

# **The Financing Challenges of SMEs in Tanzania: Perspectives during the Covid-19 Pandemic**

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## **Abstract**

This dissertation explores the financing challenges faced by small and medium-sized enterprises (SMEs) in Tanzania during the Covid-19 pandemic. Employing a qualitative research design with interviews with representatives from SMEs and financial institutions, the study explored the perspectives of SMEs seeking financing (demand side) and financial institutions offering it (supply side).

The thematic findings reveal that SMEs, especially those in sectors such as hospitality, tourism and trade, encountered intense challenges due to revenue declines, asset depreciations and increased risk perceptions among lenders. SMEs reported experiencing onerous information requirements, stringent terms, increased collateral requirements, and reduced access to financing during the pandemic, these insights were however not the same for the health sector as some SMEs indicated favourable experiences in accessing financing during the pandemic period. The study also found a gap in SME awareness of government support programs with most participants unaware of initiatives like the Bank of Tanzania's Covid-19 liquidity facility, suggesting a need for improved outreach and communication in future crisis events. On the financing side, financial institutions demonstrated a cautious financing approach due to economic uncertainty and falling business activity with priority being on risk reduction through prioritizing low-risk clients and protecting financial institutions through enhanced financing conditions and collateral.

The research concludes that Tanzanian SMEs faced increased challenges in accessing financing during the pandemic due to economic uncertainty, reduced revenues, increased risk perception of SMEs by financial partners, inadequate and ineligible collateral and the lack of comprehensive support programmes to uniquely support SMEs over the course of the pandemic. Recommendations emphasize improved support from development partners and the government for SMEs and the financial institutions that support SMEs during crisis events to ensure a resilient SME sector. Future studies could expand by investigating sector-specific impacts and exploring quantitative approaches to measure the financing challenges of SMEs more broadly during crisis periods.

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## List of Acronyms

<b>AFDB</b>	<b>African Development Bank</b>
<b>BRELA</b>	<b>Business Registrations and Licensing Agency (BRELA)</b>
<b>BOT</b>	<b>Bank of Tanzania</b>
<b>COVID-19</b>	<b>Coronavirus disease 2019</b>
<b>CTI</b>	<b>Confederation of Tanzanian Industries</b>
<b>DANIDA</b>	<b>Danish International Development Agency</b>
<b>DEAP</b>	<b>DSE Enterprise Acceleration Program</b>
<b>DSCR</b>	<b>Debt Service Coverage Ratio</b>
<b>DSE</b>	<b>Dar es Salaam Stock Exchange</b>
<b>EAC</b>	<b>East African Community</b>
<b>EBITDA</b>	<b>Earnings Before Interest, Tax, Depreciation, Amortization</b>
<b>EGM</b>	<b>Enterprise Growth Market</b>
<b>FSDT</b>	<b>Financial Sector Deepening Trust</b>
<b>GDP</b>	<b>Gross Domestic Product</b>
<b>IFC</b>	<b>International Finance Corporation</b>
<b>IMF</b>	<b>International Monetary Fund</b>
<b>ITC</b>	<b>International Trade Centre</b>
<b>LDC</b>	<b>Least Developed Countries</b>
<b>MFI</b> s	<b>Microfinance Institutions</b>
<b>MNO</b>	<b>Mobile Network Operators</b>
<b>MSME</b>	<b>Micro, Small and Medium Enterprises</b>
<b>MIT</b>	<b>Ministry of Industry and Trade</b>
<b>OECD</b>	<b>Organisation for Economic Co-operation and Development</b>
<b>PD</b>	<b>Probability of Default</b>
<b>SACCOS</b>	<b>Savings and Credit Co-operative Society</b>
<b>SADC</b>	<b>Southern African Development Community</b>
<b>SDGs</b>	<b>Sustainable Development Goals</b>
<b>SGFR</b>	<b>Second Generation of Financial Sector Reforms</b>
<b>SME</b>	<b>Small and Medium Sized Enterprises</b>

<b>TCCIA</b>	<b>Tanzania Chamber of Commerce, Industry and Agriculture</b>
<b>TECC</b>	<b>Tanzania Entrepreneurship and Competitiveness Centre</b>
<b>TIPS</b>	<b>Tanzania Instant Payment Systems</b>
<b>TPSF</b>	<b>Tanzania Private Sector Foundation</b>
<b>TZS</b>	<b>Tanzanian Shilling</b>
<b>UN</b>	<b>United Nations</b>
<b>UNCTAD</b>	<b>United Nations Conference on Trade and Development</b>
<b>UNIDO</b>	<b>United Nations Industrial Development Organization</b>
<b>USD</b>	<b>United States Dollars</b>
<b>VICOBA</b>	<b>Village Community Banks</b>
<b>WBES</b>	<b>World Business Environment Survey</b>
<b>WHO</b>	<b>World Health Organization</b>

# **Chapter 1: Introduction**

## **1.1 Introduction and Background of the study**

SMEs are important actors in economies, they represent the majority of businesses globally and play an important role in job creation and economic growth (Nasr et al., 2012). The International Monetary Fund (IMF) posits that a strong SME sector is vital as it strengthens a country's resilience through broadening and diversifying the domestic economic base and increasing tax revenue collections. Moreover, SMEs form a critical component of achieving the United Nations (UN) Sustainable Development Goals (SDGs) 1,8, 9 and 10 which aim to promote no poverty, inclusive and sustainable economic growth, employment, decent work for all, resilient infrastructure, promotion of sustainable industrialization and fostering of innovation respectively.

At a global level, SMEs account for 90% of businesses and employ more than 50% of the active labour force (World Bank, n.d.) with 7 out of 10 jobs in emerging economies being generated by SMEs. SMEs contribute more than 40% to the GDPs of emerging and developing economies and more than 55% to the GDPs of developed economies with numbers estimated to be substantially higher when informal SMEs are included (World Bank, n.d.). The success stories of many of today's developed and middle-income countries are attributed to growth in the SME sector, for example the industrialization of Japan, Taiwan, and South Korea were largely the result of growth of the SME sector (United Nations, 2005).

In the Tanzanian context, SMEs are important to the economy as they contribute to job creation, government tax revenues as well as the livelihoods of many actors along the respective SME value chains. 95% of businesses in Tanzania fall into the SMEs category and enterprises classified as SMEs are currently in excess of 3 million (FSDT,2012). SMEs contribute approximately 35% to Tanzania's GDP (Tanzania Chamber of Commerce, Industry and Agriculture,2013) with the leading economic sectors being agriculture, transport and trade services employing in excess of 5.2 million people. More than 73 percent of the increase in total private employment estimated at

3.3 million people between 2002 and 2012 was created largely by micro and small firms (Diao et al., 2016). Additionally, SMEs contribute to supporting the livelihoods of women with more than 50% of SMEs in Tanzania being owned by women (FSDT,2012). The Government of Tanzania, through its Tanzania Development Vision 2025 strategy (popularly known as “Vision 2025”) classified the SME sector as an important contributor to achievement of the country’s long-term development vision towards middle income status.

Despite their immense contributions to socio-economic development, SMEs particularly those in emerging and developing nations continue to encounter challenges that hamper their growth potential. These challenges include inadequate access to finance, poor infrastructure, policy and regulatory weaknesses, power shortages, corruption, low government support and weak financial and managerial skills (Gachara & Munjuri, 2018).

IFC (2017) found that in developing and emerging economies, access to finance is the second most cited obstacle facing SMEs to grow their businesses while domestically UNIDO (2013) found that only 14 percent of SMEs in Tanzania had access to formal credit from a financial institution. Furthermore, various studies have shown that the probability of being credit constrained decreases as firm size increases and that SMEs in the least-developed regions of Sub-Saharan Africa and Asia are more likely to encounter significant financing obstacles (Ayyagari, Demirgüç-Kunt & Maksimovic, 2006). In Tanzania, key challenges constraining growth of the SME sector include an unfavorable legal and regulatory environment, poor infrastructure, underfunded business development services, limited access to financing and poorly coordinated institutional support (World Bank, n.d.). Among these constraints, access to finance is the most critical one (Mori & Richard, 2012).

The challenges SMEs face however are more pronounced in times of external shocks such as financial crises, environmental disasters or pandemics. Williams and Vorley (2017) asserted that SMEs are disproportionately impacted and are frequently the most vulnerable during times of major public crisis as they do not have adequate financial resources to cushion their operations. This is further exacerbated as financial institutions reduce liquidity in efforts to minimize credit risk worsening an already financially vulnerable economic sector.

Recently, the global economy was affected by one of the worst health and economic crisis of our times due to the outbreak of the novel coronavirus-2019. The novel coronavirus (later abbreviated Covid-19) was first identified in November 2019 in Wuhan City, Hubei Province, China. The virus quickly spread across nations and was declared a global pandemic by the World Health Organization (WHO) on 11<sup>th</sup> March 2020. At the time of this study, globally reported cases had reached 775 million while deaths exceeded 7 million (WHO, 2024). Beyond the health and human tragedy, Covid-19 created the worst global economic crisis since World War II (Naseer et al., 2023) with lower levels of gross domestic product (GDP), rising unemployment, disruptions in transport and global supply chain systems, higher levels of impoverishment and increased income inequality. The IMF (2020) found that the pandemic disproportionately impacted households and SMEs, particularly those operating in the tourism, transport, manufacturing and service sectors while the World Bank (2020) classified SMEs as one of the most vulnerable economic groups to the Covid-19 pandemic.

The Covid-19 pandemic had a significant impact on the Tanzanian economy with the SME sector bearing the biggest burden (CTI, 2021). The International Trade Centre (ITC) reported that in Tanzania, two out of three businesses were severely impacted by COVID-19, primarily due to reduced sales and difficulties in accessing inputs with tourism, hospitality, manufacturing and trade sectors being the hardest hit. The Confederation of Tanzanian Industries (CTI) reported that SMEs bore the brunt of the Covid-19 pandemic's economic impact, highlighting the need for a dedicated SME response framework to support the sector's recovery (OECD, 2021). Similarly, the African Union Commission for Trade and Industry reported a sharp downturn in the Tanzanian SME sector which had left much industrial capacity idle with productive capacity falling markedly since the crisis.

On the financing side, Tanzanian SMEs have been significantly impacted, credit access to the SME sector during the height of the pandemic declined due to poor financial performance of businesses and rising non-performing loans since the onset of the pandemic with the Bank of Tanzania reporting a decline in private sector credit of -0.2% in 2020 (the year of the height of the pandemic) compared to 7% growth in 2019 and 5% average growth in the 2016-2019 period as

banks curtailed lending, constraining a sector that is already troubled by limited access to financing.

## **1.2 Statement of the Problem**

This study seeks to explore the financing challenges of SMEs in the Covid-19 pandemic era. Specifically, the study seeks to address the following problems:

**Constrained Access to Financing for SMEs in Tanzania:** SMEs in Tanzania face significant difficulties in accessing financing, which hampers the growth of the sector. The SME sector is vital to Tanzania's economy, contributing to job creation and livelihoods for many Tanzanians. Previous studies by Mori and Richard (2012), Mori (2018), Olomi et al. (2008), Marwa (2014), and Gassiah and Kikula (2022) have consistently identified financing as a major challenge affecting the growth of the Tanzanian SME sector. Despite awareness and some initiatives by both the public and private sectors to address this issue, the challenge remains pervasive.

**Impact of the Covid-19 Pandemic on SME Financing:** The Covid-19 pandemic exacerbated the financing challenges faced by SMEs globally. Due to their high financial fragility and presence in sectors directly impacted by the pandemic, SMEs experienced significant economic fallout (World Bank, 2020). In response to the pandemic's economic effects, commercial financial institutions tightened liquidity and increased risk parameters to control credit default risk, further complicating access to financing for SMEs.

**Increased Obstacles to Financing During Crisis Events:** Crisis events, such as the Covid-19 pandemic, add additional layers of complexity to the financing challenges of SMEs. Factors such as increased information asymmetry, higher monitoring costs, asset price declines impacting loan collateral values, and multi-sectoral funding gaps lead to increased credit rationing. This often results in larger, lower-risk corporate and sovereign borrowers being prioritized over SMEs, which are perceived as higher risk (Bernanke, 1983; Cowling et al., 2012; Dell'Arcia, 2017; Bernanke & Gertler, 1989; Kiyotaki & Moore, 1997; Campello et al., 2022).

**Research Gap on SME Financing in the Covid-19 Era:** The Covid-19 pandemic represents an unprecedented global socio-economic crisis. Its effects are still being analysed, and the long-term impacts are yet to be fully understood. In Tanzania, there have been no detailed studies on the experiences of SMEs in accessing financing during the Covid-19 pandemic era, indicating a notable gap in research within this crucial yet vulnerable economic sector.

Given the vital contribution of SMEs to job creation and economic growth in Tanzania, it is essential to explore the financing challenges these businesses face during crisis events like the Covid-19 pandemic. Understanding these challenges is key to creating targeted solutions that can protect SMEs, strengthen their resilience, and sustain their contributions to economic stability and livelihoods across the country for the foreseeable future.

### **1.3 Research Objectives**

The objective of this study is to explore the challenges of SMEs in accessing financing during the Covid-19 pandemic era. The specific objectives of the study are;

- i. To explore the challenges SMEs faced in accessing financing during the Covid-19 pandemic
- ii. To explore the experiences financial institutions faced in providing financing to SMEs during the Covid-19 pandemic

### **1.4 Justification of the Study**

This study is motivated by the increasing role SMEs play in supporting economic growth and job creation in Tanzania and the need to build economic resiliency of this sector during crisis periods so as to protect livelihoods of SME actors and the economy in general.

Despite the uniqueness of the Covid-19 pandemic to the global and local economy, the financial resources implemented to build economic resilience and the importance of the SME sector to Tanzania's economic growth, no detailed study has been conducted to understand the financing challenges of Tanzanian SMEs in the Covid-19 pandemic era. A few prior studies were conducted during the height of the pandemic to assess the impact of the Covid-19 pandemic on the economy

in general with a view to support national response plans. In addition to the lack of studies assessing financing challenges of SMEs in the Covid-19 pandemic era, from what we have discerned, no prior studies have examined the impact of disasters on SMEs and SMEs' financing access or the post disaster policy needs in Tanzania hence the country's policy makers, development partners and financial institutions that serve SMEs do not have a robust understanding of the challenges SMEs face during a public crisis and/or response plans and roadmaps to implement to effectively support these SMEs through crisis periods particularly on the financing front where support is most needed.

This study seeks to deepen our understanding of the challenges faced by SMEs in accessing financing in Tanzania in the Covid-19 pandemic era and contribute to the limited literature on the effects of the Covid-19 pandemic on SMEs in Tanzania. Current studies on the effects of the Covid-19 pandemic in Tanzania focus on the macro-economic shocks. By obtaining a deeper understanding of the challenges faced by SMEs in accessing financing during the Covid-19 pandemic era based on the lived experiences of SME actors (both on the financing demand and supply sides), educational institutions, the government, development partners and financial institutions will be able to better understand the financing needs of SMEs during crisis periods and develop specific interventions and products to support SMEs to build long term resiliency and adequately respond to future public crises and pandemics.

### **1.5 Organization of the Study**

The study is organized into five chapters as follows;

Chapter 1 provides an introduction of the research to be conducted commencing with a brief background on the Covid-19 pandemic and the SME sector both globally and nationally, thereafter the research problem is presented followed by an assessment of the study's research objectives. This chapter concludes with a justification of the study where the researcher highlights how the study will contribute towards supporting various stakeholders in creating a supportive financing ecosystem for SMEs during public crisis events.

Chapter 2 commences with a presentation of the key terminologies, thereafter a review of the history of the SME sector and overview of the Tanzanian SME landscape is presented. We proceed

to discuss the Covid-19 pandemic, Tanzania's response to the pandemic and the impact of the pandemic on SMEs. This is followed by a review of the financing challenges of SMEs and the financial services landscape in Tanzania in general. The section proceeds to discuss the theoretical framework and concludes with empirical literature on the challenges SMEs face in accessing financing in light of crisis events.

Chapter 3 covers the research methodology used in the study. This section elaborates the research design, research methods, choice of SMEs and financial institutions to be analyzed, data collection and data analysis. Ethical considerations and limitations of the adopted research methodology are also discussed in this chapter.

Chapter 4 presents a discussion on the findings of the study.

Finally, the study concludes with Chapter 5 where conclusions and recommendations are presented. The conclusion also points out limitations, and draws attention to future areas of research.

## **Chapter 2: Literature Review**

### **2.1 Introduction**

This chapter reviews existing literature relevant to our study to gain an understanding of the findings of other researchers. We commence with a presentation of the definition of an SME to provide a foundation of the study. After that, a review of the history of the SME sector and a brief snapshot of the Tanzanian SME landscape is presented. The chapter proceeds to explore the Covid-19 pandemic, Tanzania's response to the pandemic and the impact of the pandemic on SMEs. Thereafter, a review of the financing challenges of SMEs is presented which is followed by a look at the financial services landscape in Tanzania. The section proceeds to discuss the theoretical framework and concludes with empirical literature from prior studies conducted on the subject of challenges SMEs face in accessing financing in light of crisis events and particularly the Covid-19 pandemic.

### **2.2 Definition of SMEs**

Universally, no standard international definition of what constitutes an SME exists. SMEs are defined differently in different countries; this is due to the nature of size being a relative term in different economies hence there is variation in what constitutes an SME across countries. Common metrics referred to in measuring what constitutes an SME are total number of employees, total investment and sales turnover. OECD countries refer to SMEs as firms employing up to 239 people while in India SMEs are defined according to turnover and the amount of funds invested. China has a more complex classification system that includes number of employees, industry category and total assets.

In Tanzania, the definition of an SME is set by the Ministry of Industry and Trade under the SME Development Policy. SMEs in Tanzania are defined according to the sector of operation, the number of employees and the capital investment. According to the Tanzania SME Development Policy, SMEs are classified as micro, small, and medium-sized enterprises operating in sectors

such as manufacturing, mining, commerce, and services. Micro enterprises are businesses that employ up to four people, typically family members, or operate with capital of up to TZS 5.0 million. A large number of micro enterprises operate within the informal sector. Small enterprises are primarily formal businesses that employ between 5 and 49 people and/or have capital investments ranging from TZS 5 million to TZS 200 million. Medium enterprises typically employ 50 to 99 people and/or operate with capital investments between TZS 200 million and TZS 800 million. In cases where an enterprise belongs to more than one category, then the level of investment serves as the determining factor (Ministry of Industry and Trade, 2003).

**Table 1:** Classification of SMEs in Tanzania

<b>Category</b>	<b>Employees</b>	<b>Capital Investment in Tanzanian Shillings (TZS)</b>
<b>Micro-Enterprise</b>	1-4	Up to 5 million <i>(equivalent to USD 1,836 based on exchange rates at the time of the study)</i>
<b>Small Enterprise</b>	5-49	Above 5 million to 200 million <i>(equivalent to USD 1,836 and USD 73,457 respectively based on exchange rates at the time of the study)</i>
<b>Medium Enterprise</b>	50-99	Above 200 million to 800 million <i>(equivalent to USD 73,457 and USD 293,828 respectively based on exchange rates at the time of the study)</i>
<b>Large Enterprise</b>	100 and above	Above 800 million <i>(equivalent to USD 293,828 based on exchange rates at the time of the study)</i>

**Source:** Ministry of Industry and Trade,2003

### **2.3 Historical Context of the SME Sector in Tanzania**

In 1967, following adoption of the Arusha Declaration, Tanzania embraced a form of socialist ideology called “Ujamaa”. “Ujamaa” advocated for socialism as a solution to support the social and economic development of Tanzania post-independence. Under ‘Ujamaa’, private enterprises ranging from banks, insurance companies, trading companies and manufacturing companies were nationalized. The government discouraged private enterprises in favor of public enterprises and in the spirit of “Ujamaa’s” collective ownership doctrine, co-operative owned ventures were encouraged while SMEs were discouraged and severely controlled. The government created state owned entities to supply goods and services to its people. State restrictions were implemented on establishing new ventures, and public servants were prohibited from running private enterprises. This approach led to suppression in the development of entrepreneurship and the SME sector in

general (Olomi, 2001). The ‘Ujamaa’ system was aimed at supporting equitable development for the people in a post-independence Tanzania by ensuring economic activities are owned and centrally controlled by the government without consideration for the developmental contribution of the SME sector.

Despite Tanzania’s achievements with socialism on matters of education, health care and community development (Temu & Due, 2000), the system of Ujamaa led to a weak economy marked by several imbalances on a macroeconomic level which resulted in an economic crisis in the 1980s and early 1990s (Kanaan, 2000). The ensuing tough economic conditions brought on by the crisis forced people to establish small businesses to survive resulting in the beginning of a small but vibrant SME sector. At the national level, the government implemented changes to support economic recovery of the country from the crisis, this coupled with conditions imposed by IMF’s Structural Adjustment Programs and pressure from the international community, Tanzania was forced to commence changes in the country’s economic policy (Wobst, 2001). Tanzania transitioned from a state-led economy to a market-economy, with the final shift in the country's economic model occurring in 1991. The changes resulted in the privatization of many state-owned entities and rapid growth of the SME sector.

## **2.4 Snapshot of the SME Sector in Tanzania**

### *2.4.1 Introduction*

According to the Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA), 95% of the businesses in Tanzania are Small and Medium Enterprises (SMEs) contributing about 35% to Tanzania’s GDP. The contribution of the SME sector to the country’s economy is substantial with 5.2 million persons being employed in this sector and business ventures classified as SMEs outnumbering 3 million (FSDT,2012). The government recognizes that SMEs are vital in supporting poverty reduction, gender equality, employment creation and economic growth and through the Ministry of Industry and Trade developed and operationalized the SME Development Policy in 2003 to guide the growth of the SME sector.

### *2.4.2 SMEs for Catalytic Growth and Development*

In Tanzania, SMEs operate in agriculture, trading, mining, manufacturing, logistics and service industries with some SMEs being highly inter-linked (Ministry of Industry and Trade, 2003). SMEs are essential actors that support catalytic economic growth for Tanzania, FSDT (2017) posited that investments into the SME sector catalyze linkages across various sectors of the Tanzanian economy creating multi-sectoral derived economic growth. In addition to their ability to create catalytic growth, Tanzania SMEs contribute to human capital development through skills development and job creation hence mopping up millions of underemployed individuals into the labour market (Baragwiha, 2013). According to Ellis et al. (2018), the SME sector created more jobs than any other sector positively contributing to national initiatives towards job creation. Tanzanian SMEs have also been uniquely recognized for the role they play in supporting the economic empowerment of women, with more than 50% of Tanzanian SMEs being owned and/or managed by women (FSDT, 2012) therefore acting as a catalyst for equitable economic prosperity.

#### *2.4.3 Challenges of the SME Sector in Tanzania*

Despite the significant contributions of the SME sector to Tanzania's economy, it continues to face challenges that prevent it from reaching its full potential in driving economic growth and creating jobs for the nation. These challenges include a socialist ('ujamaa') economic history that slowed private sector development, inadequate infrastructure, both soft and hard which has made conducting business difficult. AfDB (2021) noted that Tanzania's poor road and rail networks and an inefficient port make national and global trade activities of raw and processed goods cumbersome and costly, hindering national, regional and global trade opportunities for local businesses, particularly SMEs that require efficient infrastructure to conduct their businesses profitably. Additionally, Tanzania still has emerging telecommunications and digital infrastructure with access to telecommunications and technology solutions being primarily in urban areas, much of rural Tanzania remains excluded from the benefits of advanced telecommunications, this coupled with the shortage of well-trained ICT professionals, slow adoption of digital technology, low internet access and low purchasing power has created a technology gap curtailing the growth of e-commerce, an area of immense opportunities for SMEs in emerging markets (Osakwe, 2023). According to Hamisi (2011), inadequate business management skills is another bottleneck for many Tanzanian SMEs contributing to poorly managed SMEs and a low graduation rate of small enterprises to medium and large enterprises.

However, the biggest challenge affecting the Tanzanian SME sector is access to financing with many SMEs facing constrained access to financing due to poor credit history, weak collateral, poor financial management, high-risk perception and intensive credit rationing by financial institutions (Mori, 2018).

#### *2.4.4 Interventions Implemented to Address Challenges of the SME Sector*

The Tanzanian government has been working to create a conducive environment for SMEs including developing soft and hard infrastructure, improving the regulatory environment, harmonizing policies and supporting technical skills development. On the infrastructure front, the government has embarked on ambitious capital investment projects in energy, transport, telecommunications and agriculture, these investments will provide reliable access to affordable power to support small scale industries, road, rail and port networks to support national, regional and global trade for SMEs, telecommunication and technology systems to support efficiency, lower transaction costs and improve ease and speed of local and global communication and trade for both individuals and businesses while agriculture sector investments will create a reliable supply of raw materials for trading and manufacturing activities for SMEs. On soft infrastructure, the government has streamlined and harmonized systems to facilitate SMEs' access to information as well as simplify business and tax registration processes through the Business Registrations and Licensing Agency (BRELA) and the Tanzania Revenue Authority (TRA).

SMEs however remain critically underfunded. The government, development partners and financial institutions have made some progress but more is required to create meaningful impact. Some notable programs implemented to support unlocking finance for the SME sector include the TZS 1 trillion SME liquidity program for financial institutions that was activated during the Covid-19 pandemic period, the SME Credit Guarantee Scheme being administered by the Bank of Tanzania, the AFDB-CRDB credit guarantee scheme; a USD 120 million credit guarantee programme aimed at partially supporting the SME sector implemented by the African Development Bank and CRDB Bank Plc, the DANIDA-CRDB SME Credit Scheme valued at USD 13 million as well as the USAID-NBC SME credit scheme valued at USD 10 million (FSDT,2016) all these efforts have aimed at supporting access to affordable credit for SMEs. Additionally, the government in partnership with development partners has earmarked and

invested in technical assistance and capacity development programs to support the SME sector, this is evident with the launch of the Tanzania Entrepreneurship and Competitiveness Centre (TECC) aimed at enhancing the skills of SME owners in the country and the creation of institutions aimed at advocacy amongst the SME sector as well as organizing strong networks to support SME sector growth, these institutions include amongst others the Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA), the Financial Sector Deepening Trust (FSDT) and the Tanzania Private Sector Foundation (TPSF). Additionally, through the Dar es Salaam Stock Exchange (DSE), the government is promoting easier access to financing through capital markets by leveraging the Enterprise Growth Market (EGM) segment which is designed to help SMEs raise funds from capital markets with flexible terms while the DSE Enterprise Acceleration Program (DEAP) and the Endeleva Program provide SME acceleration technical assistance support for growth phase SMEs although these initiatives have had limited success primarily due to the nascent stage of Tanzania's SME sector and capital markets.

## **2.5 Financing Challenges of SMEs**

### *2.5.1 General Overview of Financing Challenges of SMEs*

Studies on the financing challenges of SMEs have been conducted since the early 20<sup>th</sup> century. In 1931, the United Kingdom's Committee on Finance and Industry published the MacMillan Report, therein particular difficulties SMEs face when attempting to raise funding were discussed, SMEs were noted to suffer from a 'financing gap' which became known as the 'MacMillan Gap' (Johnman and Murphy, 2000). In the 1970s, the Bolton Committee Report (1971) and the Wilson Report (1979) further reinforced the challenges that SMEs faced in obtaining financing.

The viewpoint that smaller firms face a unique set of challenges in terms of accessing financing has become deeply entrenched in public policy dialogue at national and regional levels for both developed and developing countries with the World Bank (2017) citing financing as the biggest challenge SMEs in emerging and developing markets face. The financing of SMEs presents a conundrum on both the supply and demand side. On the supply side, banks perceive SMEs as high-risk borrowers that are expensive to serve profitably. Dalberg (2011) found that banks shy away from financing SMEs due to higher transaction costs, higher risk, lower returns and inadequate collateral compared to lending to large corporate clients. According to Beck and Demirguc-Kunt

(2006), banks face challenges with information opacity when it comes to lending to SMEs due to poor financial record keeping. Another challenge that banks face in financing SMEs is the lack of the requisite internal technical skills and expertise to adequately serve SMEs particularly in developing countries where SMEs are still in their nascent stages and need technical experts to support their financing and growth.

Levitsky (1996) conducted a study to understand the challenges that banks face in financing SMEs and challenges noted included a high failure rate of SMEs attributed to their higher fragility to shock events and dependence on owner management hence in the event the owner undergoes distressing events the likelihood of a failure is very high thus exposing commercial banks to greater risk. Other bottlenecks noted in financing SMEs included high transaction costs and poor financial record keeping.

### *2.5.2 Financing Challenges of SMEs: Tanzanian Context*

SMEs in Tanzania face similar challenges in accessing financing from commercial banks. Tanzania has a well-developed financial services landscape with 47 banks operating in the country as at the time of this study. The banking sector is well regulated through the Bank of Tanzania and has shown robust growth and stability due to a supportive regulatory environment and high demand for financial products from households and corporates. Despite the vibrancy and strength of the country's financial services landscape, SMEs continue to encounter difficulties in obtaining loans from formal financial institutions. The 2012 Financial Sector Deepening Trust (FSDT) Baseline Survey of Micro, Small and Medium Sized Enterprises identified access to financing as the most pressing challenge SMEs face in Tanzania.

Mori et al. (2009) found that SMEs in Tanzania have a preference for informal and semi-informal financing products due to the challenges of accessibility with formal financing products, while Olomi et al. (2008) found credit access for SMEs in Tanzania was constrained by both internal and external factors. Internally, the study noted weak managerial skills, an under-developed culture of entrepreneurship, lack of separation of the business with personal and family issues, limited credit history of SMEs, poor financial literacy and lack of information on the available products from

financial services negatively affecting access to finance for SMEs. External factors noted in the study were a lack of an enabling environment with laws that protect lenders at the expense of borrowers. Similarly, Marwa (2014) conducted a study on characteristics which impair SMEs' access to finance in Tanzania and found that weak regulation, and lack of property rights were some of the significant constraints facing Tanzanian SMEs in addition to firm size, lack of sufficient managerial and business skills, informality of the activities, poor record keeping and information opacity.

### *2.5.3 Financing Challenges of SMEs during Crisis Events in Tanzania*

The financing challenges of SMEs during crisis events have not been well studied in the Tanzanian context, studies have focused on the impact of crisis events on the economy and financial services landscape in general. The global financial crisis of 2008 presents the most recent crisis event prior to the current Covid-19 pandemic crisis. According to the Bank of Tanzania (2009), macroeconomically the global financial crisis of 2008 affected the economic growth of Tanzania with real GDP growth rates declining from 8% annually before the crisis to 5% in 2009 primarily due to plummeting commodity prices in global markets and reduced trade volumes in the mining, agriculture and tourism sectors. According to Lunogelo et al. (2009), local SMEs were largely shielded from the 2008 financial crisis because of limited integration with international financial markets.

The Covid-19 pandemic created new challenges for SME financing as commercial financial institutions decreased their appetite for lending on the back of reduced trade activities and the closure of many businesses in some key sectors including tourism, trade and manufacturing where SMEs are key actors. Bank of Tanzania (2021) and IMF (2020) found that private sector credit growth decelerated during the height of the Covid-19 pandemic due to uncertainty and heightened risk aversion by commercial banks, however recovery was noted in 2021 and 2022 as private sector activity rebounded and banks eased lending.

## **2.6 The Covid-19 Pandemic: History, Impact, Responses and Tanzania's Response**

### *2.6.1 Introduction*

The novel coronavirus, later named COVID-19, was first identified in Wuhan, China, in December 2019. Its rapid spread across China and subsequently the world led the World Health Organization (WHO) to designate it as a "Public Health Emergency of International Concern" in January 2020 and by March 2020 a global pandemic (WHO, 2020). The Covid-19 pandemic resulted in over 775 million reported cases and more than 7 million deaths worldwide as of 2024 (WHO, 2024). Beyond its direct health impacts, the pandemic triggered profound global economic disruptions culminating in the most significant economic downturn since the Great Depression (IMF, 2020). The International Monetary Fund indicates that global GDP declined by 3.4% in 2020, accompanied by rising unemployment, increased poverty, and greater income inequality (IMF, 2020). Health expenditures surged to over USD 9 trillion in 2020, approximately 11% of global GDP to support containment measures, healthcare systems, and disease treatment (Health Systems Governance and Financing, 2022). Economic measures were equally extensive, with governments worldwide spending over USD 14 trillion to mitigate the pandemic's effects (IMF, 2024), these initiatives encompassed fiscal and monetary policy interventions to stabilize financial systems, support businesses, and protect vulnerable populations with households and SMEs given priority by governments.

### *2.6.2 Tanzania's Unconventional Approach to the Covid-19 Pandemic*

Tanzania's initial response to the COVID-19 pandemic was unconventional and attracted significant criticism. At start of the pandemic, the Tanzanian government implemented travel bans, testing and quarantine measures and closed schools and universities. However, in June 2020, as the global pandemic intensified, Tanzania made the controversial decision to reopen all borders. This move drew widespread criticism, with concerns raised by various international organizations that the country could face a health and humanitarian crisis as global transmission rates worsened. The Tanzanian government's focus shifted to sensitizing the public about preventive measures. However, the country's low testing rates, lack of reliable data, and absence of transparent dialogue on the extent of COVID-19 in Tanzania fostered uncertainty and fear (Pallangyo et al., 2020).

After the death of President John Magufuli in March 2021, Vice President Samia Suluhu Hassan assumed the presidency in April 2021. Under her leadership, Tanzania adopted a more proactive approach to managing the pandemic, incorporating open dialogue on disease prevalence and enhanced health and socioeconomic interventions. In September 2021, the government launched the Tanzania COVID-19 Socioeconomic Response Plan which aimed to strengthen health systems, roll out a national vaccination program, and support economic recovery.

In both the initial and subsequent response interventions, Tanzania implemented both fiscal and monetary policy responses to support economic resilience. On the monetary policy front, the government through the Bank of Tanzania (BOT) implemented initiatives to safeguard the stability of the financial services and private sector. Market liquidity was bolstered so banks can increase credit to companies constrained by the pandemic, additionally the discount rate was reduced from 7% to 5%, the minimum reserve requirements were lowered from 7% to 6% and adjustments were made to the collateral haircut on government securities - for securities with maturities of less than one year, the haircut was reduced from 10% to 5%, while for longer-term securities, the haircut was lowered from 40% to 20%. Furthermore, in an effort to support the private sector and avert a debt crisis amongst banks, BOT offered regulatory flexibility to banks for loan restructuring enabling them to restructure loans up to four times compared to the pre-pandemic limit of two times. Restructurings were mainly in the form of maturity extensions and grace periods in debt servicing. Most banks utilized the availed regulatory flexibility with 11% of the total banking sector credit being restructured. Furthermore, in 2021, BOT launched a TZS 1 trillion liquidity facility for banks to on-lend to SMEs with linkages to the agriculture sector at concessionary interest rates as a means to support economic recovery. On the fiscal policy side, the then Ministry of Finance and Planning (MoFP) accelerated domestic payment arrears while the Tanzania Revenue Authority expedited payments of VAT refunds, giving priority to SMEs. Domestic payment arrears totalling TZS 916 billion (approximately USD 336 Million) were paid by the government under this intervention (Njoya, 2022).

### *2.6.3 The Impact of Covid-19 on SMEs*

The SME sector has been one of the sectors severely impacted by the Covid-19 pandemic. IMF (2020) found that countries that implemented stringent lockdown policies and curfews and/or those with high economic dependencies on globally integrated value chains, trade, tourism, and remittances had unprecedented economic contractions with the greatest impact being observed on households and SMEs, particularly SMEs operating in the tourism, transport, manufacturing and service sectors. The UN (2021) report on the impact of COVID-19 on Least Developed Countries (LDCs) revealed that SMEs have struggled significantly to cope with the socio-economic impacts of Covid-19 with effects noted on both the supply and demand sides. On the supply side, SMEs faced labour shortages as workers and business owners fell ill, cared for children or dependents due to school closures, or were unable to work because of movement restrictions. Secondly, measures implemented to contain the disease through lockdowns, curfews and quarantines resulted in further declines in available labour resources while supply chain disruptions caused shortages of raw materials, intermediate goods, and spare parts required by SMEs. On the demand side, SMEs experienced a sudden and significant decline in demand and revenue, severely impacting their liquidity and overall financial stability. Consumers faced loss of income and heightened uncertainty leading to reduced consumer confidence and, subsequently, lower spending and consumption. Some sectors, such as tourism, hospitality, personal services and transportation where most SMEs operate were affected by a greater magnitude as physical presence of the workers and customers is essential for operations. The World Bank (2020) found that SMEs have been disproportionately impacted by the Covid-19 pandemic with higher business failure rates for SMEs at the height of the health crisis, financial illiquidity due to both demand and supply shocks, constrained access to financing and mass employee lay-offs.

The vulnerability of SMEs to the Covid-19 pandemic is attributed to a number of reasons. Firstly, SMEs were disproportionately concentrated in the sectors most impacted by the crisis in particular light manufacturing, wholesale trade, retail trade, transport services, tourism, food and hospitality services and other professional and personal service industries. Secondly, SMEs often struggle to access information on disease containment measures, effective business strategies for navigating the crisis events, and government support initiatives. Additionally, SMEs due to their small size lack the bargaining power and economies of scale necessary to negotiate the best financing and

supply chain terms that favour large corporates and multi-national enterprises hence are more vulnerable during tough times. SMEs also have challenges with their supply chain linkages as they have a limited number of suppliers which exposes them to disruptions in transportation and supply shortages further increasing their vulnerability.

The Tanzanian SME sector felt the full weight of the adverse economic effects brought on by the COVID-19 pandemic. The East African Business Council conducted a study to assess the impact of Covid-19 on the SME sector at the height of the pandemic and found that in Tanzania, SMEs operating in the tourism, hospitality, trade and manufacturing sectors were affected due to disruptions in global travel, trade and logistics brought about due to restrictions in other countries aimed at curbing disease spread. Additionally, global demand for commodities declined hence reducing volume and prices for agricultural and mining commodities from Tanzania exposing SMEs involved in the production and trading of commodities resulting in some SMEs laying off staff while others had to suspend their operations.

On the financing front, smaller firms are financially fragile and have limited cash reserves to survive business downturns hence making them more vulnerable to crisis. SMEs do not have the same preferences and /or flexibility to tap into different sources of finance including capital markets with the Pecking Order Theory (Myers and Majluf,1984) indicating SMEs' preferences for retained earnings before debt and external equity financing to ensure retention of ownership and business autonomy. However, when funding requirements during a crisis are high, SMEs are unable to tap into external sources of finance as easily as their larger counterparts, this challenge is more pronounced in developing economies where capital markets are nascent hence making fund raising difficult (World Bank, 2020). Moreover, SMEs face constrained access to financing as financial institutions adopt credit rationing when making credit decisions, this challenge becomes more pronounced during a public crisis as banks reduce their risk appetite to minimize default risk (Okuwhere & Osifo,2022).

## **2.7 The Financial Services Landscape in Tanzania**

Financial institutions are a critical component to supporting economic growth and social development globally. The Tanzanian financial services sector has gone through a number of

changes aimed at improving their contribution to the country and her people. In 1991, the government started to implement the First Phase of Financial Reforms to allow financial services to be market driven. The economic reforms implemented under the First Phase of Reforms resulted in an open market economy and market forces being used to allocate funds in a more efficient way hence enhancing the effectiveness of monetary policy instruments and promoting competition and efficiency in the financial services sector.

The First Phase of Reforms were reviewed in 2001 and 2003, the success of the initial measures was noted but it became apparent that additional efforts were required to improve the financial services sector, financial inclusion for most Tanzanians was lacking, access to long term funding to finance infrastructure, housing and the business sector was constrained and in particular SMEs faced challenges in accessing both short term and long-term credit to foster their growth. This led to the Second-Generation Financial Sector Reforms (SGFSR) implemented from 2006 to 2011 to address the shortcomings of the First Phase of Reforms. The Second-Generation Financial Sector Reforms (SGFSR) resulted in increased efficiency of the financial services sector, programmes were implemented by the government in partnership with the International Monetary Fund and the World Bank to support Tanzania by providing her access to long-term development finance with a focus on key economic sectors and strengthening micro and rural finance under an enabling policy and an enhanced legal and regulatory framework (Bank of Tanzania,2016). The outcome of these reforms was growth in the number of financial institutions in the country and increased financial inclusion for Tanzania.

Today, Tanzania has an active financial services industry with the number of players in the financial services sector currently totaling 47; comprising of 34 commercial banks, 4 community banks, 4 microfinance banks,2 development finance institutions,1 non-bank financial institution,1 housing finance company,1 mortgage refinancing company. Additionally, Tanzania has 1,352 Tier 2 microfinance institutions. The total asset base for all financial institutions is currently in excess of TZS 54 trillion (Bank of Tanzania,2024). Tanzanian banks offer a multitude of products and services to individuals, SMEs and corporates ranging from saving and transactional accounts on the liabilities side to loans, overdrafts and trade finance instruments on the assets side as well as off-balance sheet solutions. In addition to assets and liabilities, some financial institutions provide

financial advisory services and more recently some banks offer complimentary capacity building programmes to support individuals and SMEs to better manage their finances and improve their financial literacy. Two commercial banks hold the lion's share of the asset base with 52% of the total banking sector assets, these are CRDB Bank Plc and NMB Bank Plc.

Banking services are offered through brick-and-mortar infrastructure and digital channels. The government in coordination with financial institutions have invested heavily in supporting ease of access to financial services across the country through developing policies and infrastructure to ensure effective delivery of financial services. Despite the efforts and successes made to date, rural consumers still face challenges in accessing financial services due to expensive last mile distribution of financial services. As the time of this research, Tanzania had 957 branches across the country with the concentration of branches being in the urban cities of Dar es salaam, Arusha, Mwanza and Dodoma. Many banks have commenced providing their financial services through agent banking services in efforts to increase access to financial services particularly to previously unbanked lower-income clients and rural customers. In addition to physical agent banking services, financial services are also provided through digital platforms with seamless integration implemented through the Bank of Tanzania's Tanzania Instant Payment Systems (TIPS) hence allowing for efficient access to banking services across all commercial banks and ease of conducting payments instantly.

The Covid-19 pandemic accelerated the speed of banks in implementing digital solutions to support consumer access to financial products from their mobile devices through applications and USSD gateways as social distancing became an effective way of reducing disease transmission hence resulting in improved financial inclusion particularly for regions where physical branches are not easily accessible. In addition to financial institutions, mobile network operators now also provide financial services with products ranging from saving products, micro-loan products and transaction capabilities commanding a sizeable share of wallet of savings and transactions due to the ease and low costs of using mobile money services.

Beyond the formal financial services landscape, peer savings schemes and semi formal and informal financial institutions (popularly known as SACCOSs and VICOBAAs) are also active in

the Tanzanian financial services landscape especially in rural and low-income communities where access to formal financial services is limited with many micro and small enterprises utilizing them to access much needed financing without the bureaucracy of commercial banks.

## **2.8 Theoretical Framework**

Four key theories feature prominently on discussions of the financing challenges of SMEs; these are the Theory of Information Asymmetry developed by Akerlof, Spence and Stiglitz in the 1970s, the Credit Rationing Theory developed by Stiglitz and Weiss in 1981, the Pecking Order Theory developed by Myers and Majluf in 1984 and the Financial Inclusion Theory. A review of each of these theories is presented below together with an analysis of the respective theory in light of crisis events as well as the Covid-19 crisis.

### *2.8.1 Theory of Asymmetric Information*

The theory of asymmetric information was developed and formalized in the 1970s and 1980s by George Akerlof, Michael Spence, and Joseph Stiglitz. The information asymmetry theory posits that information imbalances between different stakeholders involved in making a decision (e.g. buyers and sellers) leads to inefficient outcomes in markets and decision making. Information asymmetry is usually seen when one party to a transaction is better informed than the other party resulting in sub-optimal decision making, adverse selection, moral hazard and monopolies of knowledge.

In the context of SMEs, SME owners are viewed as having more information about their businesses compared to financial institutions. Various studies have attributed information asymmetry as a key contributor to the financing challenges of SMEs as banks do not have complete information about an SME's business therefore resulting in financial institutions reducing loans to SMEs compared to the financing sought by creating a phenomenon known as "credit rationing". In addition to credit rationing, asymmetric information leads to adverse selection and moral hazard in financing SMEs.

To counter the information asymmetry of projects, financial institutions increase interest rates to manage credit risk. Higher interest rates result in low-risk borrowers withdrawing from credit markets as they are unwilling to pay the information asymmetry risk premiums while riskier borrowers are willing to pay higher interest rates to access financing resulting in adverse selection as lower quality borrowers are financed. Financial institutions manage the risk of adverse selection by implementing robust risk assessment and analysis prior to financing thus some banks may decline some transactions despite the potential for higher interest due to the risk of adverse selection further reinforcing credit rationing behavior. SMEs are disproportionately affected by adverse selection in credit markets owing to poor financial records and weaker financial performance attributed to their infancy and size.

Moral hazard on the other hand occurs when a borrower engages in high-risk decisions that are contrary to the financing agreement with the lender hence exposing the lender's investment to higher risk. Moral hazard stems from financial institutions lacking visibility on fund utilization and business operations of the borrower therefore providing room for borrowers to make riskier decisions with loaned funds deviating from pre-agreed conditions of the loan. Financial institutions manage moral hazard by reducing the value of loans and/or implementing stringent credit underwriting procedures, the outcome of these measures is limited financing for SMEs and higher financing and transaction costs.

Information asymmetry and its effects are more severe during crises periods due to higher information opacity between borrowers and lenders and a lower risk appetite by financial institutions to lend. Various studies have been conducted to understand the impact of crisis periods on information asymmetry. Kirabaeva (2011) found that asymmetric information, adverse selection and moral hazard are more pervasive during crisis periods while Brunnermeier (2009) and Krishnamurthy (2010) found that crisis events aggravate adverse selection in credit markets with the resultant outcome being higher financing costs and reduced funding for borrowers in credit markets. Similarly, Mishkin (2022) conducted a study on asymmetric information and historical financial crises, the study found that the effects of asymmetric information on financing decisions was more severe during crisis periods in comparison to non-crisis periods reinforcing

the position that information asymmetry effects are more pronounced during times of financial turmoil.

### 2.8.2 *Credit Rationing Theory*

The credit rationing theory was developed by Joseph Stiglitz and Andrew Weiss in 1981 and explains the choices banks make in relation to credit decisions under conditions of asymmetric information, moral hazards and risk aversion explained above. The theory argues that information asymmetry between management and financiers is the major reason why SMEs have constrained access to finance; only SMEs know their true financial condition, strength of investment and intention to repay debt while financiers may not have complete information and rely on the information sourced from SME owners and the market. Consequently, ‘the bank manager’ makes decisions using asymmetric information, and operates under an adverse selection risk. This results in banks taking risk-based decisions on the amount and terms of credit facilities to SMEs which results in credit to SMEs being apportioned based on the information the banker has access to. According to Stiglitz and Weiss (1981), asymmetric information can lead to credit rationing conditions by modifying the (perceived) risk-return distribution. Furthermore, credit rationing may result in financiers declining to fund good investments and produces a divergence between capital demand and supply (Alfo & Trovato, 2006).

The biggest challenge with credit rationing is it reduces efficiency as good investments may not be able to access the funding they need. Credit rationing coupled with information asymmetry may result in enterprises with similar risk profiles being availed different credit amounts. Moreover, some categories of SMEs face additional problems due to information asymmetry and risk aversion thus becoming negatively affected by credit rationing- this includes young enterprises that may not as yet have built a strong track record, enterprises with insufficient financial records, enterprises in rural environments – such enterprises are seen as particularly risky, have higher information opacity and may therefore face greater credit rationing effects when accessing financing from financial institutions.

Studies on the relationship between the credit rationing theory and crisis periods have been conducted; Blanchard (2009) argued that credit rationing intensifies during crises due to heightened risks. The credit supply shock theory (Bottero et al., 2020) further suggests that firms

subjected to credit rationing are more likely to face limited access to external financing during such periods. In the context of the Covid-19 pandemic, Khan (2022) found that credit rationed firms were less likely to access financing due to tightened market liquidity and higher perceived risk by financial institutions.

### 2.8.3 *Pecking Order Theory*

The Pecking Order Theory was developed by Myers and Majluf in 1984 (Myers,1984) and (Myers & Majluf,1984)) and posits that the cost of financing increases with asymmetric information, this has the effect of creating a hierarchy of preferred funding sources for enterprises starting with company retained earnings which have the lowest cost and the lowest information asymmetry to debt as a second option and equity from external shareholders as a last resort. The Pecking Order Theory also has its foundation in information asymmetry; the internal management of a company has more information about a company than external investors such as banks, consequently with increased information asymmetry, each class of investors (debt or equity) attaches a risk premium for investing funds into an enterprise hence resulting in differing costs of financing. Furthermore, the theory purports that an enterprise's choice of finance sends signals in the market. Using retained earnings and internal shareholders' financing is considered to be a strong signal, it shows that the concerned enterprise has sufficient reserves to take care of their financing needs or the shareholder sees sufficient value in their enterprise to inject further equity. Debt financing may infer that management is confident to meet the fixed payments which is also a relatively good signal. On the other end of the spectrum, according to the Pecking Order Theory, if an enterprise raises financing by issuing new shares, it is perceived as a negative signal because it is believed that a company generally issues new stock when it perceives the stock to be overvalued.

The Pecking Order Theory is evident in practice in the SME space, empirical evidence can be seen from the study by Ou and Haynes (2006) and Howorth (2001) where it was found that SME owners prefer to source capital from their own savings and retained earnings; after exhausting self-financing options they then seek financing in the form of loans from friends and family or from banks and lastly consider the introduction of new shareholders to inject equity capital into the enterprise. Furthermore, SME owners usually shy away from equity investors due to the impact of

diluting their shareholding that this financing mechanism brings. SME owners prefer to retain control and managerial independence of the firm.

During periods of crisis as is the case with the Covid-19 pandemic, company internal resources are not sufficient to support operations of the entity resulting in an increased preference for SMEs to access external sources of financing. De Souza et al. (2022) conducted a study to understand the Pecking Order Theory for Brazilian SMEs during the Covid-19 pandemic and found that companies increased seeking external financing for their SMEs during the pandemic. The study found that SMEs liabilities grew significantly during the pandemic era to support their liquidity requirements. Additionally, the study found that larger SMEs are more likely to access debt financing whilst small SMEs have greater reluctance to access external financing due to barriers to financing and the need to retain control of their businesses.

#### *2.8.4 Financial Inclusion Theory*

The financial inclusion theory is another important discourse in access to financing products for SMEs. According to the World Bank (2018), financial inclusion refers to the process by which households and business can access financial services in a responsible and sustainable way. Financial inclusion ensures that individuals can access financial services such as credit facilities, saving accounts, insurance products in a dignified and fair manner, (Demirguc-Kunt et al., 2015). Financial inclusion is important in supporting SMEs and their growth as it allows them to access financial products to grow their businesses, improve operational efficiency and protect their businesses and assets. Eton et al. (2021) conducted a study to analyse the relationship between financial inclusion and financing for SMEs and found that financial inclusion has a positive effect on the ability of SMEs to access financial services and raise financing.

Financial inclusion poses a significant barrier to SMEs in Tanzania in accessing financing. Kazimoto (2014) observed that SMEs in Tanzania are financially excluded due to a number of reasons including the lack of adapted financial products to serve SMEs, high costs in accessing financial products, weak distribution of financial service centres, low access to technology and digital financial products and high transaction costs. Furthermore, the study found that SMEs face

additional challenges in accessing financing due to weak collaterals, poor financial record keeping and high interest rates which play a further role in their financial exclusion particularly when it comes to accessing financing.

The Covid-19 pandemic negatively impacted the financial inclusion of SMEs. Kasradze (2020), Pellegrino and Abe (2022) and Jia et al. (2022) found that the Covid-19 had a negative impact on financial inclusion of SMEs due to lockdowns and restrictions which limited the ability of SMEs to access banking services from physical branches particularly in developing economies, however this was partially mitigated by the accelerated adoption of digital financial solutions which allowed financial institutions to provide individuals and SMEs with access to financial services and products therefore ensuring the existing financial inclusion gains are not reversed and SMEs continue to access financing and affiliated products in a safe and sustainable way. Lewis and Liu (2020) report that the Covid-19 pandemic provided new opportunities to address financial inclusion challenges for SMEs through digital business models that allowed SMEs to access banking services remotely and improve SMEs credit history for the SME owner/manager as transactions were now formalized through technology driven platforms instead of physical business transactions which sometimes lacked paper trails, making the assessment of credit history for SME owner-managers difficult. Furthermore, digital platforms allowed easy and effective roll-out of relief and stimulus funds to support SMEs across various markets.

## **2.9 Empirical Literature**

This sub-section examines prior studies conducted on challenges and barriers SMEs face in accessing financing from financial institutions through a thematic analysis with four key themes identified, namely; collateral requirements, cost of funding, availability of information on financing options and business risks. This review considers these themes in light of crisis events and particularly the Covid-19 pandemic.

### *2.9.1 Collateral Requirements*

Collateral refers to the assets pledged by borrowers to lenders as security for debt repayment (Gitman, 2003). Adequate collateral is one of the key requirements financial institutions require to advance credit facilities. The value of the collateral pledged to banks is used as security to recover the principal loan value in case of default by the borrower. This collateral can be in the form of fixed assets such as land, buildings or machinery, cash cover or personal and corporate guarantees. In most developing countries, tangible assets are requested as eligible collateral with real estate being the preferred form of collateral. Collateral helps to address moral hazard risks prevalent in financing the SME sector thus providing an in-built duty of care in utilizing loan funds by beneficiaries as financial institutions can liquidate pledged collateral assets to recover their funds. Most financial institutions ask for collateral equivalent to 100% or more of the loan (Mullei & Bokea, 2000). In Tanzania, the regulatory requirement is 125% of the loan value, however regulatory provisions exist for unsecured and partially secured loans subject to the loan amounts being less than 5% and 10% of the financial institutions core capital respectively (BOT,2011).

From the perspective of the financial institution, collateral for credit advanced is important as the pledged assets provides the institution with an asset whose value can be realized in the event of a default, a risk mitigant plan for a loan. Cocco (2000) stated that collateral serves as the lender's second line of defense. Aghion and Bolton (2008) argued that collateral serves as a tool for resolving the moral hazard problems in the lending business. From the perspective of SME owners, collateral requirements may pose a challenge as nascent enterprises may lack adequate tangible assets to pledge as collateral. Beck et al. (2006) conducted a study using the World Business Environment Survey (WBES) for a sample of countries and found that collateral requirements are one of the top three difficulties SMEs face in accessing financing.

The collateral conundrum for SMEs is the result of both external and internal factors. Developing countries including Tanzania lag behind in land titling and property registration with many properties being constructed on informal land. This lack of adequate land titling has contributed negatively to the stock of eligible collateral SMEs can use to access credit for business growth and expansion. Vuvor and Ackah (2011) found that collateral requirements were one of the top challenges for SMEs in Ghana in accessing financing, however the problem was tied to lack of

eligible property due to informality. SME owners may have access to properties but the said properties cannot be used to access financing as they lack the requisite title documentation and hence cannot be encumbered per land and banking laws making them unusable as collateral.

In the case of Tanzania, banks create a first lien on title deeds, however with only 2% of landed properties in Tanzania having a title deed, this raises a big problem on how much of the property stock can be used as eligible collateral by banks to access financing. An SME owner wishing to access a loan may have a property to pledge as collateral, but if the property lacks the documentation from the government, the property despite its value cannot be used as collateral. Studies have been conducted on the relationship between collateral, property rights and credit access with contrasting conclusions. Galiani and Schargrotsky (2010), USAID (2021) and Feyertag et al. (2021) cite that formalization of property rights through the issuance of formal land titles supports access to credit and activates the flow of investment for households and SMEs. Contrastingly, Kyessi and Sekiete (2014) and Mbilinyi et al. (2022) found that land rights formalization to support the issuance of tangible collateral has not had a significant impact on access to credit as banks place greater reliance on the financial performance of the SMEs when making credit decisions and not the underlying collateral which is seen as a last resort in recovering a delinquent credit facility. Despite the different outcomes in these studies, property rights are seen as an essential component in supporting financial inclusion and access to financing with land reform programmes earmarking access to financing and activation of investment on land assets as a key outcome of land formalization programmes.

In addition to the current challenges of lack of titled land, SME owners find that the required collateral thresholds are too high as banks employ the “forced sale” values when assessing eligible collateral. Furthermore, banks usually require the assessed value to be in excess of the loan amount hence creating a high bar for SMEs to access funding, this practice results in the value of the collateral being reduced at two points; on the assessment methodology (i.e. forced sale value or distressed value as opposed to market value) and thereafter on the loan to value requirements for the loan.

The preference of financiers to use tangible assets as collateral also creates a further challenge for SMEs with intangible assets such as technology and patents impeding innovation in the SME space; an enterprise may have an innovative and lucrative product or service but may be constrained by not having access to tangible assets to pledge to a bank in order to access the requisite financing.

Menkhoff et al. (2012) found that SME borrowers in less developed economies have less eligible collateral assets which can be pledged as security to banks, this results in SMEs accessing insufficient amounts of funding for their ventures due to the rationing of funding to match the collateral value of the SMEs. Similarly, in a study conducted in Bangladesh, Hoque et al. (2016) found that SME managers did not apply for financing from banks due to having insufficient collateral while Makena et al. (2014) in their study on the challenges of accessing finance for women owned businesses in Kiambu County, Kenya found that the lack of tangible collateral negatively affected an SME's ability to raise funding from banks hence hampering business growth. Furthermore, while collateral challenges pose a concern for all SMEs, they disproportionately impact women-owned SMEs due to the historical marginalization of women in property ownership rights.

An interesting observation made in the study by Jimenez and Saurina (2004) was that collateral may negatively affect the risk profile of a loan; their findings showed that collateralized loans to be more risky post-access than loans given without any collateral, consequently deducing that collateral may be used by banks to reduce the strict evaluation parameters since they provide a fallback position in the event of a default, this may then result in bankers accepting riskier loans as they have 'insurance' in the assets pledged as collateral.

Fatoki and Smit (2011) in their study on South African SMEs found collateral requirements for accessing credit to rank highly amongst constraints faced by SMEs in accessing financing in addition to managerial competency, networking, business information as well as the macro-economic and legal environment while Gangata and Matavire (2013) and Gangata et al. (2013) found that for SMEs, meeting collateral thresholds was ranked as the topmost challenge facing SMEs seeking financing in Zimbabwe. Similarly, Ramlee and Berma (2013) in their study of

Malaysian SMEs found that collateral remains an obstacle for SMEs to get loans from commercial lenders.

In light of crisis events, the following was noted. Asset prices influence collateral values and play a central role in access to financing for SMEs. Exogenous shocks to asset prices have the ability to impact SMEs access to financing and the quantum of financing accessible. Kiyotaki and Moore (1997) and Bernanke and Gertler (1989) presented studies that explore how asset prices influence credit decisions through changes in collateral values. Both studies concluded that rising asset prices increases the value of collaterals, thereby easing financing limits, expanding firms' borrowing capacity, and improving access to bank credit. Increased borrowing stimulates the economy and drives further rises in asset prices, thus accelerating collateral values further creating a "financial accelerator effect" through the property price channel. Similarly, during periods of falling asset prices as may occur during crisis periods, firms' access to credit is reduced as collateral values are lower and therefore eligible loan amounts decline, amplifying economic downturns. Campello et al. (2022) found that higher collateral values during periods of prosperity relate to higher investment and debt issuance while lower collateral values during crisis periods resulted in lower debt issuance.

The Covid-19 pandemic created asset price shocks in real estate markets with residential, retail, commercial and industrial property values falling causing a decline in collateral values and consequently the value of eligible financing borrowers can access. Horan et al. (2023) in their study to assess the impact of the Covid-19 pandemic on collateral channels and bank financing for SMEs found that the Covid-19 crisis created real estate asset price shocks which eroded the value of bank collaterals therefore directly affecting lending with credit facilities backed by real estate collateral receiving one third less credit following the outbreak of the pandemic.

On this analysis, we noted that lack of collateral, ineligible collateral, poor property formalization in developing economies, insufficient collateral and stringent collateral requirements by banks create constraints to SMEs that seek to access financing from financial institutions. It is also noted that while collateral is important, it is not the primary determinant of credit access, banks also place emphasis on the business model and performance of an enterprise to be financed.

Furthermore, this analysis highlights that crisis events have a direct impact on asset values which influence the value of loan collaterals and thus the quantum of financing borrowers can access.

### *2.9.2 Cost of Credit*

According to Beck (2007), in developing countries, access to and cost of finance are ranked by SMEs as a key growth barrier. The cost of credit includes the direct costs comprising of the interest charged on the funds accessed, facility fees, legal costs, conveyancing costs for collateral registration, insurance premiums and indirectly the travelling and administration costs the SME incurs in applying and accessing a loan.

From the perspective of financial institutions, interest rates reflect the ‘rental’ cost for a borrower to use their funds, while the other administrative fees charged reflect the cost of labor of the different parties involved in structuring and managing the transaction. Interest rates that banks charge borrowers are determined by market interest rates, yields on risk free debt instruments, interest rates paid to depositors as well as the risk profile of the borrower.

High interest rates are a deterrent to SMEs accessing financing from formal financial institutions. Kauffman and Wilhelm (2006) found that many SMEs do not attempt to access financing from banks due to the high interest rates charged while Calice et al. (2012) found that high interest rates offered by formal financial institutions forced many SMEs to seek alternative informal funding sources. Maalim and Gikandi (2016) showed that interest rates are negatively and significantly related with SMEs accessibility to credit. Furthermore, their study found that other loan administration costs negatively and significantly affected credit access. Correspondingly, Ochanda (2014) observed that loan costs had a negative impact on access to credit. A study carried out by Mwangi and Bwisa (2013) found youth owned SMEs faced challenges in accessing credit due the high cost of credit.

Hallberg (2000) argued that the high cost of credit to SME borrowers was the result of higher risks associated in lending to SMEs, high costs involved in acquiring information about borrowers with SMEs having the added challenge of high information opacity and monitoring costs involved in

mitigating SME lending risks. Another important factor in the cost of credit to SMEs in developing markets is relationship banking. Berger and Udell (1995) and Padilla and Pagano (1997) in their respective studies found that relationship banking allows banks to know more about their customer and also gather more information to be used in the decision-making process of loan granting; this knowledge allows the bank to define more appropriate terms of the loan including interest rates, covenants and administration costs. Consequently, SMEs with long-term relationships with their banks tend to pay lower rates and negotiate less stringent collateral requirements and loan covenants due to the reduced information asymmetry resulting from the existing relationship.

The challenge of the cost of credit in financing SMEs is more pronounced during crisis periods. Bernanke (1983) posited that crisis events have a negative impact on the cost of financing as they increase risk and uncertainty and disrupt the credit allocation process resulting in higher borrowing costs and restricted credit supply. Traditionally, banks charge higher interest rates to compensate for the additional real and perceived risks of SMEs. During crisis periods, this risk premium for SMEs increases further due to smaller firms having increased financial fragility and higher default risk therefore we see higher interest rates on SMEs during crisis periods (Cowling et al., 2012). According to Dell’Ariccia et al. (2017), the cost of credit is higher during crisis periods as financial institutions conduct more detailed analysis and post-disbursement monitoring to ensure credit risk is effectively controlled with the additional cost of analysis and monitoring being passed on to borrowers in the form of higher financing costs.

Crisis events usually result in rising market interest rates as demand for funding increases while market liquidity declines due to increased market risk and uncertainty. A notable example of the impact of crisis events on market interest rates and consequently financing costs occurred in 2008 as the global economy went through an endogenous financial shock caused by the sub-prime mortgage market that culminated into the global financial crisis, during this period the supply of credit dwindled while demand for financing increased pushing up interest rates and hence the cost of financing to borrowers (Ivashina & Scharfstein, 2010).

Beyond the health and human loss tragedy, the Covid-19 pandemic’s ensuing economic crisis has a strong resemblance to the global financial crisis of 2008 with both events creating global

economic disruptions. While the global financial crisis was the result of endogenous events with banks suffering the greatest losses, the Covid-19 pandemic created exogenous shocks to financial systems on both the supply and demand side due to disease spread and the lockdowns and curfews that affected trade, transport, manufacturing and human capital. Financial institutions globally responded by engaging in precautionary lending activities to preserve liquidity and minimize credit risk resulting in constrained credit supply and higher interest rates on loans with SMEs bearing the greatest burden of these constraints due to their higher perceived risk profile.

Recently, studies have been conducted to gauge the impact of the Covid-19 pandemic on cost of funding for borrowers. Hassan, Politsidis, and Sharma (2020) found that the Covid-19 pandemic resulted in higher interest rate spreads on loans as banks increased interest rates to manage higher risks induced by the pandemic. Similarly, Chodorow-Reich et al. (2020) found that SMEs faced higher interest rates when accessing credit from commercial banks during the peak of the Covid-19 pandemic exacerbating existing challenges of high cost of funding for SMEs.

Governments globally recognized the impact the pandemic would have on the quantum and cost of financing particularly for SMEs and responded with various fiscal and monetary policy interventions being implemented to protect financial systems and the SME sector from the high costs of funding. Kuckertz et al. (2020) examined the policy measures introduced in 40 countries to support SMEs during the COVID-19 crisis. The study found that 63.41% of these countries had implemented policies specifically targeting SME financing, with interest rate cuts being a key component of the interventions. Additionally, liquidity facilities, credit guarantee schemes and financial assistance programs targeting SMEs were rolled out to support the supply of low-interest rate loans to SMEs as market liquidity in the SME financing space declined (Cusmano et al., 2020).

### *2.9.3 Availability of Information*

Access to information by both SMEs and bankers is key to ensure SMEs get access to the requisite financing and banks understand the SMEs risk profile and provide the right amount of financing. The World Bank (2013) indicates that limited information negatively affects SMEs ability to access financing. In comparison to large firms, SMEs have less structured reporting and limited

public information about their performance and business activities therefore necessitating financiers to seek out the information to make the right investment decisions, this has a direct impact on transaction costs of financing SMEs.

According to Petersen and Rajan (1994), Berger and Udell (1995) and Vander Bauwhede et al. (2015) the information available on an SME by a financial institution is a key driver of access and cost of financing. Banks utilize the information provided by a borrower to create a risk profile of the SME which ultimately determines the borrower's eligibility for financing, the quantum of financing the SME can access, conditions and covenants of credit facilities and the interest rate to charge on financing facilities. Furthermore, as the financing relationship with the borrower progresses, borrowers continue to share information including financial performance, profitability, business plans and prospective investments with their financing partners with this information being continually utilized to assess the risk profile of the borrower and consequently the pricing of the SME's existing and new credit facilities as well as the ability to access additional financing. Beck and Demirguc-Kunt (2006), Ayyagari et al. (2008), and Beck et al. (2008) reiterated similar observations in their respective studies on SMEs. Udell (2004) found that one of the top reason banks quote as an impediment to financing SMEs is the lack of sufficient information about SME businesses.

Limited access to SME information leads to two key phenomena, asymmetric information and credit rationing. As previously elaborated, asymmetric information occurs as SME owners possess more information about their enterprises than lenders resulting in different perceptions of an investment proposal by the lender compared to the SME owner. Lenders being aware of this information asymmetry limit the allocation of credit to borrowers therefore resulting in the rationing of funds (i.e. credit rationing) (Stiglitz & Weiss, 1981) with less than efficient credit allocation of funding being the outcome.

Mori and Richard (2012) found that Tanzanian banks considered lending to SMEs as riskier due to lack of sufficient information, this included lack of sufficient documented evidence from SMEs that enabled the banks to conduct the required analysis, poor awareness on the part of the SMEs on why they do business, limited knowledge on financial management and unfaithful records.

Similarly, Marwa (2014) asserted that information opacity remains a key contributor to the financing challenges of SMEs in Tanzania as financial institutions are unable to conduct detailed risk assessments on SMEs and therefore fail to make the most appropriate financing decisions thus hampering SMEs access to financing.

In addition to affecting financing access, information availability for SMEs is a significant driver of the cost of financing for SMEs during the SME's banking relationship as banks utilize information provided by a borrower to create the risk profile of the SME borrowers which ultimately determines the quantum and cost of funds for SMEs (Berger & Udell, 1995). Winborg and Landstrom, (2000) reported that despite the importance of information to make the right financing decisions, SMEs are reluctant to share comprehensive information on their operations with the primary reason being fear of information going to competitors.

Technical skills and knowledge are also contributors to information opacity and the subsequent financing challenges. Coleman (2000) found that SME owners and managers lack the technical skills to present financial information in the standard required by banks, additionally the study found that small and micro enterprises are unable to pay for the services of professional accountants and auditors to ensure they keep proper financial records and generate audited financial statements, a pre-requisite for many financial institutions in making credit decisions with the outcome being that some creditworthy micro and small enterprises are denied financing simply because of failing to present information as required by formal credit providers. Furthermore, many early-stage SMEs may not have financial records at all to begin with which negatively affects their chances of accessing funding as banks require historical financial performance to make informed credit decisions.

On the other end of the information conundrum is financial literacy and the SME knowledge gap of financing products. Many SME owners lack information on the mix of products available from financiers to unlock their unique financing challenges, the best way to minimize funding costs, how to invest and save, and knowledge about maintaining a credit record to ensure a good credit rating when being assessed by credit reference bureaus for financing purposes. Financial literacy

of SME owners is especially problematic for SMEs in developing economies where SMEs are survivalist in nature and financial literacy rates are low.

The financial products knowledge gap is more pervasive amongst smaller enterprises, Abor and Biekpe (2006) in their study of Ghanaian SMEs found that knowledge about financing schemes was lacking with more than 50% of the respondent SMEs being unaware of special financing schemes to support SMEs, the study attributed this phenomenon to poor marketing and awareness campaigns by the financiers. It was also noted that the firms surveyed stated that their lack of knowledge about lending criteria and products may have negatively affected their ability to access the required credit facilities. Moreover, SME owners also indicated that they found it difficult to get information about available financing solutions partly due to weak marketing and relationship management.

Information challenges are intensified by crisis events. According to Mishkin (2022), crisis events and economic shocks create socio-economic uncertainty and aggravate information asymmetries between borrowers and lenders. The Covid-19 pandemic created information challenges at both national level and enterprise level. Given the rarity of a global pandemic of a magnitude similar to Covid-19, information challenges were noted at national levels globally as governments were unclear of the full economic effects of the pandemic with the resultant outcome being a decline in financing globally. However, over time as the crisis heightened, information on the economic effects of the pandemic and the future economic projections could be made by governments (IMF,2020).

According to Blackburn and Scharper (2014), at enterprise level, SMEs are less likely to be informed of government assistance programs hence further entrenching the information challenges of SMEs during crisis periods when more support programs are deployed therefore affecting their access to financing. This phenomenon was observed in the Covid-19 pandemic era, despite various national level stimulus programmes to support access to financing for SMEs, many SMEs did not have sufficient information on available programmes and interventions that were created to alleviate their financing challenges. For example, despite, substantial investments in building the resilience of the SME sector through financing programmes, Innovations for Poverty Action

(2021) found that 74% of firms in low-income countries reported lack of awareness as a primary barrier in accessing Covid-19 relief program funds. A study conducted by Nucleus Commercial Finance (2021) found information challenges affected SMEs, only 23% of SME owners profiled were aware of the SME Covid-19 schemes implemented by the UK government while a meagre 18% understood the procedures in accessing support. Similarly, in Ghana, Amegayibor (2023) found that only a quarter of SMEs had accessed government supported Covid-19 stimulus programmes indicating that the majority of SMEs did not benefit from nationally driven Covid-19 SME focussed stimulus programmes with respondents citing a lack of information on available programmes for SMEs, unclear application procedures and more concerning, information access and consideration for support being based on political party affiliation. Comparable results were observed in Zambia where the government implemented the Government Stimulus Package to support SMEs affected by the pandemic by providing affordable financing solutions, Mwaanga et al. (2021) found that most of the profiled SMEs were unaware of Covid-19 financing support programmes resulting in low uptake and a failure in supporting the targeted beneficiaries. Similar findings indicating that SMEs were largely unaware of Covid-19 financing programs were made in Malaysia (IsDB,2022) and Eswatini (ITC,2022).

#### *2.9.4 Regulatory Environment*

The lack of conducive regulatory environments may curtail financing access for SMEs. Beck (2007) highlighted that weaknesses in legal systems present in developing countries serve as an obstacle for financing access for SMEs concluding that governments have a responsibility to implement supportive regulations for SME financing. Fouejieu et al. (2020) strongly affirmed that financial regulation plays a key role in SMEs' access to financing as effective regulation supports safe financial systems, improved bank soundness and lower non-performing loan ratios resulting in increased funding resources and appetite to support lending activity to SMEs. Furthermore, the study found that there is an inverse relationship between non-performing loan ratios and SMEs financial access as lower asset quality at financial institution level (i.e. high non-performing loan ratios), often the result of weak financial regulation, results in lower financing activity by financial institutions to SMEs.

Nevertheless, the regulatory environment debate is not clear-cut with some researchers advocating for less restrictive regulatory environments. McLean and Charles (2020) found that lending regulations negatively affected the ability of SMEs to access funding and encouraged firms to operate opaquely which had the effect of increasing asymmetric information. Black and Strahan (2002) stressed that the financial services regulatory ecosystem should balance between supporting safe financial services and access to financing as a highly regulated environment increases entry barriers for financial institutions and SMEs eligibility to access financing thereby perpetuating a problem the same regulations were created to solve.

Given the importance of the financial regulatory environment to support SME's access to financing, financial regulatory reforms are important channels to unlock financing for SMEs. Fouejieu et al. (2020) advocated for developing economies to adopt financial regulatory reforms that provide a balance between creating a stable financial eco-system and supporting sustainable access to financing for SMEs. Egypt presents a notable example on the power of regulatory reforms in unlocking SME financing. In 2009, the Central Bank of Egypt implemented changes to encourage financial institutions to lend to SMEs by exempting bank deposits from statutory minimum reserve (SMR) requirements equal to the amount of loans provided to SME clients, this had a positive impact on growing SME lending by commercial banks. (CBE,2009).

The impact of financial regulations to SMEs access to financing during crisis periods has also been researched. According to Rojas-Suarez (2016), crisis events can negatively affect access to finance for SMEs as banks reduce their financing activities to ensure compliance to financial regulations which are tightened during crisis periods to protect the banking sector. SMEs carry a higher default risk which is more pronounced during crisis periods due to the greater financial fragility of smaller firms. Increased risk negatively impacts risk ratios such as capital adequacy and delinquency ratios, the outcome of this is banks curtail SME lending to meet regulatory compliance thresholds. Furthermore, adverse events may alert regulators to tighten regulations so as to ensure the safety of the banking sector exacerbating an already dire situation. Whilst supporting a safer financial services landscape is a positive move for the overall economy, it usually results in constrained access to financing for borrowers perceived to be high risk such as SMEs. A holistic approach in balancing regulatory compliance and access to financing is important during crisis events.

Governments implemented various financial regulatory adjustments at the peak of the Covid-19 pandemic, these included amendments to loan to value (LTV) conditions, statutory minimum reserves (SMR) and allowances to allow for unsecured lending. IMF (2021) found that regulatory adjustments implemented to support financial institutions to lend during the pandemic had a positive impact on credit access as banks continued to support borrowers albeit at reduced rates. According to the Bank of Tanzania (2021), conducive regulatory reforms that take cognisance of the pandemic and future crisis events are pertinent to build resilience, financial stability and reduce the vulnerability of SME borrowers during crisis periods.

### *2.9.5 Risk Perception and Risk Appetite*

Mori and Richard (2012) observed that financial institutions perceive SMEs as risky clientele hence resulting in more stringent credit assessments and lower credit accessibility. In light of crisis periods, Kundin and Erecgovac (2011) found that during crisis periods, the credit risk spread between large firms and small firms increases hence making accessing funding more expensive for smaller firms due to the perception by financial institutions that these firms are more financially fragile.

DeYoung et al. (2015) conducted a study on the impact of financial crises on SMEs financing and found that financial institutions increase their perception of risk for SMEs during crisis periods due to their higher financial vulnerability with banks restricting lending for SMEs as they are seen to have reduced repayment ability. Similarly, Vo et al. (2022) found that the risk perception of SMEs is more pronounced during crisis periods and that risk perception has a significant bearing on SMEs' post-pandemic bank lending decisions as banks restricted lending to SMEs due to the perception that SMEs have a reduced ability to repay loans during times of crisis. The study also found that SMEs were reluctant to access funding owing to fears and concerns on their ability to repay loans during the crisis period. Zubair et al. (2020) observed that during the height of the Covid-19 crisis, SMEs in the Netherlands increased demand for external financing, however smaller and younger firms were reluctant to apply for external financing due to fear of rejection of their financing requests by commercial banks, the SMEs perceived that banks would not fund them during the pandemic due to their higher risk profile. Similar outcomes were noted by Cowling et

al. (2016) and DeYoung et al. (2015) with smaller firms having a higher reluctance to access external financing and facing higher rejection rates on their financing requests from banks due to the perception of having higher risks on both the borrower and lender side during the global financial crisis.

## **Chapter 3: Methodology**

### **3.1 Introduction**

This chapter describes the research methodology adopted to address and answer the research question and objectives. The chapter covers a number of components as follows: firstly, a discussion of the research approach is presented, this is followed by the research design, thereafter definitions of the target population, sampling techniques and sample size have been presented, this is followed by an exploration of the data collection tools, procedures and analysis methods. The chapter concludes with discussions on ethical considerations which apply to the research methodology, and limitations of our chosen research methodology.

### **3.2 Research Approach**

The research approach refers to the overall framework guiding the research project; there are three research approaches that can be utilized in any study; namely qualitative, quantitative, and mixed methods (Creswell, 2003). This study utilized the qualitative research approach which works through exploratory studies whereby the research gathers views, opinions and the lived experiences of subjects. According to Creswell (1994), the qualitative research approach is grounded in discovery of phenomena in their natural setting by the researcher and can be conducted through case study, phenomenological study, ethnography study, grounded theory study, and/or content analysis.

Prior studies have been conducted to explore the challenges SMEs face in accessing financing in Tanzania (Olomi et al., 2008; Mori & Richard, 2012; Mori, 2018; Marwa, 2014; Kessy & Temu, 2010; Gassiah & Kikula, 2022). Despite extensive research on this topic, insufficient attention has been given to the specific challenges SMEs encountered in securing financing during the COVID-19 pandemic, an important historical event that has had widespread socio-economic effects on households and SMEs with effects expected to be sustained over the long-term horizon. The novel

nature of the Covid-19 pandemic and the lack of detailed prior studies on the research topic from the Tanzanian context calls for exploration of the subject matter through the lived experiences of study participants hence the choice was made to adopt an exploratory qualitative research approach for this study.

According to Saunders et al. (2016) when a study seeks to understand a phenomenon, develop a rich theoretical perspective than what is in existence, understand the lived experiences of the study participants and/or to understand the attributed meanings and associated relationships of the study participants and their experiences then an exploratory qualitative research approach is preferred. Similarly, Creswell and Creswell (2018) recommend a qualitative exploratory research approach when the study seeks to explore a phenomenon. The qualitative research approach in this thesis has adopted an inductive nature hence allowing the generation of theory by drawing generalizations and inferences out of the lived experiences and observations of study participants.

### **3.3 Research Design**

The research design refers to the plan of how the research question and objectives will be answered. It addresses how data will be measured, collected and analyzed. The research design details the following key factors; the target population, sample size, sampling techniques, data collection methods and data analysis.

A multiple case study research design was used, the reason for this choice was to allow for a nuanced and detailed understanding of the challenges SMEs faced in accessing financing during the Covid-19 pandemic from the lived experiences of SMEs and financial institutions. According to Yin (2009) multiple-case studies are useful to discover the lived experiences of study participants and events and can contribute towards robust theories and generalizations. A multiple case study research design provides a detailed review of the experiences of SMEs and financing partners of SMEs in various sectors, locations and of varying sizes across Tanzania hence providing results that are reflective of different actors of the SME sector versus the experiences of just one study participant in a single case study which is susceptible to providing only a singular narrative and lacking sufficient depth to form generalizations. Additionally, given that the COVID-

19 pandemic is a novel phenomenon that has not yet been extensively researched in Tanzania, the multiple case study research design provides a nuanced understanding of this unique event. This approach paves the way for more focused future research, potentially guided by quantitative or mixed-methods research approaches.

### *3.3.1 Target Population*

The target population for our study is;

- i. All SMEs distributed across Tanzania in all economic sectors and across the different SME size parameters as stipulated in the national SME Development Policy. According to FSDT (2012), these currently outnumber 3 million.
- ii. All financial institutions serving SMEs (i.e. commercial banks, community banks, microfinance institutions, SACCOSs, VICOBAAs) registered and regulated by the Bank of Tanzania.

### *3.3.2 Sample Size and Sampling Technique*

#### **1. SMEs**

The samples utilized in the multiple case study research design were selected using a non-probability sampling method, namely purposive sampling. Purposive sampling is a form of non-probability sampling where study participants are selected from the population based on the judgement of the researcher (Saunders et al.,2019). The choice for purposive sampling was motivated by the need to ensure the sample selected is most relevant to the goals of this study. According to Palinkas et al. (2013), purposive sampling is generally utilized in qualitative research to identify information rich cases related to the study phenomenon. A two-stage screening approach was utilized to create the purposive sample. Firstly, we ranked the regions according to the number of registered SMEs. The top three regions; two median regions; and three bottom regions were selected. Thereafter we reviewed SMEs across the selected regions and picked 3 samples for each regional group with the selected samples being of variable sizes and sectoral specialization hence ensuring that we got a study sample that is representative. In the event that an

SME was either non-operational or declined to participate in the study, an alternative respondent from the same allocated group was selected. The sample size for SME respondents based on the above analysis amounted to 16 SMEs

## **2. Financial Institutions**

To create the sample of financial institutions to survey, we selected financial institutions that provide financing solutions for SMEs, thereafter the financial institutions were divided to provide 3 samples from the commercial banks group, 1 sample from the community banks group, 1 sample from the microfinance institutions group and 1 sample from the SACCOS group resulting in a sample size of 6. No venture capital or private equity funds were considered in the study as they were no locally domiciled funds that support SMEs at the time of the study.

According to Boddy (2016), in a qualitative research approach, sample size is a matter of context and dependent on the paradigm of the research being conducted with some studies being conducted with a sample size of one while other studies have larger samples as the researcher believes it provides a more representative view of the population. Theoretical saturation can also be used as a metric in determining sample size with sample sizes being determined to the point of theoretical saturation. Saunders et al. (2019), found that a sample of 12-30 study participants is considered sufficient for a qualitative study of heterogeneous study participants. The sample size in this study was 21; 16 SMEs and 6 financial institutions.

### *3.3.3 Data Collection Techniques*

Two semi-structured interviews to provide answers to the research questions and objectives were designed to collect data from SMEs and financial institutions. The questions present a series of open-ended questions to provide qualitative data and allow us to understand the nuances existing in the SMEs and the financial institutions sectors as it relates to challenges in accessing financing during the Covid-19 pandemic (refer to Appendix A for the interview guide). The data collection for the SME respondents was undertaken from the 1<sup>st</sup> of August to 30<sup>th</sup> of August 2024 while the data for the financial institutions were undertaken from 28<sup>th</sup> August to 4<sup>th</sup> September 2024.

### 3.3.4 *Data Analysis*

The study utilized thematic analysis to examine the qualitative data derived from multi-case study interviews with participants. The objective was to identify themes and patterns. Saunders et al. (2019) suggest that thematic analysis is valuable because it enables researchers to analyze qualitative data and identify patterns and themes. Watling et al. (2012) outline six key steps in qualitative data analysis. The first step involves defining and identifying data, with the data requirements clearly aligned with the research objectives through a set of questions. The second step is data collection, where this study gathered information through interviews, with questions and responses recorded in written notes. The third step is data reduction, during which the participant responses were assessed to determine their relevance to the study. In the fourth step, data analysis, themes and trends were identified. Finally, in the fifth and sixth steps, theory building and report writing were conducted

### 3.3.5 *Ethical Considerations*

Adherence to research ethics is imperative in academic research (Saunders et al., 2019). Bryman and Bell (2015) outlined four important ethical principles in academic research. Firstly, academic research should be conducted in a way that ensures no damage is inflicted on research participants, this includes mental, physical and reputational damage. This study ensured adherence to the first principle by protecting the study participant's personal data and potential reputational damage of individuals and businesses participating in the study through anonymity in data collection, all study participants unique identification information has been anonymized, additionally study participants were made aware of their right to withdraw from the study at any time and have access to review and correct their statements made during the study. The second principle requires study participants to consent to being participants of the study. This principle has been achieved in this study as all study participants were informed of the study and its objectives and thereafter requested to consent to participate in the study. The third principle addresses the right to privacy of study participants, this principle was addressed by giving study participants the right to not answer any question in the event that they feel the question may infringe on their right to privacy. The fourth principle addresses deception. Academic research should not be deceptive, this study addresses this principle by providing study participants with transparency of the study and its

objectives and ensuring the research is conducted in a manner that is honest and transparent. In addition to ensuring adherence to the study participants rights to privacy, confidentiality, consent, choice of participation and researcher's honesty and transparency, the study followed the guidelines of the University of Cape Town Ethical Clearance Process. University of Cape Town ethical clearance for this study was granted on 29<sup>th</sup> July 2024.

### *3.3.6 Limitations*

The first notable limitation of this study is the methodology of the research. Despite the strength of a qualitative approach, qualitative research approaches are not able to confirm causal relationships the same way quantitative research approaches can. Secondly, because the study is qualitative the study participants' responses may be biased and present a subjective view. Another limitation is related to the nature of the Covid-19 crisis, the Covid-19 pandemic and the lived experiences of the target population and sampled study participants were dynamic hence over time the experiences may have changed, the study was conducted at a point in time well after the height of the Covid-19 pandemic hence study participants may not have remembered the full experiences since commencement of the pandemic and some of the responses of the study participants may be more reflective of more recent experiences, furthermore some key events may have been forgotten by the study participants.

## **Chapter 4: Discussion of Findings**

### **4.1 Introduction**

This chapter presents a discussion of the findings based on 16 interviews with SMEs and 5 interviews with financial institutions. The analysis is organized into four main sections. Section 4.1 provides an introduction, while section 4.2 reviews the demographic characteristics of the respondents. Section 4.3 examines demand-side themes based on feedback from SMEs and section 4.4 explores supply-side themes drawn from financial institutions' responses. Finally, section 4.5 concludes the chapter.

### **4.2 Demographic Profile of Respondents**

This section provides an overview of the demographic characteristics of the SMEs (demand side respondents) and financial institutions (supply side respondents).

#### ***4.2.1 SMEs***

On the demand side, the study interviewed 16 SMEs and achieved a response rate of 100%. The demographic composition of these SMEs was captured through a structured questionnaire. Key demographic characteristics captured included the activity of the SME, number of years the business has been in operation, sectoral focus of the business, if the business is located in an urban or rural setting, the registration type of the business (limited company or sole proprietor), the number of employees in the SME, the indicative size of the business based on the number of employees and range of investment.

Table 2 provides a summary of the demographic composition of the SMEs profiled in the study. The following key highlights are noted from a review of the table : 16 SMEs were engaged in the study, 10 SMEs were located in urban areas while 6 SMEs were located in rural areas, 9 SMEs were registered as limited liability companies while 7 companies had been registered as sole proprietors, key business activities of SME respondents included agriculture, agribusiness, retail trading, wholesale trading, light manufacturing, catering and events ,construction services, tourism (hotel & tours), logistics, restaurant/cafe, pharmacy and professional services.

**Table 2: Demographic Profile of SME Respondents**

ID	Nature of Business	Economic Sector	Location	Years in operation	Registration Type	# of Employees	Financing Status	Invested Value Range in TZS	Investment size category	Duration of Interview	Date of Interview
S1	Manufacturing medical supplies	Manufacturing	Urban	6 years	Limited company	22	Loan from a bank Own funds Grant financing from development project	TZS 200 Million-TZS 800 Million	Medium	74 Minutes	1/08/2024
S2	Exporting of cocoa	Agribusiness	Semi-rural	7 years	Limited company	18	Loan from a bank Own funds	TZS 200 Million-TZS 800 Million	Medium	95 Minutes	7/08/2024
S3	Retail trading	Trading	Urban	12 years	Limited company	4	Loan from microfinancing institution and SACCOS Own funding	TZS 5 Million – TZS 200 Million	Small	62 Minutes	15/08/2024
S4	Hotel and Tours	Tourism	Urban	22 years	Limited company	12	Own funding	TZS 200 Million-TZS 800 Million	Medium	85 Minutes	22/08/2024
S5	Construction of buildings	Civil Works	Urban	16 years	Limited company	10	Own funding Loans from banks		Small	70 Minutes	1/08/2024
S6	Export of agriculture products	Agribusiness	Urban	10 years	Limited Company	13	Loan from bank Grant funding	TZS 200 Million-TZS 800 Million	Medium	68 Minutes	08/08/2024
S7	Agri processing of maize and paddy into maize flour and rice for retail and wholesale trade locally and regionally	Agribusiness	Rural	15 years	Sole proprietor	8	Own funding Loans from banks	TZS 200 Million-TZS 800 Million	Medium	82 Minutes	7/08/2024
S8	Manufacturing of condiments and food ingredients	Manufacturing	Semi-Rural	10 years	Limited Company	40	Loan from development finance institution Own funding Grants	TZS 5 Million – TZS 200 Million	Small	95 Minutes	21/08/2024
S9	Wholesale general supplies	Trading and Manufacturing	Urban	50 years	Limited Company	100	Loan from bank Own funding	TZS 200 Million-TZS 800 Million	Medium	75 Minutes	2/08/2024
S10	Farming of fruits & vegetables for local and export markets	Agribusiness	Rural	18 years	Limited company	27	Grant Loan from bank Own funding	TZS 200 Million-TZS 800 Million	Medium	90 Minutes	13/08/2024
S11	Aggregating cotton for export	Agribusiness & Textiles	Rural	27 years	Limited company	50	Loans Own funding	TZS 200 Million-TZS 800 Million	Medium	109 Minutes	30/08/2024
S12	Consulting services (Smartcodes)	ICT Services	Urban	18 years	Limited company	9	Own funding	TZS 200 Million-TZS 800 Million	Medium	78 Minutes	10/08/2024
S13	Café & Restaurant	Food & Beverage	Urban	25 years	Limited Company	30	Own funding Family loans	TZS 5 Million – TZS 200 Million	Small	67 Minutes	11/08/2024
S14	Events & Catering	Hospitality	Urban	5 years	Sole proprietor	10	Own funding Loan from informal saving groups and SACCOS	TZS 5 Million – TZS 200 Million	Small	71 Minutes	11/08/2024
S15	Transport & Logistics	Logistics	Urban	24 years	Limited company	40	Loan from bank	TZS 200 Million-TZS 800 Million	Medium	80 Minutes	22/08/2024
S16	Pharmacy	Health	Urban	10 years	Limited company	4	Own Funding Loans	TZS 5 Million – TZS 200 Million	Small	73 Minutes	16/08/2024

Author's design from research data

#### 4.2.2 Financial Institutions

On the supply side, the study identified six financial institutions and achieved a response rate of 89% (i.e. 5 financial institutions). The demographic composition of the financial institutions was captured and key demographic characteristics recorded included the type of financial institution (i.e. commercial bank, community bank, microfinance institution, savings and credit cooperative societies (SACCOS)), the type of client target market, location of the financial institution, if the institution is providing the services in an urban or rural setting and the number of years in operation.

Table 3 provides a summary of the financial institutions profiled in the study. The following key highlights are noted from a review of the table: 5 out of 6 financial institutions responded to the study request, 2 financial institutions were commercial banks, 1 financial institution was a community bank, 1 financial institution was a microfinance institution and 1 financial institution was a SACCOS.

**Table 3: Demographic Profile of Financial Institution Respondents**

Respondent	Type of Financial Institution	Target Market	Location	Years in Operation	Duration of Interview	Date of Interview
F1	Commercial Bank	Corporates SMEs Individuals	Urban Head Office with national distribution in rural and urban areas	Over 25 years 28 years	93 Minutes	3/09/2024
F2	Commercial Bank	Corporates SMEs Individuals	Urban Head Office with national distribution in urban and semi-rural areas.	Over 20 years	90 Minutes	4/09/2024
F3	Community Bank	SMEs Individuals	Rural	Over 15 years	77 Minutes	29/08/2024
F4	Microfinance institution	SMEs Individuals	Urban with rural agency	Over 5 years	83 Minutes	3/09/2024
F5	SACCOS	Individuals	Semi-Urban	Over 5 years	68 Minutes	28/08/2024

Source: Author's design from research data

### **4.3 Demand-side perspective: Challenges SMEs face in accessing financing during Covid-19 pandemic**

The study aimed to examine the challenges that SMEs faced in accessing financing during the Covid-19 pandemic. The qualitative exploratory study responses were analyzed, leading to the identification of key themes. The themes identified to explain the challenges faced by SMEs in accessing finance during the Covid-19 pandemic include i) disruptions and declines in business activities, revenues, cashflows and profitability, ii) property price declines and insufficient collateral values; iii) long turnaround times and onerous information requirements and iv) lack of awareness of Covid-19 pandemic support programmes. Below is a discussion of the themes:

#### ***4.3.1 Disruptions and Declines in Business Activities, Revenues, Cashflows and Profitability***

Out of the 16 SMEs profiled in the study, 14 SMEs reported to have experienced declines in business activities, revenues and cashflows at the height of the pandemic which they indicated to have occurred between March 2020 and September 2021. The decline in business activities and cashflows affected their ability to raise funding, the reasons for the decline are as follows:

##### *a) Decline in local consumer confidence*

Social distancing and declined local consumer confidence in the population negatively affected purchasing. Despite Tanzania remaining fully open throughout the pandemic, many people had a general fear of the disease and opted to stay at home with many office-based employees having the option to work from home. The reduced movement of people in public places negatively affected businesses that traditionally required the customer to be physically present to generate revenue. Furthermore, travel restrictions in other markets affected a key sector of the Tanzanian economy, tourism.

Respondent SMEs in the trading, restaurant/cafe, events & catering and hotel & tours businesses all indicated that reduction in the movement of people reduced revenues and consequently cashflows in their business. Affected respondents reported that cashflow was severely strained as revenues declined while costs did not change and, in some instances went up as SMEs needed to procure masks and sanitizers for workers to create a safe work environment.

An SME that runs a popular café and restaurant in Dar es salaam (Respondent S13) indicated the following upon reflecting on the effects of the Covid-19 pandemic on their business and financing challenges: *“Covid-19 reduced our business revenue, customers stayed at home or left the country. I remember we had approached a local financial institution for a short-term facility to help us cover our cashflow shortfalls during this period but the request was declined on account of high risk in the hospitality sector at the time. It was not an easy phase and nothing like we have experienced before in this business which we have been in for over 20 years. Fortunately, we were able to tap into shareholders and family savings to support the business with financing as we needed funding to establish our digital platform, improve marketing activities and linked with the newly established food delivery applications like piki and duka direct to protect revenues.”*

Another SME operating in the events & catering business (Respondent S14) provided the following insights: *“My business relies on conferences and wedding events to generate revenue. The Covid-19 pandemic killed the events & catering business All conferences were cancelled to avoid disease spread and no one wanted to hold wedding celebrations anymore. I was forced to make the decision to suspend operations during the pandemic period and focus on other activities.... I am lucky that I did not have any bank financing as that would have been very difficult to manage. I had accessed a small loan from my SACCOs and an informal women’s savings group to buy catering equipment from China before the pandemic period, given the trust we had amongst each other they provided me with time to resume payment of the loan and when I did get cashflow from my other businesses, I slowly paid off the loan.... getting financing from a bank was very difficult for me even before the pandemic period, I did apply for a loan before the pandemic but it was declined.... social financial groups like SACCOs and VICOBA are good for small enterprises like mine as they help us to get quick financing at good terms and during tough times, they are able to give me time to pay. They also serve as a form of ‘faraja’ (social insurance) as they supported me financially when I lost my husband during the pandemic period.”*

Contrastingly not all businesses experienced business challenges, two companies found that business picked up during the pandemic period and this is attributed to their business lines being in sectors linked to the health sector.

A pharmacy owner from the Mwanza (Respondent S16) shared the following insights; *“Business was good during the pandemic period as customers rushed to buy masks, sanitizers, supplements like baby zinc, vitamin c and even aspirin. People sought these products both for protective measures and some for the perceived health benefits, as there was heightened public awareness around immunity and preventive care during this time.... there was a lot of panic buying in the urban areas and prices went up .... I applied and got a loan from a micro-finance institution to buy supplies in bulk as sometimes we had shortages.”*

Another company involved in the manufacturing of surgical masks and distribution of cleaning supplies (Respondent S1) saw a surge in demand for their products, they also indicated being able to access grant financing from a development partner and loans from a bank and an impact investor to scale production to meet local and regional demand. This is noted in the following responses from Respondent S1 : *“ We manufacture medical grade surgical masks, Covid-19 created a high demand for medical grade masks , also due the global shortage for surgical masks and the late President Magufuli’s stance to the population to buy locally manufactured masks the country had a shortage ....To meet the increased demand we applied for financing support from our bank for working capital and capex which was availed to us, we also managed to access a grant from a development partner that had set up a Covid-19 facility to support SMEs.”*

The SME respondent insights on declining revenues align closely with findings by Demmou et al. (2021), who demonstrated that the COVID-19 pandemic severely disrupted SMEs' cash flows and revenues due to demand shocks, restrictions, and supply chain interruptions with hospitality, events, and recreation sectors recording the highest failure rates, driven by cash flow deficits and limited access to financing. Similarly, Wieczorek-Kosmala (2021) highlighted that operational interruptions, lockdowns, and social distancing measures caused sharp declines in income leaving SMEs in the hospitality sector struggling to meet liquidity needs and facing significant credit constraints. Contrastingly, the Covid-19 pandemic presented unique opportunities for some SMEs, such as those operating in the health sectors due to increased demand for medical supplies. Juergensen et al. (2021) emphasized that SMEs in the health sector benefitted from increased sales and market share during the pandemic capitalizing on gaps in global supply chains with governments, development partners and financial institutions actively supporting these SMEs through financing, emergency procurement policies and prioritizing local producers to secure essential goods. The study further noted that

health-focused SMEs found it relatively easier to access financing as significant funding was channelled to these beneficiaries through grants, low interest loans and subsidies. The findings are strongly aligned to Respondent S1 and S16 insights presented above.

*b) Decline in global demand for export commodities*

Tanzania is a key exporter of agricultural commodities including both food and cash crops and many SMEs aggregate, trade and export agriculture commodities to local, regional and international markets. SMEs engaged in cash crops such as cotton and coffee saw decreased business and financing access while those in food crops were largely unaffected by the pandemic with increased regional and global demand supporting revenue growth and easing financing access.

An SME involved in the trading of maize and rice to the regional market (Respondent S7) highlighted the following: *“Demand for our maize and rice doubled with exports being made primarily to Kenya which had reduced harvests due to Covid-19 restrictions. I received many orders for maize and rice to Kenya, Zambia and Rwanda, business was positive.”* On the financing side, Respondent S7 indicated the following: *“My bank was able to avail my business with sufficient working capital financing to ensure aggregation of crops from farmers, this allowed me to buy cheaply and maximize on profits.”*

Similar observations were noted from Respondent S10, an SME in the farming, trading and exporting of horticulture produce with the following insights: *“demand for our products remained strong both locally and globally, we initially faced disruptions in air and ship logistics but these were quickly resolved.....our bank did not make any significant demands beyond additional collateral when we applied for working capital financing and we generally had a good year .....our orders are all backed by contracts with EU buyers..... the financing cycle was delayed a bit.”*

Contrastingly, the insights noted from the SMEs involved in the trading of cash crops (namely cocoa and cotton) were different. Respondent S2 (an SME involved in the export of cocoa) indicated the following: *“for our company there was a noticeable decline in demand for raw cacao beans to our buyers during the Covid-19 pandemic due to disruptions in industry in our export markets in Asia, Europe and USA.”*

The lower demand affected the SME's financing with Respondent S2 further noting the following: *“we could not meet the terms of our structured trade finance loan; we had to request for a restructuring of the financing. We also needed to access additional financing to support operations and buy seasonal stock.... our request for an overdraft was initially denied as we did not meet the collateral value, once we provided the bank with more collateral, we managed to get the loan although it was below our request but it helped us cover the gap somewhat.”*

A similar theme was noted in the cotton sub-sector with Respondent S11 involved in cotton exports indicated the following: *“demand for cotton lint declined during the pandemic period as factories overseas were closed so we faced a low business period.”* In relation to financing, Respondent S11 indicated the following, *“we already had financing in place in the form of working capital which our bank was able to restructure given the Covid-19 circumstances, this gave us more time to sell our stock and make payments, the situation resolved after some months.”*

The experiences of agri-food SMEs highlighted by the respondents align closely with findings from other studies. For instance, PwC (2021) observed that many SMEs struggled with working capital financing during the COVID-19 pandemic, which led to the need for loan restructuring. However, international development agencies and governments intervened by offering relief programs to banks to support agribusiness SMEs, recognizing their critical role in maintaining food security. Similarly, the World Bank (2020) and Nyumba and Ngugi (2022) noted that financial institutions, with support from organizations like the International Fund for Agricultural Development (IFAD) and the World Bank, worked to ensure liquidity within agricultural value chains, thereby mitigating some of the financial difficulties faced by agri-food SMEs during the crisis. Insights shared by SMEs involved in cash crop exports are consistent with those of Rizou et al. (2020) which revealed that demand for cash crops significantly dropped due to reduced industrial activities in key markets thereby negatively affecting operations, cash flows, and ability of SMEs to meet financing obligations.

*c) SMEs with Global Supply Chain Linkages struggled with Funding*

SME respondents with strong supply chain linkages reported being negatively impacted by Covid-19 due to supply chain and logistics disruptions both on the supply and demand side as

shipments from manufacturing countries were delayed while shipments on the ground to neighbouring countries encountered delays due to intermittent blocks, additional health checks and sometimes truck drivers from Tanzania requiring to be quarantined.

An SME that engages in wholesale trading (Respondent S9) reported to face challenges in procuring goods as shipping was delayed due to curfews and lockdowns in sourcing markets. The impact of this was reduced goods for trading and hence lower sales and cashflows. Additionally access to markets was difficult. Respondent S9 reported as follows: *“Shipping to Tanzania was delayed..... we also experienced delays in our export operations to Rwanda, Zambia, Kenya, and the DRC due to drivers needing to complete health checks and, occasionally needed to be quarantined further delaying delivery of goods”*. The lower sales impacted the respondent SME’s ability to service their debt financing, *“we could not meet repayment dates, luckily, we were able to have financing restructured to ease repayment pressure”* reported Respondent S9. He also expressed appreciation for his banker’s quick intervention and support, noting the following, *“on financing we have a good partnership with our bank and they are always helping us with solutions.... our banker understood our problems and provided a restructuring solution in time to stabilize the business before conditions worsened.”*

These insights are reflective of the positive impact of good relationship management on SME clients and closely align with the findings of Beck, Demirguc-Kunt and Maksimovic (2008) who observed that relationship banking supports SMEs to obtain flexible financing options and credit restructuring due to the trust and understanding built with their banks and Donker et al. (2020) who found that SMEs with close ties to their banks were provided with quick restructuring solutions and emergency credit lines during distressing times as banks felt more confident about the SME's commitment and history.

Another SME (Respondent S6) that has specialized in exporting organically certified agri-products saw revenue plummeting at the height of the pandemic, necessitating them to temporarily suspend operations. *“Tanzanian farmers were on the field harvesting but our European export markets were facing economic downturn and reduced demand ..... exporting products was difficult due to limited cargo planes, we could not secure timely shipments to our clients which was difficult due to high perishability..... we saw revenue declines given our specialization in a niche non staple agriculture segment and had to scale down.... we had plans*

*to set up a greenfield local value- addition facility and pack house enhancing cold storage value chains in the Southern Highlands but with the Covid-19 pandemic, we had to cancel new investments as the future was not guaranteed. The business needed working capital financing to survive the period but failed to secure bank funding because we did not have security acceptable by banks.... our bank did however help us to increase our repayment term due to the tough business environment so we did not get classified.....we got financing from family members...”*

*d) Deferred Payments, Rising Receivables and Negative EBITDA increased credit risk and impacted ability to access financing*

Most businesses faced a challenging business environment creating systemic challenges both on supply and demand sides. Many SMEs profiled in the study indicated that cashflow management became a challenge as their customers delayed payments creating cash flow lag and working capital finance strain making them unable to settle their own payments timeously. This became a cycle for many SMEs. It was surprising to note that despite some local financial institutions having trade finance products such as factoring and receivables financing, no SME in the study reported to access such a product with many not having knowledge of what these products provide. In addition to cashflow problems, one SMEs reported ‘negative EBITDA’ as a reason for failing to get financing. EBITDA is a financial proxy to pre-assess debt serviceability and most financial institutions avoid companies with negative EBITDA as it indicates they are unable to profitably run their operations. Some companies posted negative EBITDA during the pandemic period because revenues declined and were unable to fully cover operating costs. *“Support in working capital financing would have helped us to address our cashflow issues during Covid-19 but many financial institutions declined us due to negative EBITDA”* reported one banker turned SME owner” (Respondent S8).

Respondent S5 indicated the following, *“the Covid-19 pandemic affected the construction sector, new construction projects disappeared .... a lot of our funding was tied in contracts and unpaid invoices as our work is done through a sub-contractor model. Payments were deferred, we needed money to cover our costs but failed to secure funding during the pandemic.”* Respondent S12 shared a comparable perspective as follows, *“we could not meet our operational costs as revenues went down significantly... the company failed to raise working capital financing to support operations and had to downsize on headcount.”*

The insights gathered are strongly aligned with earlier research by Bartik et al. (2020), which highlighted those delayed payments and cashflow challenges during the pandemic placed immense strain on small businesses, particularly those in sectors heavily dependent on contractual work. Similarly, McKinsey & Company (2020) noted that declines in revenue, coupled with fixed operational costs, led to widespread negative EBITDA among SMEs, which in turn limited their access to critical financial support. Furthermore, the lack of awareness and accessibility of trade finance tools such as factoring and receivables financing, as also observed by World Bank (2020) compounded the financial difficulties for SMEs, underscoring systemic gaps in financial institutions' support for high-risk segments during crises.

#### ***4.3.2 Property Price Declines and Insufficient Collateral Values***

According to insights derived from SME respondents, property prices fell by over 20% due to declines in purchasing power and limited real estate market activities owing to increased investor caution and lower cashflows and liquidity in the market. SMEs struggled with insufficient collateral and collateral devaluations as property prices declined.

Respondent S5 (an SME operating in the construction sector) who indicated challenges in accessing financing through invoice discounting and factoring also reflected on the time their company needed to access additional financing to deliver on a project however their financing request with another bank was denied on account of two key concerns ; firstly *“economic uncertainty reduced financial institutions’ appetite for property transactions as overall property appetite had diminished”*. Secondly, the respondent indicated that he was unable to secure the financing required due to the value of collateral the SME wanted to pledge which based on Covid-19 pandemic valuations was unable to meet the required coverage ratio of 125%. The SME respondent reported to have inquired on support through a credit guarantee scheme but the financial institution indicated that there was no acceptable guarantee instrument for the construction sector at the time.

Another SME operating in logistics (Respondent S15) applied for financing and reported the following; *“We could not to access the required financing to expand our business in logistics and trading.... pledged collaterals the bank had previously used had declined; this was discovered upon the mandatory fresh valuations conducted by the financial institutions. We re-applied for financing with additional collateral from another family member who provided the*

*requisite authorization to use their house to help the business unlock financing and were successful to lock in new financing during the pandemic”. A troubling turn of events for this SME was however noted during the interview, “due to unsatisfactory business performance, we are currently in recovery procedures with our bank, there is a risk that both the initial and subsequent collateral pledged may be auctioned off to repay our outstanding debt.”*

The theme of insufficient and devalued collateral as an impediment for financing access during the Covid-19 pandemic aligns with findings of Horan et al. (2023) which noted that property price shocks during the Covid-19 pandemic led to devaluations that compromised SME’s ability to access financing.

### ***4.3.3 Long Turnaround Times and Onerous Information Requirements***

Another notable theme that emerged from SME respondents was more onerous information requirements and long turnaround times in getting financing decisions from financial institutions during the pandemic period. This outcome was attributed to more stringent financial analysis and the economic uncertainty of the pandemic with financial institutions asking for more due diligence documentation and delaying decision making to allow for reflection and observation of how the pandemic progressed.

*“...despite several follow-ups, we faced much longer delays in getting a final decision on our financing application which was declined”* indicated Respondent S5.

Similarly, Respondent S6 indicated the following *“.... but the financing cycle was delayed a bit”* while Respondent S10 stated the following *“....it took a slightly longer time to get financing from the bank which was a challenge for us given the seasonality of the agri sector and perishability of our products.”*

The Covid-19 pandemic caused significant delays in SME loan application turnaround times with the perspectives of SME respondents in relation to long turnaround times being closely aligned to several studies. According to UNCTAD (2021), increased economic uncertainty and heightened default risks led banks to adopt more detailed credit risk assessments lengthening the credit approval processes. Lockdowns and operational disruptions further slowed down loan processing, particularly as banks faced challenges with an influx of applications and limited operational capacity (OECD, 2020). White et al. (2021) also noted that reliance on

physical documentation and in-person verification exacerbated delays, especially in regions with limited digital infrastructure with developed digital infrastructure positively impacting access to financing for SMEs during the pandemic. These combined factors created substantial barriers for SMEs in accessing timely financial support during the pandemic.

Onerous information requirements were also noted as a challenge with Respondent S16 who stated as follows: *“the bank requested for many documents in addition to the documents I had already shared, I think they wanted to make sure I had the guaranteed offtake in place for our key buyers so I had to sign additional documents with our buyers to show demand, this was difficult to gather but I eventually met their requirements”*.

Similar requirements were noted by Respondent S7 who indicated the following; *“the bank wanted us to provide documentation to show demand for our rice and maize is guaranteed which was different to prior years where our sales history and account turnover was sufficient to get comfort and access to financing.”*

#### ***4.3.4 Lack of Awareness of Covid-19 Pandemic Support Programmes***

As discussed in earlier chapters, the Covid-19 pandemic created a negative economic impact on the economy with the SME sector being disproportionately affected. Governments and development partners globally implemented programmes ranging from grants to liquidity facilities to cushion SMEs. Notable programmes implemented included the US Paycheck Protection programme, a USD 659 Billion programme aimed at providing loans to cover payroll costs to support SMEs (Kuehn, 2021), the UK’s Coronavirus Job Retention Scheme (CJRS), Coronavirus Business Interruption Loan Scheme and the Bounce Back Loan Scheme (BBLs) all aimed at cushioning SMEs from the pandemic through grants and forgivable loans, the Central Bank of Nigeria and NIRSAL’s USD 130 Million Covid-19 fund for SMEs, Kenya’s USD 300 Million Covid-19 Credit Guarantee Scheme and South Africa’s COVID-19 Loan Guarantee Scheme and other various grant and debt Covid-19 relief windows that were activated globally to support financing of SMEs during the pandemic period. In Tanzania, the most significant support programme for SMEs was the TZS 1 trillion (approximately USD 367 Million) Bank of Tanzania Liquidity Fund introduced in July 2021.

The findings from the SME respondents found that all respondents did not have an awareness of any financing mechanisms that were implemented by the government to support them through the Covid-19 pandemic. This could be attributed to the fact that the TZS 1 trillion Covid-19 liquidity fund was activated 16 months after Covid-19 was declared a pandemic and the fund did not provide funding directly to SMEs but supported financial institutions to on-lend to SMEs with limited outreach to the public being conducted.

Generally, study respondents expressed disappointment over the lack of national level support compared to their international counterparts. One SME in the services sector (Respondent S12) highlighted this disparity: *“I remember hearing about furlough financing packages for UK companies on the news, but we had nothing like that available in our market. ...we faced a lot of struggles due to low business activity, which put a pressure on our operations and forced us to reduce our workforce because we couldn’t afford to pay salaries and moved some staff to consultant roles for when assignments came up.”*

Similarly Respondent S8 (an SME operating a business that manufactures food ingredients and condiments for the hospitality sector) indicated the following: *“there were no support programmes to help us.....we just had to wait out the pandemic to recover, our key buyers who are mostly hotels reduced orders as the hotel business suffered .....our bank at least helped to restructure our loan which was a good thing as it gave us relief from repayments but financial support would have alleviated our problems, it was a difficult time for us and until today we are working to recover from Covid-19.”*

These sentiments underscore the challenges faced by local SMEs in accessing the same level of support available to SMEs in other markets during the tough economic times of the pandemic and highlights the lack of national level support as an area of improvement for Tanzania in future public crises.

Beyond the government, development partners such as UNDP, GIZ, Aga Khan Foundation, Oxfam and AGRA implemented a number of programmes to support SMEs during the Covid-19 pandemic period. Only two respondents from the sample of 16 SMEs in the study indicated that they had knowledge of programmes being implemented by development partners to support SMEs through the Covid-19 pandemic period. One SME indicated to have received grant financing from a Covid-19 pandemic support programme, the support provided the SME

(Respondent S1) with much needed liquidity to scale local production of personal protective equipment and sanitation supplies to allow them to meet the increased national demand as well as cushion the local market from the global supply shortages.

Respondent S1 highlighted the benefit their company achieved by being able to access grant financing to unlock their liquidity shortfalls and scale production of masks, protective medical supplies and cleaning products during the height of the pandemic period as follows : “ *the grant financing we received helped us to unlock liquidity, we needed to scale production quickly to supply pharmacies and meet hospital orders but did not have the financing to achieve this as the bank process was long, the grant came at an opportune time and allowed us to deliver orders when most needed while bank financing was underway.* ”

Contrastingly, an SME actor in the tourism sector operating a boutique hotel and tours & safaris company in Arusha (Respondent S4)) indicated the following: “*I did not know of any programme that could help my business when the pandemic got worse. Even though Tanzania was open, business was very tough as we did not get travellers coming for safaris here. Everyone was scared. I had to use other income sources to ensure my loan for the hotel was being paid on time to avoid losing my property. We thank God now we have good touristic numbers. President Samia’s Royal Tour has boosted Tanzanian tourism in the recovery era but during the Covid-19 pandemic, business was challenging for us in this industry.*”

The thematic finding of lack of awareness of financing programmes for SMEs links with findings by Beck, Demirguc-Kunt and Maksimovic (2005), Berger and Udell (2006), Abor and Biekpe (2006) and Fatoki and Asah (2011) referenced in earlier chapters who all found that SMEs often lack information about the variety of financial products and schemes available limiting their financing access. The lack of awareness theme is not peculiar to the Covid-19 pandemic experience of Tanzanian SMEs, Carletti et al. (2020) and Duarte et al. (2021) found that some SMEs in the UK and USA were also unaware of crisis related financing options despite these countries having large programmes that were well publicized and hence could these SMEs indicate how they could not effectively utilize available funding in the market to alleviate crisis induced financial strain. The study argues that targeted awareness initiatives are crucial in ensuring SMEs can effectively leverage crisis financing and advocates for improved communication and simplified access to information about emergency financing.

#### **4.4 Supply-side perspective: Experiences of Financial Institutions in Financing SMEs during the Covid-19 pandemic**

On the financing supply side, the analysis of the exploratory qualitative data identified economic uncertainty, deepened information asymmetries, declining collateral values and high coverage ratio requirements, actual and perceived high risks of lending to SMEs and increased probabilities of default, more stringent financing conditions and sectoral restrictions as key themes that describe the financing challenges of SMEs during the Covid-19 pandemic from the perspective of financial institutions. Below is the presentation and discussion of the key issues in the thematic findings.

##### **4.4.1 Economic Uncertainty**

Covid-19 created a high degree of economic uncertainty. Financial institutions responded to this by enhancing risk assessment and credit rationing to protect asset quality and financial performance. SMEs, characterized by greater financial fragility, limited cash buffers, and higher risk profiles, were disproportionately affected by the economic uncertainty brought about by the Covid-19 pandemic. Below are notable insights on SME financing pertaining to economic uncertainty from the financial institution respondents.

*a) General sentiment and concern on economic uncertainty with the SME sector being seen as a high-risk sector*

A large commercial bank (Respondent F2) indicated the following: *“Covid-19 was an uncertain period for our business, we did not know how the pandemic was going to unfold both in terms of impact to our health systems and the economy in general...”*

A micro-finance institution (Respondent F4) also shared similar sentiments: *“it was unclear how the pandemic would affect our young business as nothing like this had been experienced in Tanzania before.”*

The SME sector carried a greater burden from economic uncertainty due to SMEs having higher financial fragility and being extremely susceptible to economic shocks. *“We were walking through uncharted economic waters and needed to be cautious in lending to high-*

*risk sectors such as SMEs, especially those in the tourism sector” asserted Respondent F2 (a commercial bank).*

Meanwhile Respondent F1 added the following: *“The SME sector took the biggest hit as we were operating in an economically unpredictable eco system, the disease was spreading and economies were declining globally, traders could not access inventory from China as factories were closed and exporters struggled with shipments outside Tanzania. Many SMEs did not have cash buffers so they struggled and were highly exposed to the shock and uncertainty of Covid. At the bank level, lending to this sector was conducted with caution. ....so, although lending grew at bank level, our SME lending declined with concerted efforts being made on supporting existing SME clients to make good on existing debt through debt restructuring and supporting them with the digital transitions so they could continue to receive and make payments.”*

*b)Economic Uncertainty was More Pronounced in the Tourism Sector*

Respondent F2 (a commercial bank) added the following: *“SMEs operating in tourism and hospitality sectors were directly affected, the companies in Arusha that had been good depositors due to payments being made by travellers saw account activities drying up. Many hotel occupancy rates in the tourist corridor declined significantly making some hotel financing transactions to go into default as the concerned SMEs failed to make payments. We tried to work with the SME clients linked to tourism on debt restructures but some SME businesses were affected and have continued to struggle beyond the pandemic period indicative of a ‘financial long covid.’”*

*c)Economic Uncertainty created liquidity challenges and increased credit rationing*

Economic uncertainty also created liquidity challenges for some. *“We could see what was happening in the news in other countries, .....it was difficult to predict or respond to the problem as we did not know what will happen next. Our business does not have strong links to global economies as we are member based but we saw a decline in member contributions during the pandemic period ... I think this was because some of our members who are mainly farming cash crops faced financial difficulties and hence could not contribute like before, this*

*reduced available funds for lending to other members.”* stated a respondent from a SACCOS (Respondent F5).

A similar sentiment was shared by Respondent F1: *“We were worried about the economic uncertainty surrounding the pandemic, liquidity was allocated to low-risk transactions, this ensured an efficient allocation of our funding and protected liquidity. SMEs were obviously affected by this approach; their higher risk profile made them to be unattractive borrowers.”*

Comparable reflections were shared by Respondent F2: *“Liquidity was limited, large corporates experienced financial shocks and applied for funding to cover liquidity gaps, we allocated funding to low-risk clients first.... SMEs carry high risk due to their small operations, weak cashflows and lacking economies of scale to be protected from shock so we prioritized supporting large corporates to weather the pandemic as repayment was more certain.”*

Respondent F4 indicated the following: *“a lot of uncertainty prevailed, some of our clients especially those who do trading and imports faced difficulty, as a private financial institution with no external support we had to protect our funding and focus on businesses that were solid and did not have big exposure to Covid. We focussed on business that support food and essential goods & services to ensure liquidity is efficiently applied.”*

Despite the widespread economic uncertainty, financing of essential goods was given priority at financial institution level with financing products to support the importation of medical supplies, wheat and edible oils being given a priority, *“Notwithstanding the uncertainty, Tanzania needed medical supplies both Covid and non-Covid related, food, fuel. You know our country imports many things, fuel, edible oil, wheat and what have you from other countries.... we continued to support businesses that were bringing essential supplies to Tanzania. Food security and health security were important to us.”* indicated Respondent F1

These economic uncertainty insights from financial institution respondents align closely with findings from other studies. Liu and Yao (2023) observed that economic uncertainty during the COVID-19 pandemic significantly impacted SME financing. Banks adopted more stringent risk analysis measures and prioritized lending to low-risk, large corporates, effectively rationing credit away from SMEs. Similarly, Lewis and Liu (2020) highlighted that heightened caution amongst banks, driven by fears of defaults during the pandemic disproportionately

affected SMEs due to their higher risk profile. Furthermore, the OECD (2020) reported that uncertainty resulted in financial institutions tightening credit criteria making it increasingly difficult for SMEs to secure loans compared to their larger corporate counterparts. In summary, economic uncertainty led financial institutions to prioritize liquidity and mitigate risk, resulting in limited access to financing for many SMEs due to their risk profile.

#### ***4.4.2 The Covid-19 Pandemic Deepened Information Asymmetries***

The Covid-19 pandemic entrenched information asymmetry by reducing access to reliable data, and creating uneven access to information. This made decision-making more difficult for businesses and individuals. Banks responded to information gaps by rationing credit to low-risk transactions. SMEs being high risk borrowers suffered information gaps. Below are key insights from financial institution respondents.

Respondent F2 indicated the following in relation to information asymmetry caused by Covid-19; *“Information asymmetry is already an obstacle when financing SMEs, the Covid-19 pandemic brought additional information asymmetry. There was confusion on stock availability, shipping and delivery timelines. We could not realistically forecast revenues for companies that were reliant on global supply chains which made decision making difficult, the outcome of this was credit rationing and priority for low-risk customers.”*

Respondent F1 expressed similar views; *“We had to make decisions with incomplete or delayed information, this made us take risk-based decisions focussing on low-risk transactions much to the detriment of high-risk clients like SMEs.”* The same respondent further added: *“as financial institutions transitioned to remote work, information asymmetry widened as many SMEs were not comfortable with technology as the relationship with SME bankers was through physical meetings and visits.”*

*“Covid created an information asymmetry between those with access to reliable data (certain government agencies) and financial institutions and SMEs who did not have full visibility of the pandemic. It was difficult to make good financing decisions with information gaps so we reduced lending to risky client segments.”* stated Respondent F4.

The theme of information asymmetry entrenching financing challenges of SMEs during the Covid- pandemic is closely aligned to the conclusions of Pearce and Bah (2024) who found

information asymmetry to be a significant challenge for SME financing during the Covid-19 pandemic.

#### ***4.4.3 Covid-19 negatively affected collateral values and collateral value requirements at financial institution level***

Another prominent theme from financial institution respondents relates to collateral. The Covid-19 pandemic significantly disrupted the property market, causing retail, residential, and commercial property values to decline. The asset price declines affected lending as some transactions failed to meet the regulatory required coverage ratio of 125% and banks increased their coverage ratio criteria to build safety nets in the event of recovery proceedings during a depressed property market. Below are some insights shared by financial institution respondents on collateral values.

Respondent F1 indicated the following *“Property prices across the country came down.....we needed the borrowers to give us property with a forced sales value covering at least 125% of the loan value to secure financing but many applicants in the SME segment failed to meet thresholds...also the fresh valuations had significantly lower values, this meant that even if an SME would qualify for a loan, their qualifying amount was less because the security asset had a lower value compared to pre-pandemic times, this reduced lending in the SME sector.”*

Respondent F2 highlighted a similar theme pertaining to collateral value declines hampering SME financing from the financial institution side, *“an SME client had wished to increase their funding, fresh valuations were required but the value of his house dropped requiring him to post more collateral which he did not have so we could not avail financing. .... SME customers needed more security assets to get access to the same financing value, this made life more difficult for SMEs who needed cashflow, but we had to protect the bank from credit risk.”*

Respondent F3 conveyed similar sentiments; *“both urban and rural properties lost value during the pandemic, the values of collaterals diminished significantly with losses of 20%-30%, we could not sell properties. Lower property values made it difficult for our clients who are mainly farmers and SMEs to access funding.... we also faced difficulty as we struggled to recover our loans during foreclosure – the values the assets fetched in the market were very low, I think it would have been good to see some credit guarantee funds supporting Covid-19 collateral shortfalls to help banks and borrowers.”*

Asset devaluations and overall uncertainty forced financial institutions to tighten lending criteria by requiring more collateral. More pledged collateral provided the financial institution with greater security. Respondent F2 shared the following reflections ; *“I recall for some transactions we asked the client to post collateral of up to 170% coverage ratio, we were worried about the asset devaluing further so the high value helped to offset this risk.....SMEs struggled with access to additional collateral so they were affected somewhat, I think some guarantee funds like PASS did help some SMEs to cover collateral shortfalls which reduced their challenge a bit, but banks were cautious and covered their credit risk positions which affected the SME borrower.”*

Respondent F4 also highlighted the increased collateral conditions, *“credit risk was high, to counter this, we ensured we were well covered with collaterals ,higher coverage ratio was requested.....it was a measure to protect the financial institution”* He further added the following , *“it was a triple blow for SMEs, asset values declined, financial institutions demanded higher coverage ratios and many SMEs already had limited eligible collateral due to the challenges of most of property in Tanzania being on informal land.”*

Contrastingly, Respondent F5 stated the following: *“our lending has been primarily based on the savings of our members, we did not change the collateral requirements for our members so the Covid-19 pandemic did not change this policy, we also rely on the social connections of our members as a soft collateral.”*

The respondents' insights on collateral values align closely with findings from other studies. According to ECB (2020) SMEs were especially vulnerable to asset price declines and collateral value shortfalls due to their limited asset base, this negatively affected their ability to access financing during the pandemic period while Horan et al. (2023) found that asset price shocks and property value depreciations diminished SMEs ability to secure much needed funding during the Covid-19 pandemic period. The findings also affirm the findings of Bernanke and Gertler (1989) and Kiyotaki and Moore (1997) who explained how asset price shocks negatively affect private sector financing.

#### ***4.4.4 Actual and Perceived High Risks in SME Financing and Increased Probability of Default during the Covid-19 Pandemic***

Another notable theme that emerged from financial institution respondents relates to a general concern that the Covid-19 pandemic deepened the risk profile of SME borrowers and the default probabilities for SME clients. This is reflected in the following insights from the respondents.

Respondent F4 highlighted the following: *"Our loan portfolio is composed of SMEs and individuals. During the pandemic, we observed an increase in the risk profile of SME clients, with some loans going into default more frequently compared to those from individuals. Lending to individuals was tied to their salaries through our salaried loan product. In contrast, SME lending depended on account turnover and verified cash flows. During this period, we saw a sharp decline in cash flows and account turnovers which made it difficult for existing SMEs to meet their payment obligations. We naturally reduced our appetite for SME financing and shifted our focus to large corporates and salaried loans to protect our balance sheet and maintain stable incomes."*

Similarly, Respondent F2 echoed comparable concerns: *"SMEs typically operate with thin profit margins and weak cash reserves. When Covid struck, their revenues took a significant hit, which affected their profitability and ability to service debt. SMEs in sectors such as tourism, exports, and trading, faced greater default risks due to reduced cash flows as visitors and commodities were impacted by lockdowns. We worked with many SMEs to restructure their debts but consciously avoided extending new financing to SMEs in the affected sectors."*

Respondent F1 emphasized the pandemic's impact on credit risk assessments: *"We measure risk for all our clients by assigning a probability of default (PD) grade to each client. The Covid-19 pandemic adversely impacted the PD grades for SMEs. Many SMEs struggled with overall business performance as collections and revenues declined, this increased their PD."*

The insights shared by the respondents are closely linked to findings of Nigmonov and Shams (2021) who found that COVID-19 pandemic has a significant impact on default risk. Similarly, Vo et al. (2022) found that the Covid-19 pandemic increased the risk perception of SME

borrowers at financial institution level, this negatively affected their ability to access funding during the pandemic period.

#### ***4.4.5 More Stringent Financing Criteria, Conditions, and Sectoral Restrictions***

As businesses faced declining revenues, their ability to service new and existing debt declined, resulting in increased defaults on loans and heightened concerns among financial institutions on their SME loan portfolios. Financial institutions implemented more stringent financing conditions to navigate the higher risk in the SME sector with some sectors being suspended for new financing.

Some financial institutions profiled indicated to have revised their lending criteria, this included more onerous financing ratios and suspension of lending to some sectors such as hospitality and tourism to mitigate sector-specific risks. *“Some of the clients we serve saw falling revenues and cashflows, this made them ineligible to qualify for new financing during the pandemic as we had put in place higher DSCR (debt service cover ratios) to ensure that we only finance strong businesses”* indicated Respondent F2.

*“SME business activities in sectors like tourism and trading declined, this was not good for debt serviceability, we increased post disbursement monitoring for all loans to ensure financial performance and debt serviceability happens as agreed so our financing agreements were stricter”* indicated Respondent F1.

Respondent F2 referred to statistics from the EY Banking reports, *“you see total lending increased during the pandemic by 3.9% but SME lending for many financial institutions declined at the height of the pandemic, this was due to SMEs having higher risks and falling revenues, there was a focus on large corporates with robust revenues to protect incomes and risk for banks.”*

The responses from financial institutions reflects a cautious approach aimed at protecting their portfolios, which, while understandable, exacerbated the financial difficulties faced by many SMEs. In summary, more stringent financing criteria and conditions coupled with sectoral restrictions created a challenging financing environment for SMEs during the pandemic.

#### **4.4.6 Financial Institutions Recognized the support from the central bank in navigating the Covid-19 pandemic**

On a positive note, most of the profiled financial institution respondents indicated optimistic sentiments on the steps the central bank took to support the sector during the pandemic period. Respondent F1 indicated the following: *“BOT did a lot to support the sector, we saw the SMR being revised downwards which provided many banks with additional liquidity for lending. Furthermore, BOT’s discount rate also came down to 5% hence providing banks with access to affordable liquidity during a difficult time in the sector.”*

Similarly Respondent F2 indicated the following sentiments on restructuring allowances implemented during the pandemic: *“BOT published a circular to provide more restructurings on loans (up to 4) this was a good move as it allowed banks to restructure struggling loans which reduced the incidence of loan classifications and the non-performing loan ratio. Many loans would have been classified as non-performing without this regulatory amendment pushing up non-performing loan ratios in the sector.”*

Respondent F4 was however dismayed on the conditions to provide collateral to access the Covid-19 liquidity fund noting the following: *“accessing the fund needed us to place collateral in the form of government securities, we did not have available securities to pledge hence we struggled to access funds.”*

#### **4.4.7 Adoption of Technology for SMEs in Accessing Financial Services**

Additional findings from the supply side revealed some positive effects of the Covid-19 pandemic on the SME sector. The crisis compelled banks to enhance their service delivery through digital channels, this transformed how SMEs interacted with financial institutions. The adoption of technology, primarily, facilitated the integration of technology into many SMEs' business practices which had a positive effect on better financial management and record keeping.

*“We delivered financial services through digital platforms, we supported our SME clients to adopt mobile and other technologies to access funding, save, transact without needing to visit branches”* reflected Respondent F2.

*“Even though Covid was a bad time for the health and economy of the country, it accelerated the adoption of technology in delivering financial services, we now have enhanced our digital services giving SMEs better oversight of their funds, better record keeping and improving SME owners’ efficiency”* indicated Respondent F1.

Respondent F4 also stated the following: *“digitalization has empowered SMEs to monitor their cash flow and make informed decisions based on real-time data. This did not unlock financing but has supported digital financial inclusion for some SMEs in Tanzania.”*

## **Chapter 5: Conclusions and Recommendations**

### **5.1 Introduction**

This chapter aims at providing a detailed summary and conclusion of the study. The researcher also provides key recommendations that can be adopted to support financing of SMEs during crisis periods similar to the Covid-19 pandemic and concludes with a discussion on the limitations of the study and recommendations for future research.

### **5.2 Summary of findings**

The primary study objective of this research was to explore the challenges facing SMEs in accessing financing in the Covid-19 pandemic era. The study was conducted by looking at both the demand side and the supply side of SME financing. Interviews were employed as the primary method of data collection, a sample of 16 participants from the demand side (i.e. SMEs) and 5 participants from the supply side (financial institutions that finance SMEs) participated in the study. The data was analyzed using thematic analysis.

#### *5.2.1 Demand side*

On the demand side, the study engaged 16 SMEs operating in Tanzania. Overall, the SMEs profiled indicated that Covid-19 entrenched the challenges of SMEs in accessing financing in Tanzania with many SMEs reporting to have had a difficult operating environment and constrained access to financing.

The majority of the SMEs profiled indicated to have faced declines in revenue during the Covid-19 pandemic with SMEs involved in hospitality services, tourism, logistics and trading reporting ‘significant’ declines in revenue during the pandemic which they attributed to travel restrictions and delays in logistics as other countries had implemented lockdowns and curfews to control disease spread. Some of the SMEs profiled indicated that the lower revenues and cashflows affected their ability to service existing debt as well as the ability to access much

needed new financing. Some SMEs in the study indicated that they had to work with their financial institutions to restructure their debt through debt moratorium periods (grace periods) while some of the SMEs indicated that their financing requests submitted to financial institutions were declined as they failed to meet increased credit risk parameters implemented by the banks (indicative of increased credit rationing behavior by banks) or they were operating in sectors that their banks had suspended new financing towards such as tourism. The profiled SMEs that successfully secured financing from financial institutions during the Covid-19 pandemic reported facing more demanding and restrictive conditions including more physical collateral requirements, longer decision making and overall stricter conditions.

An interesting theme observed in the study that may warrant further research is that some SMEs, despite business recovery in the post-pandemic period, continued to face financing challenges rooted in the effects of Covid-19 highlighting the long-term impact of Covid-19 on SMEs, a sort of 'financial long-covid'. Future studies to explore this issue further may be useful to the sector as such studies can support financial institutions and development partners to develop long term strategies to address 'financial long-covid' effects. Some SMEs in the study acknowledged the efforts of their financial institutions in providing support during their period of financial distress by offering restructuring, this presented a positive view for financial institutions and the benefits of relationship management and relationship banking for SMEs.

Two SMEs operating in health linked sectors had a different experience in accessing financing during the Covid-19 pandemic period with each reporting that their financial institutions were positive and responsive to their financing requirements, one of these SMEs also indicated that they were able to receive grant financing from a development programme that had set up a special facility to support SMEs that had linkages to Covid-19 response efforts.

Generally, the majority of SMEs in the study had no knowledge of government programmes and funding facilities to support them to navigate the Covid-19 pandemic with many SMEs feeling like they had been left to their own devices to buoy through the crisis. In July 2021, 16 months after Covid-19 was declared a pandemic, the government through the Bank of Tanzania established a liquidity facility to support financial institutions to provide affordable loans to the private sector to the tune of TZS 1 trillion (equivalent to USD 367 Million) with SMEs being primary beneficiaries of this programme. However, a concerning theme was that despite the establishment of this facility, all SMEs profiled in this study indicated that they did not

have an awareness of the facility or any government programmes that were established to support them to access financing or ease their business challenges during the Covid-19 pandemic, likely as a result of inadequate communication.

### 5.2.2 *Supply side*

On the supply side, the study found that financial institutions adopted a cautious approach to SME sector lending during the Covid-19 pandemic. Financing was rationed to low-risk clients much to the detriment of SMEs. All participants from the supply side reported that the pandemic created challenges and disruptions in financing activities. Total lending in Tanzania during the height of the pandemic increased by only 3.9% in 2020 down from 12.5% growth in 2019 (Ernst & Young, 2020), however lending to the SME sector was subdued with some financial institutions indicating a decline of up to 20% for SME lending activities due to higher credit risk especially in the tourism sector. Key factors identified by supply-side respondents as hindering SMEs' access to financing during the pandemic period included economic uncertainty, declining business revenues on the side of SMEs, reduced risk appetite at financial institution level, information asymmetry and data gaps, high collateral requirements, declining property values and increased probability of default scores.

Economic uncertainty was a primary concern for financial institution. Financial institution respondents indicated a high degree of uncertainty in the lending landscape as Covid-19 presented a new phenomenon that had not been previously observed making it difficult to project how the future would unfold or the impact the pandemic would have on the economy and revenues of businesses, the economic uncertainty deepened information asymmetries resulting in intense credit rationing for SMEs. Respondents indicated that their SME clients experienced revenue declines during the pandemic with the decline in revenue being most pronounced in the tourism sector. Financial institutions found that many SMEs experienced cashflow shortfalls and were unable to honor their agreed debt repayments hence necessitating debt restructuring. Liquidity was also affected as deposits at bank levels and contributions at SACCOs level declined further deepening credit rationing behavior.

Some financial institutions indicated to have revised their lending criteria to mitigate sector-specific risks, while others suspended new financing for the most affected sectors. Overall, respondents indicated a reduced appetite to finance SMEs during the pandemic.

In Tanzania, real estate assets that may be used for collateral purposes have not been formalized due to a weak land titling process hence making many real estate assets with value held by SMEs unfit to be used as collateral. The study found that the Covid-19 pandemic further entrenched the collateral adequacy challenge for SMEs. Supply side respondents indicated that the Covid-19 pandemic resulted in real estate asset prices declining by over 20%. Financial institutions indicated that the decline in property values resulted in requirements for more collateral to meet regulatory coverage ratios for lending which many SMEs failed to meet. Additionally, to protect the loan portfolio and provide an adequate safety net for the financial institution to recover a good value in the event of default, respondents indicated that collateral requirements on the supply side were increased, this had the effect of requiring SMEs to provide additional collateral for new financing or if additional collateral was not available to reduce the financing amount being sought resulting in lower financing being availed if at all.

All financial institutions profiled in the study indicated an increased demand for financing from their customers. The increased demand for financing increased bank's credit rationing behavior as limited resources needed to be allocated to the best quality borrowers with large corporates with sufficient collateral and strong group support to withstand economic downturns being better positioned to access financial institutions' limited financing resources hence constraining available resources for SMEs.

A key theme regarding support emerged from the supply-side respondents; banks uniquely highlighted the central bank's assistance noting its importance in helping them navigate the crisis effectively and acknowledging the liquidity facility introduced during the pandemic which provided affordable funds for on-lending to the private sector. They also appreciated the reduction in the Statutory Minimum Reserve (SMR) from 7% to 6%, allowing banks to increase liquidity for lending. Additionally, the central bank's discount rate reduction, initially from 12% to 9% and later to 5%, was recognized as a key step in supporting affordable financing across the market. On credit regulations, financial institutions valued the central bank's allowance for up to four loan restructurings, up from the previous limit of two, giving private sector borrowers much needed flexibility and grace periods to manage the pandemic's economic impact. The community bank respondent was generally positive but the microfinance institution indicated that they were unable to fully utilize the liquidity facility as they did not have government securities to pledge.

A non-financing theme that emerged was that Covid-19 forced financial institutions to enhance the delivery of services through digital avenues, SMEs were required to quickly adapt to digital technologies to be served by financial institutions. This transition that was primarily accelerated by the pandemic has helped many SMEs to adopt the use of technology in accessing financial services hence improving their efficiency and supporting better record keeping as digital technologies make it easier to keep a proper trail of financial records, an area SMEs have faced challenges with.

### **5.3 Conclusions**

The study concludes that Tanzanian SMEs faced heightened challenges in accessing financing during the Covid-19 pandemic. These difficulties stemmed primarily from declining revenues and cashflows, falling asset prices, suspension of lending for some sectors, supply chain challenges, information asymmetry, a high-risk environment and increased credit rationing behavior at financial institution level.

The Covid-19 pandemic induced an economic downturn and supply chain disruptions which affected business revenues and cashflows particularly in sectors where SMEs are prevalent such as trading, logistics and tourism. SMEs did not have sufficient cashflows to support business operations and debt serviceability resulting in debt restructuring on existing financing while new financing was severely rationed by supply-side actors. SMEs faced further financing hurdles as the pandemic reduced asset prices hence impacting collateral values. Meanwhile financial institutions demanded additional collateral safety nets to protect against the property market windfall. The novel nature of the pandemic also exacerbated information asymmetry in financing decisions. Banks prioritized portfolio quality, channeling their limited liquidity toward low-risk, high-value clients. Moreover, beyond the TZS 1 trillion liquidity fund started 16 months after the pandemic, Tanzania lacked a broad-based response plan to support SME financing during the peak of the pandemic leaving SMEs to navigate the crisis alone. The absence of a targeted intervention further compounded the already existing financing difficulties faced by SMEs.

## 5.4 Recommendations

The primary objective of this study was to examine the financing challenges faced by SMEs during the COVID-19 pandemic. The findings indicate that the pandemic exacerbated financing challenges for SMEs, affecting both the demand and supply sides of financing. Moreover, direct financing support for SMEs through national level and development programmes was limited, with the majority of profiled SMEs reporting a lack of support and awareness of programs to address their financing difficulties at the height of the Covid-19 pandemic. Based on these insights, the study provides the following recommendations for SMEs and financial institutions:

On the SME front, the researcher recommends several measures that SMEs can take including diversification of funding sources by opening up to regional patient capital sources as well as development programmes. As elaborated earlier, the Tanzanian financial ecosystem is largely dependent on savings and debt financing, many Tanzanian SMEs are largely unaware of alternative financing options such as private equity, impact investors, venture capital and crowdfunding, these actors are very active in our regional peer, Kenya. Some of these investment vehicles have regional appetite for the Tanzanian markets but transaction volume is non-existent due lack of awareness. Exploring these avenues could significantly diversify and enhance financing for SMEs particularly when conventional lenders tighten credit policies during crises. There also needs to be effort from government and development partners to position Tanzania as an attractive destination for these private funding actors who bring in patient capital that is able to look beyond crisis periods and towards long term growth.

Secondly, SMEs need to enhance their knowledge of development partners and programmes that support unlocking financing challenges, a number of programmes were active in East Africa to support SMEs to access Covid-19 pandemic support through concessionary debt and grants but only two SMEs in the study indicated knowledge of such programmes. Development programmes are able to mobilize finance at scale during crisis periods that they deploy downstream to beneficiaries at low to zero costs hence offering a good alternative source of financing for SMEs during crisis periods, Tanzania did not leverage this.

Crisis events cannot be prevented but SMEs can be better prepared for crisis events by building safety nets to protect their businesses from economic shocks, this can be done by improving

financial and cashflow management as well as optimizing investments into assets that can be used as eligible collateral or be quickly converted into cashflow to support them during crisis periods. Microfinance institutions are essential to SMEs financing as they can provide financing quickly, they are however liquidity constrained, development partners can look at enabling these institutions with liquidity at low rates given their ability to uniquely support SMEs.

The insights from some SMEs as well as prior research highlights that relationship banking is important for SMEs in accessing financing as it helps to build trust with the financial institution, lowers information asymmetry as it allows the collection of ‘soft’ information which cannot be deduced from credit history with trust and character of the SME being used to assess financing eligibility (Berger and Udell, 1995,2006). Research by Howorth and Moro (2012) found trust enhances decision-making, allowing SMEs to access more tailored financial products and potentially at lower costs. SMEs need to establish stronger relationships with their financing partners as this can lead to more favorable financing terms and support during downturns as was experienced by some SMEs in this study. Furthermore, to protect SMEs financing access during crisis events, SMEs should negotiate with financing partners early on if they anticipate difficulties in meeting loan obligations, this is easier when the SME has a cordial long-term relationship with the financing partner. Being pro-active can also help to ease the financing burdens of SMEs as seeking debt restructuring or repayment moratoriums in advance can prevent defaults, preserve credit ratings, and improve long-term financial stability for SMEs.

On the matter pertaining to collateral, SMEs can work with financial institutions to explore the possibility of using non-traditional collateral such as receivables, inventory, or asset-based financing products. Additionally, credit guarantees from development programmes such as Africa Guarantee Fund and Aceli Fund can be pro-actively proposed by SMEs with their financial institutions in Tanzania.

On the financial institutions, government and development partners front, the following recommendations are proposed to alleviate supply side challenges. Firstly, at national level, Tanzania’s response plan did not provide a comprehensive support mechanism for SMEs financing despite Tanzania’s economy being heavily reliant on SMEs for job creation and income generation. There is a need for the government to implement targeted support programs

to incentivize financial institutions to lend to SMEs despite the heightened risks during crisis periods. Interventions to be implemented may include credit guarantee schemes to mitigate collateral shortfalls that are pervasive in the Tanzania SME financing eco-system and compounded by asset price declines during crisis periods. Funding liquidity facilities and emergency funds specifically tailored for SMEs can also be used to enhance financial institutions' funding base and push for SME financing providing lifelines to the SME sector.

Financial institutions need to adopt a more holistic approach to managing SME clients during crisis periods as these clients provide them with revenues during periods of economic prosperity hence working with SMEs to build resilience during crisis periods makes long term business sense. Financial institutions can offer extended repayment periods, reduced interest rates and repayment holidays during crisis periods.

Various development programmes provide financing instruments to financial institutions that work with SMEs including liquidity, grants and cash back incentives. Financing institutions need to explore these programmes to extend these benefits to SMEs in Tanzania. Governments could also step in by providing sovereign partial credit guarantees to financial institutions to mitigate the risk of non-performing loans in the SME sector. Another area that can be improved is through providing financial literacy, this can be done by financial institutions in partnership with the government and development partners to help SMEs better understand their financing options, access available support programs, and manage their debt and cashflows more effectively during crisis periods.

Since certain sectors (like tourism, logistics, and trading) were hit harder, sector-specific financial interventions could be designed in the future offering concessional loans or sector-targeted grants to help SMEs in these industries recover more rapidly during similar crisis periods. Lastly, harmonized partnerships between government bodies, development partners, and financial institutions can facilitate responses at scale hence reducing fragmentation and allowing policies to be backed by financial resources.

By adopting a combination of these recommendations, the financing challenges faced by SMEs during crisis periods, such as the Covid-19 pandemic, can be alleviated, allowing them to maintain operations and recover more effectively.

## **5.5 Limitations**

This section outlines the limitations of the study and suggests potential areas for future research.

The primary limitation of this study lies in its methodological approach. We employed a qualitative research design to collect data. While qualitative research is valuable for exploring new or complex issues, it lacks the ability to establish causal relationships, which is a strength of quantitative studies. Additionally, qualitative research often involves subjective data, which can introduce responder bias and affect the reliability of the findings. A third limitation relates to the timing of the data collection. Although the study focuses on the impact of the Covid-19 pandemic, data collection commenced in August 2024, 16 months after WHO declared the pandemic over. This time lag may have influenced the results as participants could have experienced memory decay leading to challenges in accurately recalling their lived experiences during the pandemic. A fourth limitation concerns the generalizability of the findings. The study is specifically focused on the Covid-19 pandemic, which was a unique global crisis, as such, the findings may not be easily transferable to other crises, limiting their applicability to future crisis situations.

## **5.6 Future Research**

This study utilized a qualitative research methodology, future research could employ quantitative approaches to better measure and quantify the financing challenges faced by SMEs during the Covid-19 pandemic. A quantitative approach could offer more robust insights into causal relationships and provide a broader statistical basis for understanding SME financing challenges during crisis periods.

The Covid-19 pandemic disproportionately affected certain sectors of the economy. There is an opportunity for future studies to segment SMEs by industry, such as tourism, manufacturing or agriculture. A deeper understanding of how these sectors were impacted could inform targeted interventions by the government and development partners for similar crisis events that may occur in the future.

Technology played a pivotal role in supporting trade and delivering financial services in unprecedented ways during the pandemic with some banks shifting from traditional banking practices to technology-driven approaches for credit risk assessment and loan distribution. Future research could explore how these technological innovations transformed SME financing during the pandemic and identify strategies to digitally expand financial products that support SMEs and enhance financial inclusion.

Another valuable area for future research would be to assess the long-term recovery trajectories of SMEs in the post pandemic period. Overall, the unique circumstances of the Covid-19 pandemic offer a valuable case for ongoing research into SME financing during periods of crisis, when SMEs are particularly vulnerable

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# Annexures

## 1. Annexure 1: Interview Questionnaire

### Annexure 1: Interview Questionnaire

UNIVERSITY OF CAPE TOWN



### Master of Commerce in Development Finance INTERVIEW/SURVEY CONSENT FORM

**Participant name:** .....

I volunteer to participate in a research project conducted by **ASHA TARIMO** as partial fulfilment of the requirements for the **MCom Development Degree** at the Graduate School of Business. I understand that the research is designed to gather information about **The Challenges faced by Small & Medium Sized Enterprises (SMEs) in Accessing Financing in Tanzania: Perspectives in the time of Covid-19** and that I will be one of approximately 16 participants being interviewed for this research.

#### Background and purpose of the research:

The Covid-19 pandemic had an unprecedented health and economic impact on households and businesses with reducing financing activities being implemented by banks and other financial institutions. SMEs faced a disproportionate impact with banks reducing lending thus curtailing the operations and growth of SMEs. This study seeks to explore the challenges and barriers of SMEs in accessing financing during the Covid-19 pandemic era. The specific objectives of the study are;

- i. To explore the challenges SMEs faced in accessing financing in the time of the Covid-19 pandemic
- ii. To explore the experiences financial institutions faced in providing financing to SMEs in the time of the Covid-19 pandemic

#### Ethics approval

The ethical clearance for this study was approved by the UCT GSB Research and Ethics Committee on 29<sup>th</sup> July 2024.

#### Participation and confidentiality

I understand that my participation in this research is voluntary, that I will not be compensated and that I may withdraw at any time. The interview will take approximately 45 - 100 minutes to complete and will be audio recorded.

I understand that I will not be identified by name in any reports using information obtained from this interview and that my confidentiality as a participant in this study will remain secure. Subsequent uses of records and data will be subject to standard data use policies which protect the anonymity of individuals and institutions.

Should you have any questions or concerns please contact me at [trmash001@myuct.ac.za](mailto:trmash001@myuct.ac.za) or my supervisor [latif.alhassan@uct.ac.za](mailto:latif.alhassan@uct.ac.za)

**Consent**

I consent to participate in this interview, based on the terms outlined above and subject to the following additional condition of my own (if any).

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**Signed by interviewee**

-----  
**Date**

.....  
**Signed by Student**

.....  
**Date**

## **The Challenges faced by Small & Medium Sized Enterprises (SMEs) in Accessing Financing in Tanzania: Perspectives in the time of Covid-19**

### **1. INTRODUCTORY LETTER TO CONDUCT INTERVIEWS FOR THE STUDY**

Dear Sir/Madam,

My name is Asha Tarimo. I am a Master of Commerce in Development Finance student at the University of Cape Town Graduate School of Business.

I am conducting a study to understand the challenges faced by Small & Medium Sized Enterprises (SMEs) in Accessing Financing in Tanzania in the time of Covid-19. I am writing to ask for your participation in this study to share your business's experiences and views in light of the study topic mentioned above.

Your business was randomly selected from the database of SMES provided by the Tanzania Chamber of Commerce, Industry and Agriculture.

If you choose to participate in this survey, your feedback to the research questions will be anonymous and no company specific data will be recorded to ensure confidentiality of each study participant's data. Data collected will only be released and/or published as part of group summaries to show overall study findings and trends. Kindly also take note that once you confirm participation, you may opt to withdraw from the study at free will by contacting the undersigned.

To confirm your participation, kindly contact me on +255 766 82 9903 to indicate your intention to participate in the study and available time slots to conduct the study interview. I look forward to your favourable consideration and participation.

Kind Regards,

Asha Tarimo

## INTERVIEW QUESTIONS FOR SMEs

### Section A: General Information

1. What is the nature of your business:
2. What sector is your business is Operating in:
3. Where is your business located:
4. Is your business located in an urban or rural setting:
5. Is your business formally registered:
6. What is the type of business registration:
7. How many years has your business been in operation for:
8. How many employees does your business have:
9. What is the indicative size of your business (if possible kindly mention turnover value):

### Section B: General Information Pertaining to Credit Access for your business pre-Covid-19 Pandemic Period

1. How was your business financed in the pre Covid-19 pandemic period?
2. Did your business have a financing gap?
3. How was the financing gap in the pre-Covid pandemic period addressed?
4. Did your business approach financial institutions to access financing to support the financing gap of your business in the pre-Covid pandemic era
5. How was your experience being in accessing financing from financial institutions to meet your financing gap and support your business?
6. If you faced challenges in accessing financing from financial institutions, kindly elaborate on the challenges you faced?
7. If you had applied for financing, was your request successful? If not, what were the reasons provided by the financial institutions?
8. Answer if funding request was unsuccessful. Upon an unsuccessful funding request from a financial institution, what steps did you take to meet your funding requirements?
9. Did the financial institution provide any support to help you become bankable in the future when applying for financing?

### Section C: The Impact of Covid-19 on Financing for SMEs

1. How did the Covid-19 pandemic affect your business?
2. What were the primary challenges your business faced during the pandemic?
3. Did your business require additional financing during the COVID-19 pandemic?
4. If yes, what was the key reason for seeking additional financing during the Covid-19 pandemic period?
5. What sources of financing did you apply for to mobilize the additional required financing you had during the Covid-19 pandemic period

6. Explain in detail if you were able to mobilize the required financing, if it was sufficient to meet your requirements and which financing partner provided the financing that you required?
7. Did you face any challenges when trying to access financing during the Covid-19 pandemic period? If yes, can you provide details on the challenges you faced when trying to access financing?
8. How would you describe the ease of accessing financing during the Covid-19 pandemic era compared to the pre-Covid-19 pandemic era.
9. Generally, how did the Covid-19 pandemic affect your overall financing requirements?
10. Did the outcome of your financing request have an impact on your business operations during the pandemic? If so, kindly elaborate on the impact the decision had on your business?
11. If you had existing financing from a financial institution, did the financial institution provide any support during the pandemic period and if yes kindly elaborate on the nature of support provided and how it helped your business during the pandemic
12. If you were unable to raise financing from financial institutions during the pandemic period, how were you able to overcome your financing challenges?
13. Did you have information pertaining to public sector and private sector led Covid-19 support programmes to support financing for SMEs? If yes, did you take advantage of these programmes and how was your experience?
14. If you participated in Covid-19 pandemic support programmes, how effective was the programme in supporting your financing needs?
15. What recommendations would you make to financial institutions to improve access to financing for SMEs during periods of crisis such as the Covid-19 pandemic
16. What recommendations would you provide to how financial institutions to improve access to financing for SMEs during normal periods and crisis periods.

## **INTERVIEW QUESTIONS FOR FINANCIAL INSTITUTIONS**

### **General Information**

1. Name of Financial Institution (Optional):
2. Type of Financial Institution (per Bank of Tanzania classifications):
3. Respondent's Position:
4. Location of Financial Institution:
5. Asset size of Financial Institution:
6. Year Established:
7. Number of Years experience in financing SMEs in Tanzania

### **Financing SMEs pre-Covid-19 pandemic period**

1. Does your financial institution finance SMEs
2. What is the share of financing for SMEs in comparison to the total bank portfolio
3. What is the bank's strategy and appetite when it comes to financing SMEs

4. What are the key challenges banks face in financing SMEs

**Financing SMEs in the Covid-19 pandemic era**

1. How did the COVID-19 pandemic affect your bank's overall lending activities?
2. What percentage of your bank's SME clients requested additional financing during the pandemic?
3. What percentage of your bank's SME clients requested debt restructuring during the pandemic?
4. Which types of financing did SMEs most frequently request during the Covid-19 pandemic and were there any differences between the types in the pre-Covid pandemic era and during the Covid-19 pandemic era?
5. Kindly explain the challenges your bank faced in providing credit facilities to SMEs during the Covid-19 pandemic
6. Kindly elaborate on the financial quality of SME financing applications during the pandemic period and compare this to the pre-pandemic period financing applications
7. Did your bank change the financing criteria for borrowers during the pandemic period in comparison to the pre-pandemic period
8. If your bank changed the financing criteria, what were the key reasons these changes were made?
9. Briefly explain the loan rejection rate during the Covid-19 pandemic period and also compare the rejection rate to the pre-Covid-19 pandemic period
10. What were the most common reasons for rejecting SME loan applications during the pandemic?
11. Was your bank supported by any government or donor support programmes aimed at providing relief to SMEs financing during the pandemic period? if so, kindly provide more details on the programmes and the benefits these programmes had on the bank as well as SMEs that your bank supported through these programmes?
12. Did your bank adjust its credit risk assessment criteria for SMEs during the pandemic? If yes, what adjustments were made?
13. What new risk management strategies did your bank implement to mitigate the impact of the pandemic on SME financing?
14. What long-term impacts do you anticipate the pandemic will have on SME financing?
15. What measures do you think would improve access to financing for SMEs in future crises
16. Do you have any additional comments or suggestions on how banks can better support SMEs during crisis periods?

