# The Contribution of Microfinance Institution Services in the Development of Small and Medium Enterprises: Evidence from Ilala City, Tanzania

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## Abstract

The objective of this study was to examine the contribution of microfinance institutions (MFIs) to the development of small and medium enterprises (SMEs) in Ilala City in Tanzania. The study aimed to determine the influence of financial and non-financial services provided by MFIs on SME capital growth, income growth and employment generation. Data on the identified variables were collected using questionnaires from 158 owners of SMEs and analysed using multivariate analysis of variance (MANOVA). The data used in the study had a Cronbach's Alpha of 0.84, which is above the required value of 0.7 (rule of thumb)The study found that MFI services had a positive influence on capital and income growth of SMEs, while MFI services had a positive but non-significant impact on the ability of SMEs to create jobs. The study therefore recommends that public sector analysts and managers develop specific policies that impact on SME growth.

**Keywords:** Microfinance institutions, small and medium enterprises, multivariate analysis of variance (MANOVA)

## 1. Introduction

The role of small and medium-sized enterprises (SMEs) in creating the economy and wealth has been well observed around the world. SMEs are usually based on low capital, high labour intensity and easy technology transfer (Worokinasih & Potipiroon, 2019; Oni, 2012; Mbamba, 2002). As a result, SMEs have become an important source of entrepreneurial skills, inventions and job creation. For example, SMEs account for over ninety per cent of African enterprises, over fifty per cent of jobs created in Africa and over fifty per cent of gross domestic product (Abor & Quartey, 2010; Obi, et al., 2018; Chege & Wang, 2020; Westman, Moores, & Burch, 2021). Globally, SMEs create employment opportunities with low investment per job, which has led to greater involvement of local people in the economy, encourages the use of mainly local resources, supports the invention and use of local technologies, and provides training at low cost to society. It is estimated that Tanzania's SME sector consists of more than 3 million enterprises, generating 27% of the total gross domestic product. Most of them are in the agricultural sector and more than half are owned by women (Admassie & Matambalya, 2002; Massawe, 2000; Geoffrey & Emenike, 2018).

Although SMEs are a great help to many people, small businesses have statistically high failure rates, making it difficult for lenders to accurately assess the viability of their businesses, the skills of the entrepreneur, and the likelihood of repayment (Quaye, Abrokwah, Sarbah, & Osei, 2014; Salifu, Tofik-Abu, Rahman, & Sualihu, 2018; Yusoff et al., 2021). One of the challenges SMEs face is that most do not have access to formal financial institutions such as commercial banks due to stringent requirements.

It is widely acknowledged that SMEs face unique setbacks that hinder their growth and profitability and limit their ability to effectively impact sustainable development (Akingunola, Olowofela, & Yunusa, 2018). These problems include inadequate access to credit, inadequate management and technical skills, inadequate access to up-to-date market information, bureaucratic legal frameworks and the use of outdated technology. This leads to a major problem, namely slow growth. As a result, SMEs remain small for a long period of time without experiencing a rapid expansion phase until closure (Geoffrey & Emenike, 2018). This contradicts the growth theory of micro-enterprises and SMEs, which describes the learning process of a business as a living body that goes through the stages from start-up to growth to closure or death.

The increasing participation and impact of SMEs has led to an increased demand for microfinance services (Gyimah & Boachie, 2018). Loans are considered one of the tools to support SME development (Marwa, 2014). Loans enable the owner or the business to benefit from economies of scale and the added value of new technologies. Other challenges faced by SMEs include legal and regulatory policies that are not SME-friendly, poor infrastructure systems, inadequate business development services, a poorly coordinated institutional support framework, and limited access to finance (Iorun, 2014).

Both financial and non-financial services are essential for increasing the productivity, profitability and growth of SMEs. Microfinance institutions (MFIs) remain the only hope for survival as commercial banks could not support them due to their credible financial background. Formal banking systems are characterised by rigid and stringent lending policies, collateral requirements and bureaucratic procedures that by default deprive SMEs of the opportunity to obtain financial support. The perception of SMEs and the rural poor as risky, lack of collateral, poor record keeping and low credit scores lead to their exclusion.

Due to the increasing importance of financial services for SMEs, the Tanzanian government introduced the National Microfinance Policy in 2000. The aim of this policy was to improve access to financial services for low-income earners working in SMEs. MFIs have become important for SMEs that previously had difficulty accessing financial services and have partially replaced the formal financial institutions that classified SMEs as loan defaulters and not very creditworthy. The objective of this study is to examine the contribution of MFIs to SME development in Tanzania.

### 1.1 Statement of the problem and objective of the study

Despite the credibility of SMEs in the economic development of a nation, especially in developing countries like Tanzania, the sector has suffered many setbacks at the hands of formal financial institutions such as commercial banks that view these enterprises as underperforming and risky for lending. In Tanzania, most studies, such as that of Chale and Mbamba (2014), have mainly focused on how financial services, especially loans from MFIs, contribute to SME growth. Without neglecting the importance of financing and/or credit for SME growth, other services such as pre-loan training, advisory services, management and technical training play a crucial role in the development of these SMEs. Many previous studies have not considered the impact of non-financial services on SME growth. SME growth depends on both financial and non-financial services provided by MFIs, as most SMEs are run by owners who have little or no knowledge of business aspects such as marketing, management and budgeting. Therefore, this study examined the contribution of MFIs to the development of SMEs in Ilala City considering both financial and non-financial services.

Several studies have also documented the challenges of SMEs in obtaining credit (Chuong, et al., 2020; Nalane & Sekantsi, 2020) with less focus on the outcomes of using these services. The overall objective of the study was to examine the contribution of MFIs to SME development in Ilala City. The specific objectives were:

i. determine the influence of financial and non-financial MFI services on job creation in SMEs;
ii. determine the influence of MFI services, both financial and non-financial, on SME capital growth; and
iii. find out the extent to which MFI services, both financial and non-financial, influence SME income growth.

The objective of the study is to show the importance of MFIs for the development of the SME sector in Tanzania. The study documents the importance of MFIs in the growth of

SMEs. Finally, the findings of the study contribute to knowledge by providing empirical evidence on the relationship between MFIs and SME development.

This study was limited to MFIs and other financial institutions serving low-income enterprises such as savings and credit cooperatives, borrowers and non-borrowers of SMEs in Tanzania and operating in various sectors of the economy. The study was conducted in Ilala City in Dar es Salaam Tanzania. Ilala was chosen because there are a large number of SMEs in this region, making it easy to draw conclusions.

## 2. Literature review

### 2.1 Definition of key terms

According to the Tanzania National Microfinance Policy of 2017, microfinance means the provision of financial services, including microsavings, microcredit, microinsurance, microleasing, microhousing, micro pension, cash transfers, financial education and enterprise development to low-income groups (individuals, households, enterprises) that are systematically excluded from the regular financial system. On the other hand, MFI refers to an institution that specialises in providing financial products and services to SMEs. According to Awuah and Addaney (2016), MFIs are institutions that provide financial services and small change management through a variety of products and a system of intermediation services that target low-income earners and SMEs. Kuci (2018) refers to MFIs as financial institutions and development instruments that provide financial services to promote business development and economic development in a community.

SMEs are on other occasions referred to as MSMEs, which stands for micro, small and medium enterprises. The definition of SMEs is not universal as SMEs are described differently in each nation. Geoffrey and Emenike (2018) define SMEs as companies that employ less than 250 people. Quaye, Abrokwah, Sarbah and Osei (2014) define SMEs as independent enterprises that are run by sole proprietors and have a small market share. The authors also consider SMEs to be companies that operate on scales that are below the average for the industry as a whole.

Various measures have been used to calibrate growth, although there is no universal measurement. Growth can be measured by return on assets, return on equity, net interest margin, CAMEL rating (i.e. capital adequacy, asset quality, management quality, earning power and liquidity), profitability, market share, customer satisfaction, expansion and sales growth. In this study, job creation, capital growth and sales growth are used as measures of SME growth.

One of the objectives of any enterprise is to achieve profit and growth. An enterprise is defined as an entity whose legal framework can expand over time as operational activities, tangible and intangible resources also increase (Penrose, 1995). Growth in this context is understood as an increase in size, quantity or quantifiable items or activities (Penrose, 1995). The growth of an organisation can be determined by the increase in capital, labour and technology that reflect the profitability of the business. Business expansion or growth services or non-financial services are provided by some MFIs implementing the common approach. Services offered by MFIs include non financial services like marketing and technology services, business training, production training, and sub-sector analysis and intervention.

## 2.2 Theoretical and empirical literature

The study is mainly based on three theories: the pecking order theory, the banking channel theory and the human capital theory. The choice of these theories was based on the research objectives of the study, namely the contribution of microfinance services to SME capital growth, income growth and job creation. Each theory complemented its subsequent objective.

The pecking order theory is a theory developed by Sanders Myers in 1984 (Myers, 1984). The theory states that the financing needs of firms (usually SMEs) are satisfied in a hierarchical order. Various studies have found that the use of external sources of finance has a negative impact on a firm's profitability, especially for small firms. It follows that hierarchical financing decisions must be taken into account when choosing debt levels (Akpan & Nneji, 2015). Holmes and Kent (1991) found that SMEs strictly adhere to the pecking order due to the difficulty in obtaining external finance. SMEs tend to depend on distant markets, which limits their sources of finance. This is where MFIs come in to help SMEs raise finance. The pecking order states that external funds play a crucial role in the capital growth of these enterprises. The study therefore seeks to establish the reliability of capital growth of these SMEs, as loans are part of a firm's capital.

Makorere (2014) does not believe that improved capital structure of enterprises is only directly related to access to microfinance. The author emphasises that businesses that receive not only microcredit but also training, tax exemption, fair interest rates, sufficient grace period and infrastructure are likely to perform better than those that do not.

Therefore, it is hypothesised that:

*$H_1$: MFI services have a positive influence on SME capital growth.*

The bank capital channel theory states that banks' main criteria for lending to SMEs depend heavily on capital requirements. This means that the increase in interest costs by banks increases the cost of debt financing for SMEs, thereby reducing SME profitability and capital

(Ferdousi, 2015). This tendency causes banks to reduce their lending to businesses when the capital constraint becomes mandatory. On the other hand, in favourable situations, banks are likely to lend to these companies at much lower interest rates. These constraints on banks' capital requirements can be well addressed by introducing MFIs in developing countries like Tanzania to promote the SME sector, without taking such factors into account.

In line with bank capital theory, the study aims to examine the impact of the cost of credit, i.e. the interest rate of MFIs, on SME growth and development. MFIs were established primarily to fill the gap that SMEs could not get financial support and the study aims to show how these institutions have helped SMEs.

Awuah and Addaney (2016) studied the interactions between MFIs and SMEs in the Sunyani Municipality in Kenya. The study found that there was a positive relationship between MFI services and SME growth. This was evidenced by an increase in revenues, profits and assets.

Geoffrey and Emenike (2018) consider access to sufficient volume of credit as an indispensable component to promote SME expansion and development, increase revenue, create jobs and reduce poverty.

Pei-Wen, Zariyawati, Diana-Rose and Annuar (2016) used regression analysis and descriptive statistics to analyse data from 125 SMEs to determine the impact of microfinance facilities on the performance of SMEs in Malaysia. The results of the study show that microfinance services have a positive impact on SMEs' business income. This means that SMEs may improve their income when financed through microfinance. Almost the same results have been observed in other studies (Ruslan, Gan, & Quang, 2020; Moussa, 2020; Rajapakshe, 2021)

Osoro and Muturi (2013) examined the role of MFIs in SME growth in Kenya using a sample of 100 SMEs. The study found that access to training was positively associated with SME growth. In addition, the microfinance loans that the SMEs received enabled them to improve their income opportunities.

It is therefore hypothesised that:

*$H_2$: MFI services have a positive influence on SME income growth.*

Schultz (1961) defines human capital as the knowledge, skills and abilities of a company's employees. The theory is that firms that invest in training and equipping their employees with the necessary skills and abilities are more productive than firms with less skilled personnel. Therefore, companies with skilled human resource can demand higher profits due to their investment in human capital and thus expect significant growth. The theory underpins the idea that a company's skills and knowledge can be improved through training and mentoring (McCracken, McIvor, Treacy, & Wall, 2017).

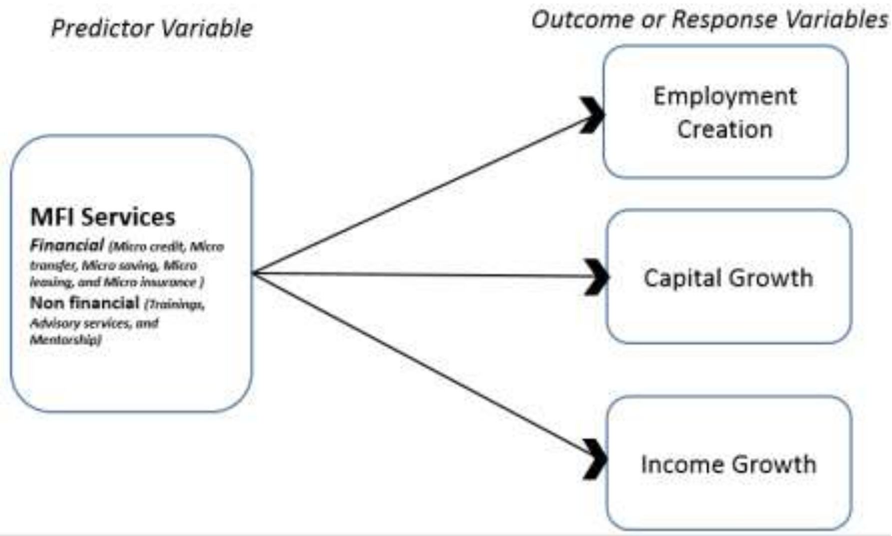
In this context, in addition to financial support from MFIs, SMEs need training in various areas of business management such as budgeting, planning, accounting, marketing, product branding, and many others so that they can take their businesses to greater heights. Training and mentoring for SME employees guarantee them a competitive edge and growth prospects. The study aims to incorporate human capital theory and show how MFI services have helped SMEs integrate more employees into their businesses. In addition, they have helped owners acquire the necessary skills that promise significant growth for these businesses.
Makorere (2014) examines the role of microfinance in promoting SMEs in Tanzania using empirical data from SME owners who received loans from MFIs in Morogoro, Tanzania. The results show that adequate access to microfinance has led to increased employment and job creation, among other benefits. Awan and Ibrahim (2015) on the role of microfinance in creating self-employment in Pakistan conclude that self-employment in Bahawalpur City can be significantly increased by expanding their income-generating or commercial activities by offering loans without collateral through various microfinance initiatives. Ilori and Ayoola (2017) on the role of microfinance banks in the growth and sustenance of SMEs in Nigeria emphasised that the expected financial services for SMEs would enable them to start and create durable and sustainable entrepreneurial activities, raise funds from financial intermediation, create employment opportunities and also increase their efficiency.
Owusu (2013) studied the impact of MFIs on SME development in Ghana. Data was collected from 400 SMEs and analysed using descriptive statistics. The results of the study show that sales and job creation by SMEs improved significantly after availing services from MFIs.

Therefore, it is hypothesised that:

*$H_3$: MFI services have a positive impact on job creation in SMEs.*

Figure 1 summarises the conceptual framework for this study. This is based on the hypotheses already identified.

*Figure 1: Conceptual Framework*




*Source: Literature Review*

## 3. Research methodology

### 3.1 Research design

The research design of this study was a descriptive one to determine the influence of MFI services on SME development. The survey design was chosen because the sample items and variables to be studied were simply observed as they are without any attempt to control or manipulate them.

The population of the study consists of 1,752 enterprises that fall under the category of micro enterprises and SMEs in Ilala City. A random sample was drawn for the study to select the SMEs that were included in the study. The Cochran formula was used to determine the sample size for the study. This resulted in a sample of 385. Finally, 158 usable questionnaires were available for analysis.

For ethical reasons, the researchers obtained consent from the respondents to conduct the study. Secondly, the researchers ensured the anonymity of the respondents by not revealing any information about them.

### 3.2 Data validity and reliability

The validity and reliability of the data ensures that the data collected can be used to draw conclusions about the impact of MFIs on SME development. To determine the validity of the data, the questionnaires were designed to be well-structured and easy to understand. In addition, the questionnaires were pre-tested on ten SMEs.

To further check the reliability of the data, the Cronbach's Alpha reliability test was conducted. The data used in the study had a Cronbach's alpha of 0.84, which is above the required value of 0.7 (rule of thumb). This therefore means that the data used in the study can be considered reliable.

### 3.3 Data collection

Primary data were the source of information in this study. Questionnaires were the main instrument of data collection. The questionnaires contained both open and closed ended questions. The questionnaire consisted of two sections: the first section collected background information and the second section focused on how MFIs influence SME growth. The decision to use questionnaires instead of interviews and documentation is mainly due to the nature of the study. While interviews and documentations aim to gain in-depth knowledge on a topic with a smaller number of respondents, questionnaires aim to identify the relationship between variables, which is the main objective of this study to determine the contribution of MFI services to SME development.

One of the advantages of questionnaires is that they are easy to use. Moreover, it is difficult for a researcher to influence certain responses of respondents with a questionnaire. However, the disadvantage of questionnaires is that they have a low response rate.

### 3.4 Data analysis

The collected data were coded and analysed to determine the descriptive statistics, correlations and multivariate analysis of variance (MANOVA). A MANOVA or multivariate analysis of variance is a way of testing the hypothesis that one or more predictor variables have an effect on two or more outcome variables.

Since the study included three outcome variables (job creation, capital growth and income growth) and one predictor variable (MFI services), a multivariate analysis was conducted to determine the relationship between SME development and MFI services.

## 4. Research findings

### 4.1 Characteristics of the sample

Table 1 summarises the characteristics of the sample. From this it can be deduced that there were more men than women in the sample (ratio of one to four), almost three quarters of the respondents were over 40 years old, very few had an academic degree, the majority of respondents were engaged in trade, almost four fifths of the respondents were less than five years old, two thirds of the respondents were formal businesses and businesses without membership. There were a total of 158 duly completed questionnaires. It seems that the sample was suitable for this study.

*Table 1: Sample Characteristics*

| Indicator | Description | Frequency | Percent |
|---|---|---|---|
| **Sex** | Male | 128 | 81.0 |
| | Female | 30 | 19.0 |
| **Age** | 0-20 years | 13 | 8.2 |
| | 21-40 years | 15 | 9.5 |
| | 41-60 years | 77 | 48.7 |
| | Above 60 | 53 | 33.5 |
| **Highest Education Reached** | None | 5 | 3.2 |
| | Primary education | 87 | 55.1 |
| | Secondary education | 34 | 21.5 |
| | Certificate level | 15 | 9.5 |
| | Diploma | 12 | 7.6 |
| | Degree level | 5 | 3.2 |
| **Type of Business** | Manufacturing | 24 | 15.2 |
| | Service | 51 | 32.3 |
| | Trade and commerce | 83 | 52.5 |
| **Number of Years in the business** | Less than 1 year | 45 | 28.5 |
| | 1-5 years | 82 | 51.9 |
| | 6-10 years | 10 | 6.3 |
| | More than 10 years | 21 | 13.3 |
| **Formality of Business** | Formal | 107 | 67.7 |
| | Not formal | 51 | 32.3 |
| **Membership based** | Members | 55 | 34.8 |
| | None members | 103 | 65.2 |
| **Total** | | 158 | 100.0 |

*Source: field data*

## 4.2 MANOVA

MANOVA provides the general model for the impact of MFI services on SME development. In this case, the Pillai's Trace value of 0.814 (normally this value is between 0 and 1, and the higher the value, the higher the explanatory power for the outcome variable) and the F-value of 1.820 are used (Table 2). This value is significant at the 5% level because the p-value is less than 0.05. This statistic rejects the null hypothesis that MFI services have no impact on SME growth and development.

The partial eta squared reported is comparable to the R squared in the simple regression analysis. In this case, the partial Eta-squared (r-squared) of Pillai's trace for MFI services is 0.407. This means that the predictor variable MFI services explains 40.7% of the variation in SME development. The other 59.3% is explained by factors not included in the model.

*Table 2: Multivariate Tests*

| **Effect** | | **Value** | **F** | **Hypothesis df** | **Error df** | **Sig.** | **Partial eta Squared** |
|---|---|---|---|---|---|---|---|
| **Intercept** | Pillai's Trace | 0.902 | 518.476[b] | 2 | 113 | 0.0000 | 0.902 |
| | Wilks' Lambda | 0.098 | 518.476[b] | 2 | 113 | 0.0000 | 0.902 |
| | Hotelling's Trace | 9.177 | 518.476[b] | 2 | 113 | 0.0000 | 0.902 |
| | Roy's Largest Root | 9.177 | 518.476[b] | 2 | 113 | 0.0000 | 0.902 |
| **MFI Service** | Pillai's Trace | 0.814 | 1.82 | 86 | 228 | 0.0000 | 0.407 |
| | Wilks' Lambda | 0.348 | 1.828[b] | 86 | 226 | 0.0000 | 0.410 |
| | Hotelling's Trace | 1.41 | 1.836 | 86 | 224 | 0.0000 | 0.413 |
| | Roy's Largest Root | 0.882 | 2.338[c] | 43 | 114 | 0.0000 | 0.469 |

a. Design: Intercept + α MFI Services

b. Exact statistic

c. The statistic is an upper bound on F that yields a lower bound on the significance level.

*Source: field data*

### 4.3 Tests of between-subjects effects (between-subjects)

The between-subjects effect test determines the influence of the predictor variable (MFI services) on each of the outcome variables (i.e. capital growth, income growth and job creation). Table 3 shows that the first criterion variable, namely capital growth, has an F-value of 2.284. This value was significant at 5% level of significance as its $p < 0.001$. This means that the study rejects the null hypothesis that MFI services have no impact on capital growth of SMEs. Furthermore, the partial Eta square (the r-squared) was 0.463 (46.3%), implying that MFI services explain 46.3% of the variation in SMEs' capital growth.

*Table 3: Tests of Between-Subjects Effects*

| Source | Dependent Variable | Type III Sum of Squares | df | Mean Square | F | Sig. | Partial Eta Squared |
|---|---|---|---|---|---|---|---|
| Corrected Model | Capital | 18.259a | 43 | .425 | 2.284 | .000 | .463 |
| | Income | 18.259a | 43 | .425 | 2.284 | .000 | .463 |
| | Employment | 39.238b | 43 | .913 | 1.428 | .070 | .350 |
| Intercept | Capital | 182.629 | 1 | 182.629 | 982.52 | .000 | .896 |
| | Income | 182.629 | 1 | 182.629 | 982.52 | .000 | .896 |
| | Employment | 255.519 | 1 | 255.519 | 399.92 | .000 | .778 |
| MFI Services | Capital | 18.259 | 43 | .425 | 2.284 | .000 | .463 |
| | Income | 18.259 | 43 | .425 | 2.284 | .000 | .463 |
| | Employment | 39.238 | 43 | .913 | 1.428 | .070 | .350 |
| Error | Capital | 21.190 | 114 | .186 | | | |
| | Income | 21.190 | 114 | .186 | | | |
| | Employment | 72.838 | 114 | .639 | | | |
| Total | Capital | 343.000 | 158 | | | | |
| | Income | 343.000 | 158 | | | | |
| | Employment | 514.000 | 158 | | | | |
| Corrected Total | Capital | 39.449 | 157 | | | | |
| | Income | 39.449 | 157 | | | | |
| | Employment | 112.076 | 157 | | | | |

a. r squared = .463 (Adjusted R Squared = .260)

b. r squared = .350 (Adjusted R Squared = .105)

*Source: field data*

## 5. Discussion

The results of the study show that the overall relationship between MFI services and SME growth is positive and statistically significant. This means that MFI services influence SME expansion. Moreover, the relationship between an SME and MFIs largely determines the survival of the SME, as SMEs do not have access to financial support from large financial institutions such as trading companies due to lack of credit history and collateral. Non-financial services such as training and mentoring, mostly provided by MFIs, also play a crucial role in the development of these SMEs as they lack many aspects of business management that guarantee their success just like large companies.

MFI services have also been shown to have a positive and significant impact on SME development. Factors such as loans provided by MFIs enabled SMEs to increase their working capital for their daily activities, purchase inputs such as machinery and increase their stocks. In addition, training and mentoring helped SMEs develop human capital skills that contribute to the proper management of these enterprises. This is in line with the human capital theory, which states that companies whose employees invest in training and development increase their skill levels and are more productive than less skilled employees, so they can expect higher returns and thus higher growth as a result of their investment in human capital. The results of the study are consistent with the studies by Makorere (2014).

The study found a positive and significant relationship between MFI services and SME development. This relationship was supported by the responses from the study where many SMEs testified that through the support and advice of MFIs, they were able to withstand financial shocks they once experienced, access financial services, increase their turnover, acquire fund management skills and also increase their client base, which had an overall impact on their income generation opportunities. These findings are in line with the pecking order theory that growth of a business is related to lending but also leads to lower profitability of the business due to high interest rates which, according to the study, are also a burden on SMEs. These findings are consistent with those of the studies by Awuah and Addaney (2016), Geoffrey and Emenike (2018) and Osoro and Muturi (2013).

Finally, the study found that MFI services and the ability of SMEs to create jobs are positively but not significantly related. The study found that many enterprises are not able to employ many people due to several factors such as few operational processes that can be carried out by a few and strong competition between enterprises operating in the same industry in the same area resulting in low client base. The findings of the study are not in line with the studies of Awan and Ibrahim (2015), Ilori and Ayoola (2017) and Owusu (2013).

### 5.1 Summary of the results

The results of the study suggest that non-financial MFI services have a greater impact on the ability of SMEs to attract more people into the business (i.e. create jobs) compared to financial MFI services. The skills required to run a business, which most SME owners lack, have led them to delegate any tasks that would be worthwhile, leaving entrepreneurs more time for other tasks with which to grow their businesses.

Moreover, the study cannot reject the null hypothesis that MFI services have no impact on job creation in SMEs. This means that MFI services did not help SMEs to employ more people. This is also evident from the fact that most SMEs are run by only one person who does all the work.

### 5.2 Conclusion

From the findings of the study, the capital growth of SMEs thanks to MFI services has resulted in these SMEs having sufficient funds for their daily activities, which are financed by loans from MFIs. The loans have also made it easier for these SMEs to expand their ventures, which is also in line with the pecking order theory that lending goes hand in hand with business growth. The study also highlights that the training and mentoring of SMEs by MFIs on savings habits has helped these enterprises to accumulate funds which they would then reinvest in future ventures.

The study highlights that the reduced financial challenges due to the introduction of MFIs have improved the earning power of these SMEs. SMEs were also able to withstand financial shocks and improve access to financial services, which was inaccessible before the introduction of MFIs, as commercial banks only offered their services to large companies. Through the relationship between MFIs and SMEs, these small businesses were able to increase their turnover and client base, but their earning power was affected by the MFIs' interest costs.

In addition, SMEs have seen an improvement in the management skills of their staff. The training and mentoring provided by the MFIs have improved the business management skills of these SMEs, which has led to expansion of these enterprises. Nevertheless, the study found that the SMEs did not hire more staff because the cost of hiring was higher and they risked their reputation by entrusting others to manage their businesses.

### 5.3 Implication for theory

This study is based on three theories, namely the human capital theory, the pecking order theory and the bank capital theory. From a theoretical perspective, the pecking order theory proposed by Akpan and Nneji (2015) states that at the beginning of a business, internal sources of finance are used and as the business grows; external debt is introduced into the business to propel it to greater heights. Although the theory states that external funding worsens the profitability of the firms, the study found that these external funds have bankrupted the firms due to high interest rates and the ability to manage the funds.

This leads to the second theory, the bank capital theory, which laid the foundation for the establishment of MFIs to meet the needs of SMEs as they do not have access to credit from commercial banks, as described by Ferdousi (2015). However, the study found that while SMEs have access to loans from MFIs, these loans come with much higher interest rates, which inhibits SME growth. A new approach should theoretically focus on the affordability of these financial services for small and medium-sized enterprises.

## 5.4 Policy and Practice Implications

The following are the main practical implications of the study for private sector managers and public sector analysts and managers:

### 5.4.1 Private sector managers

One of the major disadvantages faced by SMEs in availing MFI services is the high interest rates imposed on SME borrowers, which in turn affects their income earning capacity. Also, the stringent procedures that have to be followed to get a loan from an MFI are another obstacle that leads to stagnation in the growth of SMEs. The study therefore recommends that MFIs stop charging such high interest rates and therefore have few clients, but think in terms of economies of scale and charge low interest rates to attract many clients. But also because of the defaults of these SMEs, MFIs could work with them to ensure they do not default by making sure their businesses thrive. This could be done through training and offering services to conduct feasibility studies, market research, branding, pricing and sales techniques.

The study found that despite the services offered by MFIs to support SMEs; these businesses are not able to create more jobs. Since SMEs are an important tool for job creation in developing countries like Tanzania, the business environment should be conducive and easy for more participants. The constant fluctuations in the business climate in developing countries discourage more participants from engaging in small business creation. Therefore, the study suggests that the government should create a stable economic environment in which entrepreneurs can engage by stabilising inflation rates that affect MFI lending rates.

The study highlights the positive and significant impact of MFI services, both financial and non-financial, on SME growth in Tanzania. The study also found that only 34.8% of SMEs in Ilala City are members of an MFI. The lack of membership in these MFIs could be the reason why many SMEs without growth potential go out of business early. Factors such as lack of capital, skills and mentors are the reasons why many SMEs are unable to grow. Thanks to the availability of MFIs, SMEs now have the opportunity to grow. Therefore, private sector managers should take advantage of this opportunity by partnering with MFIs, as many of them enter business without the necessary business acumen. When you join an MFI, you not only have access to financial help, but also to mentors and skills such as money management that reduce the risk of business failure. Public sector analysts and managers SMEs in developing countries like Tanzania are an important source of development and the backbone of the economy, as they employ a large proportion of a country's labour force. The introduction of MFIs was aimed at boosting the private SME sector.

Although MFIs have a significant impact on the growth and development of SMEs, the study also found that the loans and other financial services offered to SMEs have high interest costs, which limits the profitability of SMEs. It is therefore high time that public sector analysts and managers review the guidelines for MFIs. The review of interest costs should be a key issue, with the aim of reducing interest rates and making them affordable for businesses and encouraging more people to engage in SMEs, thereby creating jobs for the masses.

### 5.4.2 Public sector implications

In addition, public sector analysts should draft a policy requiring MFIs to provide knowledge and training to SMEs. The study found that skills and mentoring play an important role in the growth and development of SMEs. The policy should ensure that these businesses have a comprehensive understanding of finance, marketing and sales. MFIs should provide training and mentoring to the managers of these SMEs to ensure that they are equipped with the knowledge to run these businesses effectively.

## 5.5 Area for further study

The respondents had a low level of education. Most of these respondents had completed primary school. In addition, most of the enterprises fall into the category of SMEs because of the size of their capital. Further studies can therefore examine enterprises that fall into the medium category, are run by highly qualified staff and use advanced technologies, and observe whether MFI services have the same impact on SME growth as those found in this study.

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