business without any official financial information concerning profit, liquidity and sale development.

There are two kinds of institutions providing microfinance services in rural areas. These are semi-formal microfinance institutions and Non-governmental organizations (Facet, 2011; Nyamsogoro, 2010). The semi-formal microfinance institutions are generally in urban areas consisting of wage and salary earners, but in rural areas it is made up of farmers and small scale businesses. Microfinance service such as credits is usually offered to only members that belong to the institutions. But sometimes, the institutions offer microcredit to non-members if financial status can be recognized. Most at times, semi-formal microfinance require collateral from the people who are in need of microcredit. More so, savings which act as loan insurance from the small scale businesses is required before individual can access loans. These microfinance institutions also offer other products like loan for emergency reasons concerning education, agriculture and health as these are the basic needs for poor people in daily bases. Furthermore, group lending system of offering microfinance services is also applicable in these kinds of MFIs. Studies show that Savings and Credit Cooperative Organizations (SACCOs), RoSCAs, SACAS, the Village Savings and Loan Associations (VSLAs), Village Community Banks (VICOBA) and community conservation banks (COCOBA) are some examples of semi-formal microfinance institutions. They provide savings and internal lending for communities (Facet, 2011; Randhawa & Gallardo, 2003; Rubambey, 2005). Also, there are some NGOs delivering microfinance services to small scale businesses in Tanzania. They employ the system of group lending where members in the group can guarantee repayment of loan. Also the individual lending system is applicable here but collateral is required for the individual who want credit. Moreover, savings is required as credit insurance. The NGO – MFIs offer credits to poor people for business support, educational reasons but not for starting up business. For small scale businesses, it is allowed to increase credit depending on the graduate stage that was reach and the history of repayment of previous credit. Here small scale businesses are allowed to change the group after the repayment cycle time of credit. These allow small scale businesses to formulate a new group which they feel more comfortable and avoiding default risk. The microfinance services providers included; Promote of Rural Initiative and Development Enterprises (PRIDE), Foundation for International Community Assistance (FINCA), Small Enterprise Development Agency (SEDA), Bangladesh Rural Advancement Committee (BRAC), Microenterprise Development Agency (MEDA) and BAYPORT (Facet, 2011; Randhawa & Gallardo, 2003). The financial NGOs are still limited in term of reaching high population and small scale businesses. This is because of their donors supporters and their operations concentrated in some of the selected regions.

## 3 Methodologies

### Study Area

The study was conducted in Mvomero district. It is among the six district of Morogoro region. It borders Kilosa district to the east, Ulanga and Kilombero districts to the south, Kilosa district to the west and Arusha region to the North (Sigalla, 2013). The district has population of 312,109. The overt economic activity is farming mostly crop production and petty trade. According to recently studies, about 4.6 people are undeserved with financial institutions (Facet, 2011; Larsen & Birch-Thomsen, 2015). This is because there are limited numbers of commercial banks, whereas semi-formal microfinance institutions are the major source of microfinance services in this district. Most of the small scale businesses in this district are cash crops farmers, livestock keepers, shopkeepers, food processers, sewing, hairdressing, tailoring, carpentry, brick making, traditional medicines, transport services and fishing. Most of small scale businesses in this area are depending on microfinance services to support their economic activities. The main microfinance institutions found in this area are FINCA, BAYPORT and SACCOs-(Jijenge and Tumaini).

**Population and sampling**

Simple random sampling technique was adopted to select small scale businesses owners who benefited from microfinance services from mikumi, mkambarani and kilosa villages in the Mvomero district. The study covered 195 respondents who were small scale businesses owners having access to microfinance services provided in Mvomero district. Among these 195 respondents, 65 were from Mtibwa, 80 from Kibati and 50 from Doma villages. Interestingly, the random selection was based on the willingness of respondents to be part of the study. All selected respondents in the sample were administered the developed questionnaire.

**Data collection technique and procedure**

In the study, a cross section data design was employed because it allows the collection of data at single point in a time (Koul, 2009). The design was most appropriate for descriptive purpose as well as determination of relationship between variable. A structured questionnaire which comprised of both closed and open ended questions was designed as data collection tool. The questions were divided into three categories which centered on the biodata of respondents, microfinance benefits and challenges of accessing microfinance services.

A pilot study was first conducted in another district outside the study area but with the same setting as small scale business involved in the study. This pilot study was conducted in an unofficial manner to afford the researchers the opportunity to correct the instrument for the main study and also enable the researchers to determine the reliability of the instrument.

Later, the researcher self-administered the 195 questionnaires to the respondents in the study area and collected them later. This system would allow the respondents to have enough time to think through the questions and give more credible and reliable information. In addition, this enhanced the response rate. Prior to the questionnaire administration, ethical considerations were addressed by ensuring that the purpose of the study was clearly explained to the participating small scale businesses. Authorization was sought from the right authorities, and no nonconformist means were used to ask for information.

**Data analysis**

The study employed Statistical Package for Social Scientist (SPSS) version 21 as a tool for analyzing the data. Descriptive analysis comprising of tables and percentages were used to establish relationship between variables to address the objectives of the study.

**4 Results and discussion**

**Biodata of respondents (MFIs customers)**

From Table I the result shows that (60%) of respondents were women who are the main small scale businesses and main customers of MFIs. They engage in small scale businesses like sewing, hairdressing and tailoring. In addition, the result further shows that majority of the respondents (36%) were 35 -54 years old. This implies that most of the respondents are matured enough in businesses and have responsibilities of taken care of their families and improve on their social status. In addition, the result shows that majority of the respondents (51%) are in informal sector, thus they establish small business as source of income for their livelihoods since they cannot be employed in the formal sector. More so, the result shows that most of respondents (51%) are married and have businesses whereby they need microfinance services like credits to improve on their businesses. Lastly, the result reveled that; most of respondents (49%) have informal education thus imposing a challenge in accessing microfinance services.

Table I Biodata of respondents

| Variables | Frequency | Percentage |
|---|---|---|
| Sector | | |
| Formal | 95 | 49 |
| Informal | 100 | 51 |
| Education Level | | |
| Informal | 95 | 49 |
| Primary | 33 | 17 |
| Secondary | 40 | 20 |
| Tertiary | 27 | 14 |
| Marital status | | |
| Single | 50 | 25 |
| Married | 100 | 51 |
| Widower/widow | 45 | 24 |
| Gender | | |
| Female | 118 | 60 |
| Male | 77 | 40 |

| | | |
|---|---|---|
| Age (Years) | | |
| 19-24 yrs | 40 | 20 |
| 35-44 yrs | 71 | 36 |
| 45-54 yrs | 71 | 36 |
| 55 and above | 13 | 8 |

**Microfinance services accessibility and benefits to small scale businesses**

Table II shows the responses from respondents about the microfinance services and its benefits/contributions to small scale business. According to the study, the respondents agreed on the benefits they derived from the microfinance services from some of the MFIs. Most of them benefited from loan services and invested into different types of small scale businesses. According to the study presented in Table II, significant proportion of the respondents agreed that loans help to increase their income levels, savings account increase savings level and there is improvement in healthcare access. This is because owners of small business save and invest the loan they collect from MFIs which give them profit and increase their income thus they can afford to access social services like education and health. These results are in accordance with the studies carried out in Ghana, South Africa and Nigeria (Afrane, 2002; Enisan & Oluwafemi, 2012; Stewart, van Rooyen, Dickson, Majoro, & de Wet, 2010). Moreover, significant proportions of the respondents agree on better financial situation of the family, increased employment opportunities and improvement in the living standard of the family. This is because the loans and other services they derive from MFIs help them to open new small scale businesses and employ more people. On the other hand, majority of the respondents disagree that microfinance services increase role in decision making process. This is because they believe that decision making has no substantial effect on microfinance services.

Table II Responses on services provision and benefits from respondents

| Service provision and benefits | Responses (percentage) | | | | |
|---|---|---|---|---|---|
| | SD | D | N | A | SA |
| Loans help to increase income level | 10 | 5 | 0 | 85 | 0 |
| Savings account increase savings level | 8 | 24 | 2 | 66 | 0 |
| Improvement in healthcare access | 6 | 36 | 16 | 42 | 0 |
| Better Financial situation of the family | 5 | 0 | 10 | 85 | 0 |
| Role in decision making process has increased | 40 | 51 | 9 | 0 | 0 |
| Employment opportunities have increased | 2 | 20 | 13 | 63 | 2 |
| Improvement in the living standard of the family | 7 | 11 | 17 | 62 | 3 |

Where: SD - strongly disagree, D - disagree, N - neutral, A – agree and SA – strongly agree

**Challenges of accessing microfinance services from MFIs by small scale businesses**

Despite the benefits small business derived from microfinance services there are some difficulties they usually face when accessing the microfinance services. From Table III, the respondents (50%) agreed that short repayment term of the loans is among the challenge they experience. This implies that the repayment period of loans is too short for small business which is difficult for profit to accumulate. Furthermore, the result shows that 62% of the respondents disagreed that the procedure of obtaining loans from one microfinance institution is easier than the other. This is because the procedure for obtaining loan is cumbersome which most of the small business owners cannot endure due to their level of illiteracy as stated in Table I. The result shows that the respondents (36%) agreed that insufficient financial management training is a challenge they face. This makes it difficult for them to manage the loan they took from the institutions since they consider the education they get from MFIs to run and improve their business. This result agreed with the study done in Pakistan where many entrepreneurs lack training on how to generate profit from the loan the obtained from microfinance institution (Ashe et al., 2011). Moreover, the result further revealed that 52% of the respondents agreed on absent of micro-insurance services as one of the challenges they confront. This is because accessibility of micro insurance helps small business to focus on developing their businesses at the same time to reduce other life risk that affect property, and even working ability (Cohen & Sebstad, 2005). The result revealed that 41% of the respondents agreed on collateral collection from individual as a factor that contributes to the failure of accessing microfinance services. This is because some of the microfinance institutions are not using group lending to secure loans, but collect collateral or use the guarantee based approach. Furthermore, certain amount of money as saving is required by most MFIs to secure the loan, which also act as collateral. This is a challenge to most small business owners since they are in the informal sector and lack physical collateral. This result is in line with the report conducted in Cameroon (Chiyah & Forchu, 2010).

Moreover, the finding revealed that 34% of the respondents agreed that inadequate use of group lending by microfinance institutions poses a challenge to them in accessing microfinance services. This is because currently, MFIs in rural areas avoid group lending due to high rate of default. From the study conducted, some respondents (33%) strongly agree that the absent of new business startup loan poses a challenge to small scale businesses. They believe that the focus of most MFIs is on supporting existing businesses, thereby making it difficult to start up a new business. Far location of loan offices is also a challenge to small scale businesses to access microfinance services. Most of small scale businesses in rural areas are living far from the microfinance offices, thus when they want to access microfinance services they have to spend a lot of money on transportation to reach the microfinance service offices. Also, poor entrepreneurship training is among the challenge small business face as agreed by respondent. This is because most of the institutions provide loans to small business without training the owners on how to be efficient entrepreneurs and to invest the loans wisely. This leads to closure of businesses after collecting the loan for a short time. Lastly, the result shows that 33% of the respondents agreed on high interest rate charges as one of the challenges. The interest rate charges in rural areas by MFIs are too high because the MFIs want to compensate for operational cost. This hinders the accessibility of loan by small business. This means at the long run, all profits gained will be used to offset the charges of interest on the loans. Furthermore, respondents provided their recommendations to MFIs by simplification of the loan acquisition process. Also respondents suggested that the interest rate charges should be reasonable so that more small business owners can access their loan service. It is also suggested that they should establish long term loan facility to member based MFIs. Furthermore, MFIs should open more offices closer to their customers to reduce the transportation cost. Respondents also recommended that it is better for all MFIs to establish group lending system because most rural small scale businesses lack physical collateral /guarantors to secure loans.

Table III Responses on microfinance services challenges accessibility from respondents

| Service provision and challenges | Responses (percentage) | | | | |
|---|---|---|---|---|---|
| | SD | D | N | A | SA |
| Short repayment term | 0 | 17 | 9 | 50 | 24 |
| The procedure of obtaining loans from this microfinance is easier than other microfinance | 11 | 62 | 11 | 12 | 4 |
| Insufficient financial management training | 9 | 31 | 13 | 36 | 11 |
| Absent of micro-insurance services | 7 | 8 | 13 | 52 | 20 |
| Collateral collection/individual | 10 | 36 | 8 | 41 | 5 |
| Inadequate use of group lending | 14 | 24 | 3 | 34 | 25 |
| Short term loan | 7 | 17 | 11 | 57 | 8 |
| Absent new business startup loan | 12 | 22 | 15 | 18 | 33 |
| Far location of loan offices | 8 | 17 | 10 | 60 | 5 |
| Poor entrepreneurs training | 15 | 28 | 10 | 41 | 6 |
| High interest rate charges | 10 | 30 | 22 | 33 | 5 |

Where: SD - strongly disagree, D - disagree, N - neutral, A – agree and SA – strongly agree

**5 Conclusions and Recommendation**

In summary, the accessibility of microfinance services is highly beneficial to small scale businesses. However, it is associated with some significant challenges such as unavailability of micro insurance service, inadequate financial management and lack of entrepreneurship training to owners of small scale businesses, to mention but a few. It is recommended that MFIs should have neutral loans contracts to attract and motivate small scale businesses. More so, they should design long term loan so as to give small scale businesses chance to accumulate profits from the loans taken. Training of owners of small scale businesses that most of them are the customers of their institution on financial management and other investment opportunities are of optimum importance. It is also recommended that MFIs should concentrate on group lending for loan services provision and avoid the collateral system. There is also need for government and other stakeholders to strengthen financial structures and legal systems which will allow the financial institutions especially microfinance institutions to provide financial startups to establish new businesses. If MFIs, government and other necessary agencies put in place most of the measures mentions in this research, there will be a high accessibility of microfinance services to small scale business which will improve the economy of Tanzania.

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