

Barriers Facing Startup Small and Medium Enterprises (SMEs) In Accessing External Capital in Tanzania

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Abstract

Despite the important role played by small and medium enterprises (SMEs) in poverty reduction, economic development, job creation and innovation for both developing and developed countries, still there are serious impediments limiting the availability of affordable and timely finances to support the startup SMEs. There has been very little research exploring the impediments particularly related to external financing of the SMEs. . This study conducted in Tanzania in 2014 explores the barriers encountering startup SMEs in Morogoro Municipality to use external source of capital as their main source of capital at the initial stage of their businesses. The findings indicate that the requirements imposed by financiers such as banks and SACCOS to starting business are the main barriers to startup business to use external capital. In addition other factors include the lack of Collateral, information asymmetry, business plan and business registration were rated to be main barriers to startup businesses to use external sources of capital. It is suggested that , the government and other stakeholders including lenders need to make some innervations so as to mitigate the problem of failing to utilize external sources of capital.

Keywords: Collateral, Information Asymmetry, Business Plan, Startup SMEs

1. Introduction.

Over the last two to three decades, small and medium enterprises (SMEs) have gained global recognition for their contributions to boosting the economic development and growth process in both developing and developed countries, respectively. These recognitions have significantly played the key role for economic sustainability and success in both developed and developing countries. SMEs have been plausibly recommended for developing countries to also contribute to boosting the economic development and growth process needed in these fragile economies.

Several studies and various reports provide compelling evidence that SMEs create jobs, increase innovation and creativity, economic growth, and poverty alleviation in different countries (Berger and Udell, 1998; Frame, 2007; Hamis, 2011; Kuzilwa, 2005; Meyer, 1998;

Mungaya, 2012; and Storey, 1994). Following its global recognition and applicable positive impacts on the economy, SMEs are being promoted in different countries to be the engine of development.

However, SMEs are encountering a major problem in securing affordable and timely finances to fund their businesses, acting as a major barrier limiting their startup and sustainable growth. Financial and other lending institutions have been applying different lending principles that have been very difficult to be met by startup SMEs (Berger et al., 1998; Bukenya et al., 2012; Cassar, 2004; Koropp, 2012; and Tagoe, 2005). The shortage of finance to start up a business has caused entrepreneur-minded persons to be discouraged to engage in entrepreneurship field, while big firms and enterprises have easily secured finances from outside sources such as banks and other financial institutions. The existing opportunities that are the key for entrepreneurship activities have received little or no response from the risk taker (the so-called entrepreneurs) mainly because of inadequate finance, which is key tool for entrepreneurship (Kuzilwa, 2005).

Accordingly, Khanka (1990) argue, "how entrepreneurs play a role in economic development absolutely varies from one economy to another, depending on different infrastructures, material resources, policies, industrial climate, financial liberalization and how the political system of the given country respond and support SMEs sector." The implication of this as far as SMEs sector is concerned is that it is very easy to observe people in one country have a spirit of starting up and engaging in businesses because entrepreneurship infrastructure is in place, while in another country people will lack the motivation and mindset of setting up businesses because of poor financial infrastructure. For the purpose of this study, entrepreneurship infrastructure means financing issues.

Tanzania Contextual Overview

From 1980s, Tanzania has been implementing a number of social and economic reforms, transforming itself from socialism and self-reliance (locally referred to as "Ujamaa na Kujitegemea") economy into market economy, necessitating economic liberalization and globalization (Hamisi, 2011). In 1999, Tanzania Development Vision 2025 was launched targeting at achieving unprecedented economic development transformation to become middle-income country by 2025. Tanzanian Development Vision 2025 had started by some macro-economic achievements. For example, over the past 10 years Tanzania has recorded impressive economic growth indicated by an average of 7% from the period 2001-2010 (FYDP 2012). Currently, Tanzania is among of the five countries in Africa with fastest growing economies (Ventures, 2012) and among the top ten countries with fastest growing economies in the world (Forbes, 2012 and The Economist, 2011).

However, little has been achieved in poverty reduction in Tanzania. For instance, between 2001 up to 2008 poverty declined from 36 percent to 33 percent even though the average growth of the economy was 7 percent (FYDP, 2012). These data shows that the growth rate that the country has experienced has neither benefited nor improved the real life of needy Tanzanians; this calls for massive efforts of integrating economic growth with general activities carried out by majority citizens. As long as Tanzania aspires to become a middle-income country by 2025 and the middle class to be the dominant class (TDV 2025), there is a need of promoting and building the required supportive environment for both private and public sectors to work together efficiently and effectively. The private sector has a great chance to build the inclusive economy and make the majority of citizens to be part of the

growth process that will set a road map for economic development and poverty reduction. Until now, agriculture absorbs 74 percent of the labor power but accounts only for 25.3 percent of the national GDP (FYDP 2012), meaning that there is surplus labor in the agriculture sector, which needs to be transformed elsewhere, certainly in the business sector.

Accordingly, Tanzania has been implementing a number of reforms for achieving its economic vision, the financial sector being among the strategic sectors for achieving TDV 2025. The financial sector has been liberalized, and it has led to rapid increase of financial service providers, particularly banks, insurance companies, stockbrokers and investment advisors, and other financial institutions (FYDP, 2012). At present, there are 39 private banks operating in the country and 19 financial institutions engaging in providing private credit (BOT, 2013), resulting in rapid financial sector assets led by growth in private credit, thereby enhancing financial intermediation and increasingly supporting economic growth (FYDP 2012). This provides alarming good news to the business sector, especially SMEs.

The rapid growth of the financial sector was expected to play a positive supporting role in financing the surplus labor from the agricultural sector to other sectors, particularly small businesses, considering that 74 percent of labor force in the country accounts for 25.3 percent of Tanzania GDP. According to SME Development Policy (2002), estimates shows that there are about 700,000 new entrants into the labor force every year, about 500,000 of these are school leavers with few marketable skills. The public sector employs only 40,000 of the new entrants into the labor market, leaving about 660,000 to join the unemployed or the underemployed reserve. SMEs hold a big share in employment all over the world, which means, if the financial sector will support the unemployed, they will be able to join the business sector and contribute much to poverty reduction and economic development.

Nevertheless, access to finance is relatively limited to startup SMEs in Tanzania (FYDP, 2012; Kuzilwa 2005), even if the economy has been expanding rapidly in recent years. The majority of startup SMEs utilizes imperfect and costly informal financing, and such means are inadequate to undertake large investments. Small and Medium Enterprises (SMEs) and agricultural investors apparently have the weakest access to finance in Tanzania, although they are expanding through private commercial and semi-formal channels such as SACCOS and micro-credit institutions accommodate the majority of the population.

Theoretical Development

Traditional capital structure advocate that always entrepreneur choose financing means which tries to minimize cost and on the other side maximize benefits associated with different sources of debit and equity. Therefore the decision to choose whether to use internal sources of capital or external source of capital is solely determined by this concept. In additional to that firm may choose funding source that will allow them to transfer risk, maintain control or signal information (gardener et al, 2012). Other owners look for the cheapest available source of capital while maintaining control of the business. In the same vain sometime it happens that shareholders and debtors they do inter into agency conflicts, these situations happen because the parties have incentives to add financial risks and operating risk of their companies. For instance the debtors do assume a big portion of the risk on the other hand owners typically take on riskier investment. To solve that debt holders most of the time do introduce contractual and monitoring policies on firms.

Categorization of Internal and External Source of Finance

This study has made two groups of sources of capital, which are internal source of finance and external or outside sources of capital. The internal or inside finance includes personal saving, money from family and relatives while external or outside finance includes money from angels' investors, venture capitalist, banks, incubators, money from government agencies and other financial institutions. This categorization is in line with the study of Berger and Udell (1998) in which sources of finance to startup businesses were bundled or grouped in the same way.

2. The Determinants of Source of Fund to Small Enterprises

For any business to grow and generate profits, it needs initial investments, which also can be termed as initial funds, these funds, determine the future growth and profitability of the startup business. Therefore, either entrepreneur can decide to finance business from his /her pocket money or get somewhere from those who are able to lend money to his/her start up enterprise. However, it is well known that, all over the world, the challenges encountering small and medium enterprises are timely and affordable credits to the startup businesses, despite the financial liberalization that has been experienced in developed and developing countries, still access to credits to startup SMEs is a problem (Bukenya et al, 2012). Financial institutions, banks and other lenders apply different lending principles to SMEs as to big firms, which have resulted in small businesses to being deprived of accessing finance (Bukenya et al, 2012). The following are the structures or characteristic, which can determine whether the startup SMEs will use internal capital or external capital.

The Relationship between Small Enterprises and its Potential Lenders

The relationship between enterprise and potential lenders, it has been argued, does contribute to the SMEs to get capital by either extending the loans or either way. Cole (1998) and Diamond (1984) argued that the interactions that exist between the loan seeker or SMEs and the financial institutions generate private information between the two. The importance of that private information is when SMEs want other loans the banks will refer to that information to decide whether to extend loans or not.

Empirical evidence from Cole (1998)'s study indicates that pre-existing relationship between the enterprises and lenders is a great determinant of the lenders to extend credit to the enterprises. The study found that use of many-financial services could affect the availability of credit. However Berger and Udell (1995) argued that, not at all times will relationship be important, sometime negative relationship develop due to bank's prime rate, they further argued that factors such as age of the firm and length of co-relationship will positively affect firm because financial institution will require no collateral or less collateral to lend money to an enterprises.

The Enterprises Size

Size of the enterprises has a significant effect on determining the sources of the capital to be used. When the size of the startup SMEs is small very often principle owner' finances are used as capital to fund the startup businesses, but when the size of the enterprises is big, because of the needs for large amount of financial capital, enterprise's owner will seek external finance to fund the business. Cassar (2004) has argued that, due to small size, enterprises tend to be faced with the great problem of matching with the cost of dealing with information asymmetries. Because of this, they end up using principle owner's capital. Sometime it does not mean that business owner do not want to use external sources but the strings attached loans by external lenders are very difficult and costly to be accomplished by startup SMEs with small size.

To the large size enterprises, sourcing their capital from outside funds is their first priority because they are well organized and always have necessary documents containing information about the general operations of the enterprises. Therefore, lenders would simply know in and out of the organization and be able to offer them the required amount of capital sought with affordable interest rate (Berger and Udell, 1998 and Cassar, 2004).

Assets Structure/Collateral

Assets play a big role in determining whether lenders will offer capital or not, asset is a part of capital to the startup businesses. Therefore, when startups SMEs have more tangible assets they get more advantage from the outside point of view. Financial lenders will willingly be able to offer funds, because the assets will secure their funds (Berger and Udell, 1998). Having collateral such as buildings and heavy trucks will reduce risk to the external lender. However, this has been hurting startup SMEs because most of them are individual owned especially home based, and therefore, this become an impediment to them to acquire external funds. Financial institutions like bank and micro credit more often are not willing to lend their money to small and start up enterprises because of the high risk of doing so, they do so by looking at collateral (Berger and Udell, 1995 and Mayer, 1998).

Financiers assume that, assets committed by the business owner will work, if the business collapses then the assets committed will decrease the effects of financial loss (Harris Raviv, 1991). The question to ask is what happens if the firm does not have collateral, what decision will be taken, obvious the answer is most of the startup SMEs will opt to use inside capital, which does not have that condition. Empirical studies from Berge and Udell (1998) and Storey (1994) have concluded that as long as banks and other financial institution use assets as contracting mechanism, micro credit and bank institutions financing will be determined if tangible assets would secure financiers.

Legal Organization

Legal organization also play a crucial role in guaranteeing access of external capital to small business, as there are different forms of legal organizations such as sole proprietor or trade, limited company and partnership. According to Storey (1994) when the small enterprises choose to be in a certain form like limited company, which is the dominant form to many startups SMEs. The legal form in which limited liability is, involves different weighing up and analysis to important issues by the businesses owner which shows how serious they are in the businesses, issues like taxation variation versus cost and public information influence small businesses to choose legal form (Cassar, 2004 and Storey, 1994,).

Financial institutions and banks always give great credit to those startup enterprises that are incorporated. They perceive and look at it as a sign that represents credibility and formality of operations, which indicate that the business has a future and potential growth (Cassar, 2004). Empirical evidence from Coleman and Cohn, Storey, and Freedman and Godwin (1994, 2000, and 1994) have found the direct relationship between financial institutions, bank leverage and incorporation and suggested that firm incorporation influences the use of bank financing.

Information Asymmetry

Access to information about the general operations of the startup SMEs is very important to the lenders. When the required information is available it simplifies decision-making and evolution of the businesses. However, there is a big problem facing small businesses, which is information asymmetry, because of information opacity encountering them, financial institution find very difficult to risk leveraging them. What constraints small businesses to get finance from outside is limited operating information and history, which hinder lenders to

evaluate the worthiness of the business (Cassar, 2004). It can be argued that information asymmetry make the financing choice to startups SMEs to vary in the whole lifetime of small businesses.

Mayers and Majluf (1984) have established a matching order of capital structure option created by the availability of information asymmetries between the SMEs and the potential lenders. Some explanations indicate that, when there is information opacity about the firm current operation and potential, the equity holders will be looking for higher return on the amount of capital they have invested than using the internal funds (Cassar, 2004). When the lenders are exposed to the risk attached to information asymmetry at the time of financing the business, lenders will require high return from the assets they have invested. Berger and Udell (1998) argue that, more often outside capitalists and intermediaries put more emphasis on the inside information about financial conditions and reputations of the inside owner when they make investment decisions.

Business Profitability, Intention to Grow and Growth Opportunities

Before investing their capital, some financiers would like to know whether the businesses would generate profit in the short run or long run. In addition, they would like to know whether the business has potential to grow and if there are growth opportunities, these have been strong criteria for the angel investors, venture investors and banks (Maggison et al, 2003 and Williams et al, 2013). Investors are risk takers, it is known that, the higher the risks the high the profit, a consequence, capital investors do their best to make sure that the information about profitability and growth opportunities are known before they decide to lend their money((Gartner et al, 2012 and Cassar, 2004).

This Study

The success or failure of new businesses is often dependent on overcoming a series of potential barriers, eg securing sufficient financial backing, adequate and appropriate guidance and training etc. Yet in light of the substantial growth in self-employment, there has been little research into the experiences of those starting-up micro and very small businesses. To date, there has been no systematic study of this, and many questions remain un answered. This study intended to explore the barriers facing startup business to use external initial capital in financing their business.

HYPOTHESIS; the obstacles to getting capital from external sources have influence on initial source of capital of the startup business.

3. Methodological design

This study has been approached from quantitative standpoint for both data collection and analysis. The primary objective was to explore factors which determine the availability of financial capital to startup SMEs, therefore quantitative approach was seen to be suitable for approaching this study like other studies relating to business especially financing have been approached. The research design is survey design and self-administered questionnaire is the type of survey that has been used in approaching respondents. The target populations of this study were 500 startup SMEs with less than seven years lifetime, operating in Morogoro Municipal. The sample size was 150 startups SMEs and the sample was selected through probability sampling through simple randomly probability. Data collection was done from early-May to mid-November 2014, in addition, data has been collected through self-administered questionnaire in which each respondent was required to respond question established independently and return the questionnaire to the researcher. Data presentation

and analysis has been done quantitatively and qualitative approach has been used for explanation of what contains in table, figure and numbers.

4. Data presentation and Analysis

This part presents data collected from startup SMEs with less than seven years lifetime to address the main research objective, which was to explore the factors which determine initial financial capital to startup SMEs in Tanzania, The results of this study are presented as tables and illustrated as figures, in a quantitative approach blended with some qualitative appraisal. Descriptive statistics is further employed in analyzing data through crosstabs analysis whereby the relationship between variables are being observed based on the established hypotheses

Table 1;

Initial sources of capital used by startup SMEs

Sources of capital	Frequenc y	Percent	Valid Percent	Cumulative Percent
Personal saving	106	70.7	70.7	70.7
Family, Relatives and Friends	18	12.0	12.0	82.7
Valid SACCOS	18	12.0	12.0	94.7
Bank Loan	8	5.3	5.3	100.0
Total	150	100.0	100.0	

Source: Data from Field 2014

The table above shows the sources of initial capital as used by startup SMEs when they were starting their business. The data show that more than 82 percent of SMEs did use internal source of capital which are personal saving, family, relatives and friends and only 18 percent of startup SMEs used external sources of capital which are SACCOS and Bank loans. Therefore this data imply that the majority part of SMEs do use internal sources of capital to fund their business at the initial point.

The Pearson Chi-square

H0. The obstacles of getting external sources of capital have no effect on initial sources of capital.

H1. The obstacles of getting external source of capital have an effect on initial sources of capital

Table 2;

Chi-Square Tests relationship between outside loan obstacles and initial sources of capital

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	20.178 ^a	12	.049
Likelihood Ratio	25.424	12	.013
Linear-by-Linear Association	9.023	1	.003
N of Valid Cases	150		

a. 14 cells (70.0%) have expected count less than 5. The minimum expected count is .37.

Table 2 above shows that. The p-value is .049 but this value is less than .05, therefore, rejects the null hypothesis that obstacle of getting external sources of capital has no effect on initial sources of capital. From this point, the result accept the alternative hypothesis which states that obstacles of getting external capital has an effect on initial capital sources; therefore this hypothesis is true as per observation.

Table 3;

Obstacles of getting loan from outside sources and initial source of capital Cross tabulation

		initial source of capital				Total
		Personal saving	Family, Relatives and Friends	SACCOS	Bank Loan	
Collateral	Count	40	11	10	5	66
	% within Obstacle of getting loan from outside sources	60.6%	16.7%	15.2%	7.6%	100.0%
Obstacle of getting loan from outside sources	% within initial source of capital	37.7%	61.1%	55.6%	62.5%	44.0%
	Count	8	2	3	2	15
Business plan	% within Obstacle of getting loan from outside sources	53.3%	13.3%	20.0%	13.3%	100.0%
	% within initial source of capital	7.5%	11.1%	16.7%	25.0%	10.0%
Information asymmetry	Count	5	0	2	0	7
	% within Obstacle of getting loan from outside sources	71.4%	0.0%	28.6%	0.0%	100.0%
	% within initial source of capital	4.7%	0.0%	11.1%	0.0%	4.7%
	Count	35	1	3	1	40

	Business was not Registered	% within Obstacle of getting loan from outside sources	87.5%	2.5%	7.5%	2.5%	100.0%
		% within initial source of capital	33.0%	5.6%	16.7%	12.5%	26.7%
		Count	18	4	0	0	22
i did not apply for loan		% within Obstacle of getting loan from outside sources	81.8%	18.2%	0.0%	0.0%	100.0%
		% within initial source of capital	17.0%	22.2%	0.0%	0.0%	14.7%
		Count	106	18	18	8	150
Total		% within Obstacle of getting loan from outside sources	70.7%	12.0%	12.0%	5.3%	100.0%
		% within initial source of capital	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Data from field

Table 3 above shows the frequencies of obstacles faced by respondents when they apply for funds from outside sources of capital. Table 1 represents the relationship between two variables namely, initial sources of capital and the obstacles entrepreneurs face when they approached external sources of capital to fund their businesses. In this result, some entrepreneurs used external sources of capital, indicating conformity with requirements for a loan by these persons, while the others certainly have been unable to meet up with the tight requirements for external loans. From the result of the cross-tabulation, 66 respondents said that they faced problems of having no collateral to secure their loans when they approached external lenders. Among these 66 respondents, 77.3 percent of them responded that they used internal sources of capital. Presumably, these persons used internal sources of capital after failing to secure loan because of shortage of collateral. Therefore, collateral made them use internal sources of capital considering that 22.7 percent among the respondents who had collateral problem had said that they would prefer to use external sources of capital as their initial sources of capital.

The data also shows that 33 percent of respondents who used personal saving as their initial sources of capital did not register their businesses, 7.5 percent did not have a business plan, 4.7 percent have information asymmetry as a major problem, and 17 percent responded that they did not apply for a loan anywhere. For those who used SACCOS as their initial source of

capital, a total of 55.6 percent had a problem of collateral, 16.7 percent had a problem of having no business plan, 11.1 percent had information asymmetry as a problem, and 17.6 percent did not register their businesses. For respondents who used bank loans, 62.5 percent had a problem of collateral, 25 percent had a problem of business plan and 12.5 percent of respondents had a problem of not registering their businesses.

Discussion

Following the presentation and interpretation of data in chapter four, this chapter discusses the data presented in connection to its implications to the sustainable development of the business sector in Tanzania, and how SMEs should be supported, especially financing startup businesses, which carry the majority of the young entrepreneurs.

Obstacles of getting funds from external sources of capital

The result has accepted that, the obstacles of getting funds from external sources of capital have an influence on the initial source of capital, agreeing with the original hypothesis. In one way or another, different obstacles facing startup businesses when they apply for funds from external sources have been forcing them to use internal sources of capital. There are some factors that were seen to be very strong in preventing new entrants to use a certain kind of capital in this study, including indentified collateral, business plan, asymmetry information and business registration. In this study, collateral has been identified as a major problem facing startup businesses to get financial capital. This arises as a major problem because of the role of tangible assets to be security for the loan in formal lending such as banks and other financial institutions. Many of these small entrepreneurs are just doing business to secure their living.

Collateral

In this study, the availability of collateral appeared to be the most limiting factor considering that 37.7 percent of entrepreneurs indicated that they had a problem of shortage of collateral when they were looking for funds from external sources. Thus ending up using internal sources of finance that mostly entrepreneurs who have relatively low tangible assets will mostly use internal sources of capital and those who have tangible assets have more eligibility to use external sources of capital. This result is consistence with the result from other empirical studies conducted in developing countries such as (e.g. Matlay et al., 2012; and Albania and Bitzens, 2005). The essence of requesting collateral by lenders is due to most of startup SMEs lacking information that would assure the lenders that their money is secured. Berger and Udell (1998) suggest that collateral mitigates information problems.

The issue to consider is, many people who start their businesses are young people who do not have any kind of tangible assets, which is why most of them resort to internal sources of capital. Other informal investors such as angel investors would have solved this problem. Roger (2005) advocates the offer of financial capital to unlisted or startup SMEs, which are unable to use formal sources of capital due to unmet conditions and poor records of accomplishment. The result is also in line with the result of other studies conducted in Sub-Saharan Africa. For instance, in Nigeria, Okpara et al (2007) reported that most owners of SMEs failed to borrow money from banks because of lack of collateral.

Business Registration

Business registration also has been observed to be among the big problems affecting access to capital to start a business as 33 percent of all respondents answered that they often cannot access and secure external leverages due to the fact that their businesses are not officially registered or do not have a business registration identity. To lenders, registering a business

qualifies how much an entrepreneur is committed to the business. From the Tanzania perspective; there are different problems that make people start their business without registering. First, the bureaucratic procedures involved when an entrepreneur applies for business' registration. These procedures are accompanied by corruption especially when take long time or when an entrepreneur does not have some documents. As a result, many entrepreneurs would opt not to register their businesses that in future risk their chance to get loans from formal institutions.

Apart from that, when small business owners register their businesses they are obliged to pay tax, and there is no clear amount that entrepreneurs have to pay, most of them have been complaining about unfair means of determining the tax amount to be paid. Sometimes, it happens that entrepreneurs, who have the same business and same capital amount, pay different amounts or percentage of tax. This is among the reasons that have influenced them to be reluctant in registering their businesses. This implies that the government system is the one that is causing most new entrants not to register their business. If the government deals with this shortcoming, hopefully, this problem will not hurt startup businesses from flourishing. This result conforms to the result of Gartner et al. (2012) who revealed that businesses that have been registered would easily get external finances. This suggests that startup businesses should be encouraged to register their businesses to easily access external finances.

Business Plan

Moreover, business plan has also be identified as a problem to many business owners considering that 7.5 percent of all respondents answered that they could not access external sources of capital because they lacked a comprehensive business plan. A Business plan is a technical document that sometimes needs professional skills for drafting. Thus most small business owners face difficulties putting their business ideas together in a formal document stating for example what type of business they want to engage in, the fiancé needed to set up, the business activities and the expected monthly profit and other related financial and environmental stakes. Consequently, many outside lenders reject the loan applications from start up businesses. Therefore, availability of formal external sources of capital for startup businesses depends also on the availability of a comprehensive business plan from entrepreneurs, and less so for entrepreneurs who only seek internal sources of capital to set off a business. This problem is compounded by the fact that the educational level of owners of businesses are low in most cases and a business plan needs professional skills to prepare, which most of them do not have. Therefore, because most of them cannot prepare a comprehensive business plan for themselves and most often do not want to seek the services of professionals due to their limited finances, they opt to use internal sources of capital as an alternative.

Information Asymmetry

In addition to the above, information asymmetry is also a problem to startup businesses in Tanzania. Tanzanian entrepreneurs like many others in the African continent usually do not have any documented information about how SMEs operate. Therefore, it become so difficult for lending institutions to know the general operation of the businesses, whether they were making profit or loss, whether they have good history of paying back their loans or not and whether they have other debts to other institutions or not. All that result into information opacity that influences lenders to reject leveraging the startup SMEs. Low control of information inside SMEs and low management of information contributes to information

asymmetry problem too, because entrepreneurs do not take their business as serious and formal work, they just run businesses in a traditional manner and not in a modern way. The result of this study in this information aspect is consistent with results of other studies that were conducted in the Sub-Saharan region. For example, the study of Bukenya and Kinata (2011) conducted in Uganda and that of Tagoe et al. (2005) in Ghana found that most of startup SMEs faced a shortage of information when they were applying for bank loans, a problem contributed by internal control weaknesses in controlling information for public use. This suggests that small startup SMEs need to increase internal information control that will help them to show their credit worthiness.

Capital Outlay or Size of Business

Initial capital amount that startup businesses use to fund their business also has a relationship with the initial source of capital; Capital amount determines whether a business will be small or big. Therefore, the smaller the size of capital outlay the smaller the startup business and the bigger the capital outlay the bigger the startup business. When startup capital outlay is small it affects the source of capital because getting a small capital is easy through personal saving or from family, relative or friends but when the capital is big the business owner will need to use outside sources to fund the business.

From the sample of this research, the capital outlay used are categorized as small businesses according to SMEs classification, but when the initial amount is small, most of the owners have used internal sources of capital to fund their business. However, the more capital outlay is increasing, the numbers of the startup business using internal sources of capital have decreased, but the number of those who are using external sources of capital have significantly increased. So capital arrangement in terms of amount has a relationship with the sources of capital. Business owners' in this study are shown to use money from their saving, that is why the amount is very small, this is a characteristics of many startup businesses.

Some empirical evidence from other studies supports this result, for example, Berger and Udell (1998), who reported that, the big size startup businesses would use external sources due to big capital outlay and small size startup businesses preferred to use internal sources. In addition, the result is consistence with the results of Cassar (2004) who observed that, a startup business with large capital outlay and size had a large proportion of bank loans, debt, long-term debt and outside financing. However, the findings of this study go against the findings of some previous studies, for example, Gartner et al (2012) found that business size and capital outlay did not have influence on the decision to select the financing means, which is centrally to the findings of this study.

Only 2 percent answered that government incentives would induce them to expand their business. The government of Tanzania has a significant role to play in helping startup SMEs to acquire external funds, especially through setting rules and regulations pertaining to financing SMEs by using its central banks when they provide loans to commercial banks. The implications of this is that if central banks will command commercial banks to lend money to startup businesses, by providing some incentives to those commercial banks, it would help more people to start new businesses and others to expand existing businesses.

Finally, 8.7 percent of respondents also indicated that low interest rates from banks and other outside lenders would induce them to expand their business. Everywhere interest rates play a significant role in inducing people to apply for loans or not. In Tanzania, financial institutions charge a 10 percent interest rate. According to business environment and the competitiveness of entrepreneurs, many of them have been failing to repay their loans and

interests, therefore many startup businesses do hesitate to use loans to expand their businesses.

5. Conclusion

This study offers clear evidence on the kind of sources of capital used in financing start up SMEs in Morogoro Municipality and represents other SMEs in Tanzania of the same kind. The study has indicated that most of startup SMEs use internal sources of capital to fund their business at the initial stage and just a few of them use external sources of capital to finance emerging firms. Overall external sources of capital play a minor role in financing startup SMEs. There are some factors that have emerged to be the leading factors in hindering startup SMEs to use external capital in financing their businesses such as collateral, legal legislation, asymmetry of information and business plan, capital outlay and business size of the startup business. However, factors influencing startup SMEs to use inside or outside sources of capital vary from different countries, even though there are other factors that are common, the findings revealed that an owner's characteristics, such as education and experiences, do not influence initial sources of capital, which is against the study of Gartner et al (2012). Findings also suggest that collateral, information asymmetry and business registration are major obstacles that influence startup businesses not to use external sources of capital, this result is in line with the study of Maziku (2012) which was done in Tanzania and Berger and Udell (1998) and Mayer (1998). Capital outlay and size of business have an influence on initial sources of capital. The smaller the capital outlay and size the more businesses use internal sources of capital and the bigger the size and capital outlay the more startup businesses start looking for outside loans, this is supported from the study of Cassar (2004). The study recommends some measures to be taken to speed up the rate of startup SMEs to use external capital by mitigating the problems that are experienced by startup SMEs in using external capital.

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