

Working paper

# Report and comments on the IGC- SIDO impact evaluation scoping visit

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October 2016

When citing this paper, please  
use the title and the following  
reference number:  
F-40406-TZA-1

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## Executive Summary

From July to September 2016, the International Growth Centre (IGC) collaborated with SIDO staff to conduct a scoping exercise to observe the operations of SIDO, its clients, and to identify areas for an empirical evaluation on the impact of SIDO's work. This exercise consisted of interviews with 111 SMEs and the SIDO regional staff across 15 regions. Doing so enabled us to learn much about the nature of SIDOs programmes and the SMEs they serve in Tanzania.

We observed that the primary impact of SIDO is helping businesses grow from the startup or household stages of production to reach a certain level. For example, SIDOs trainings and credit appears to have helped these businesses to start keeping records, prepare a written business plan and obtain at least some type of formal registration. Most of them have hired new workers and increased their capital investment and some may have acquired or applied for TBS and TFDA certification as well.

However, once businesses have reached such a level, they still face many constraints which SIDO does not seem as able to help them with. The most prominent example of this is credit- many firms outgrow the small loan sizes of Tsh 5 million or less that SIDO offers, but cannot access bank loans for amounts higher than this. By offering higher loans, SIDO could potentially help bridge the gap between the needs of businesses and the capacity of the formal financial sector to serve them. Other more firm-specific issues also begin to arise at this stage, which SIDO could better address through individual consultations and follow ups as well as trainings geared towards relatively advanced SMEs.

One of the other factors limiting SIDOs impact is ineffective subsidization of its clients. SIDO does and should help firms to alleviate the high costs of starting and operating a business in Tanzania. However, many subsidies such as industrial estate facilities and the incubator programme in particular do not seem to be helping firms to eventually stand on their own. Rather firms are encouraged by free or subsidized rent and utilities to stay longer than the maximum duration in SIDO, after they should be ready to stand on their own. These businesses need to be able to survive while paying the market rates for these costs, otherwise SIDO is either paying for services that firms don't need or keeping unsuccessful firms alive, while forgoing significant potential revenue.

Another important issue is SIDO's M&E procedures, which currently focus on programmatic indicators such as how many trainings were conducted, how many beneficiaries participated, etc. Meanwhile, there are no systematic attempts to collect data related to firm performance and the impact of SIDOs services. Such data would enable SIDO to independently identify which of its services are effective and which are not.

The above findings provide the rationale for our proposed evaluation. We are currently seeking funding that would enable SIDO to increase their loan sizes to SMEs that show growth potential and have a good record of paying back loans. The evaluation would offer a randomly selected subset of these firms loans of up to Tsh 20-50m and evaluate the loan's effect on their performance and whether they are able to access formal finance afterwards. Such a study would also provide an opportunity to assess the impact of having received different SIDO trainings on how firms utilize the loans.

## Table of Contents

Executive Summary .....	1
Introduction.....	3
Background.....	5
Observations .....	7
OBJECTIVE 1: To Facilitate SMEs Innovative Capacity, Access to Technology, Infrastructure and Technical Services .....	7
Training and Advisory Services.....	7
Incubator Programme.....	7
Industrial Estates .....	8
TDCs.....	9
OBJECTIVE 2: To Facilitate Business Skills Development for SMEs’ Growth and Competitiveness .	10
OBJECTIVE 3: To Facilitate SMEs’ Access to Markets and Information.....	12
OBJECTIVE 4: To Facilitate SMEs’ Access to Finance.....	13
Cross-Cutting Considerations .....	14
Rural vs. Urban .....	14
Other projects.....	14
Key Ideas .....	15
Clientele .....	15
Attracting Growth-Oriented Firms.....	15
Services to More Advanced MSMEs.....	16
Encouraging Graduation .....	16
Judicious and Clearly Defined Use of Subsidies .....	16
Industrial Estates.....	17
M&E .....	17
Conclusion and Next Steps .....	18

## Introduction

From 27<sup>th</sup> July to 5<sup>th</sup> September 2016, the International Growth Centre (IGC) in collaboration with SIDO staff conducted a scoping exercise in order to identify the potential to conduct a rigorous evaluation of SIDO's impact on SMEs in Tanzania. Specifically, the goal was to observe the implementation of SIDO's programmes, to understand the SMEs that were receiving services from SIDO and how they differ from those who do not receive SIDO services, and to identify a potential intervention and set of indicators on which the proposed evaluation could focus. The scoping visits consisted of interviews with SIDO Regional Office staff, SMEs who had been receiving different services from SIDO and SMEs who had not received SIDO services in each of 15 regions. Each visit was conducted by one researcher from the IGC and one officer from SIDO Headquarters.

The specific objectives of the exercise were as follows:

1. To observe the implementation of SIDO's programmes and to understand their planned and actual impact on SMEs
2. To obtain a profile of the range of SMEs that SIDO serves and to understand how they differ from other SMEs
3. To identify a potential intervention and set of indicators upon which a proposed evaluation could be based.

In total, the exercise covered the SIDO offices and a total of 111 SMEs across 15 regions. The regions covered were: Arusha, Dar es Salaam, Geita, Iringa, Kagera, Kigoma, Kilimanjaro, Mbeya, Morogoro, Moshi, Mtwara, Mwanza, Rukwa, Shinyanga and Singida (Figure 1). Of the SMEs visited, the majority were in food processing (42) and light manufacturing (27) while other industries included soap making, leather tanning, poultry, tailoring and handicrafts (Figure 2). Of the SMEs we visited, 86 (77%) of them had received some form of SIDO service, while the remaining 25 (23%) had not. 83 (75%) had received training and 38 (34%) had received loans. 28 (25%) received both training and credit. While the main purpose of this scoping exercise was to provide the necessary background for a proposed impact evaluation, the purpose of this report is to summarize our observations from our interactions and recommend improvements to SIDO's strategy and operations based on what we saw. While it is important to note that the scoping exercise was not an exhaustive empirical study, it has nevertheless led to some interesting and important observations.

The rest of this report is structured as follows. Section II provides some background on SMEs in Tanzania and elsewhere that is relevant to the observations and recommendations that follow. Section III summarizes our findings from our visits while Section IV contains our recommendations to SIDO based on these findings. Section V summarizes and concludes.

Figure 1

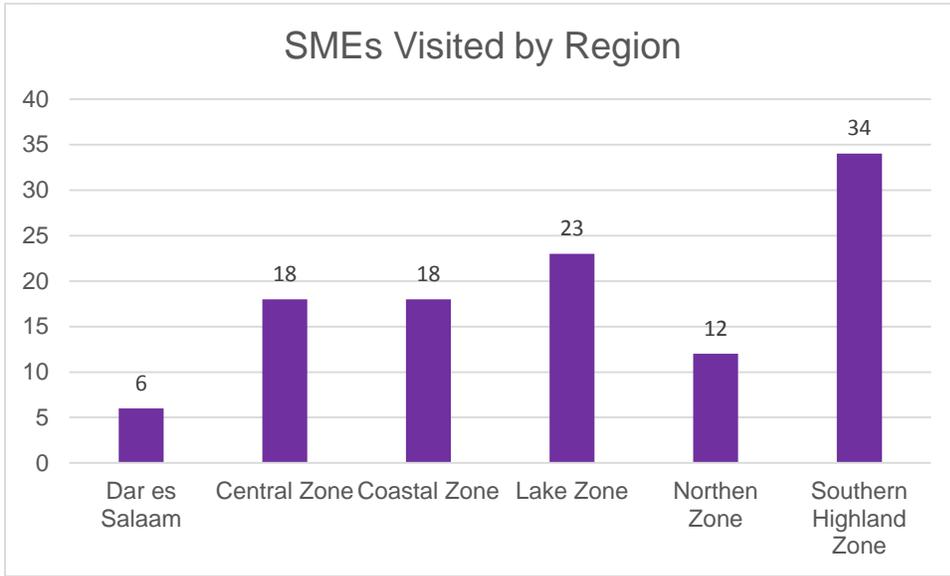


Figure 2

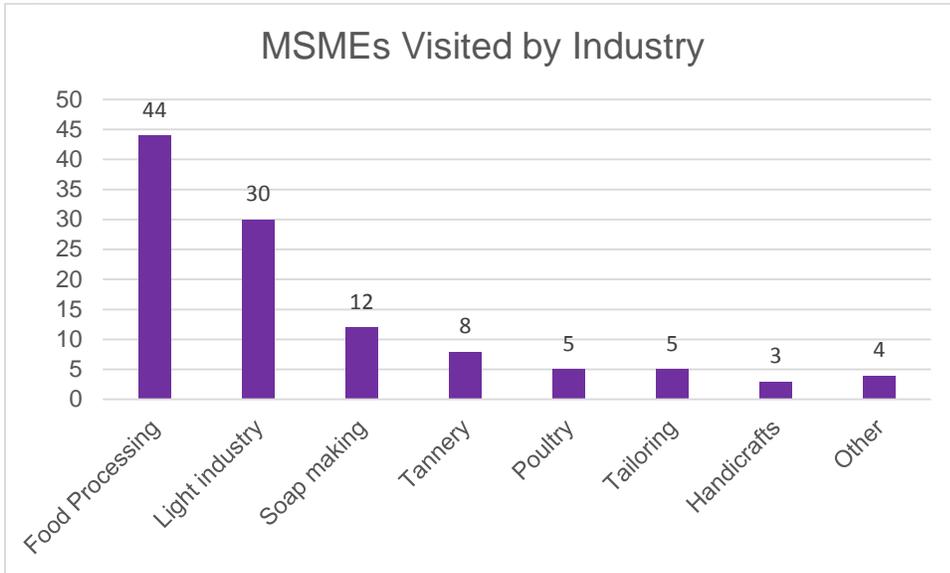
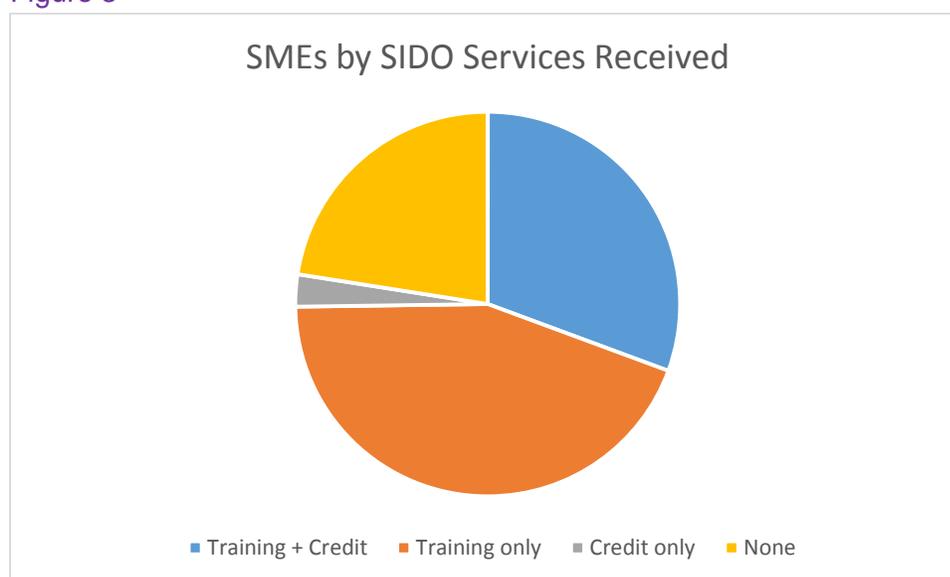


Figure 3



## II. Background

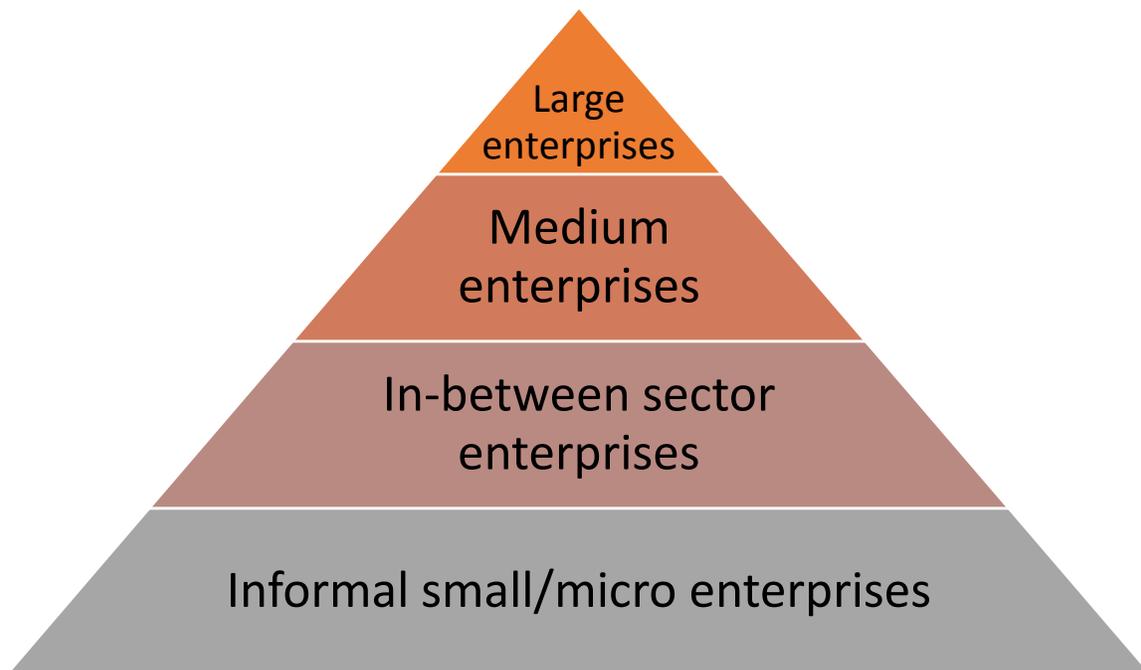
Tanzania has recently renewed its push towards industrialization, which includes an increasing focus on Small and Medium Enterprises (SMEs). According to H.E. President Magufuli, Tanzania envisions that SMEs will eventually contribute 40% of employment and 15% of GDP. SIDO has been tasked with a major role in facilitating the transformation of the SME sector in order to achieve these ambitious goals.

There is a growing body of literature on SMEs in Tanzania and the rest of Sub-Saharan Africa. The MSME Baseline Survey conducted in 2010 by Financial Sector Deepening Trust provides a rich array of data on MSMEs in Tanzania. There are about 3 million Micro, Small and Medium Enterprises in Tanzania, which employ over 5 million people, and are predominantly (74%) located in rural areas (FSDT 2012). The bulk of employment growth in Tanzania is occurring in the MSME sector. Using the data from the survey, Diao et al (2016) show that while there is considerable heterogeneity among MSME firms, a small proportion grow considerably, thus disproportionately impacting aggregate employment and productivity growth. Many of these firms exist in a so-called “in-between sector” in which they are more productive and have more growth potential than other MSMEs yet are too small or informal to access formal finance, high value markets and essential services. Facilitating these firms to graduate from the in-between sector would therefore stand to increase the contribution of small industry to Tanzania’s industrialization and overall growth targets.

It is among this type of firms where SIDO can likely have the greatest potential impact – in fact it may have already helped a number of the surveyed in-between sector firms. On the other hand, a large number of firms in Tanzania can be considered “survivalists” in that their owners do not target growth, but rather aim to provide more stable income to their households. These firms may also require support from SIDO in order to achieve their goals; however, such support would likely be different than those needed by in-between sector firms.

This segmentation of businesses in Tanzania can be visualized through a pyramid structure. At the bottom of the pyramid are the majority of businesses, which are generally informal, not very productive, and less likely to grow. These firms are typically informal, do not keep written records and may not have basic business skills. However a number of small, formal firms have productivity comparable to levels observed in formal firms, employ workers, and show the potential to grow. This, as we have mentioned above, can be referred to as the in-between sector. However, many of these firms may lack access to formal finance, may not have the full range of registrations or licenses that they need, and still face a number of obstacles to become medium firms. Medium firms typically have between 20 and 100 employees, have a well-established production process, and have access to formal credit. At the top of the pyramid are large firms, which employ more than 100 people and are often owned by foreigners or Tanzanians of Asian or Arab origin. According to Sutton and Olomi (2012), most of these firms started out quite large, implying that few SMEs have successfully graduated to become large enterprises.

Figure 4: Pyramid Structure of Tanzanian Enterprises



SIDO's role can be seen as helping SMEs to climb up to the next level of the pyramid, particularly assisting micro-businesses to enter the in-between sector and in-between sector firms to graduate into medium and large enterprises. This is consistent with Tanzania's national objectives as well as trends that are emerging in the literature. Therefore it is a useful lens to help interpret our observations and recommendations in the sections that follow. In general, we see that SIDO has been effective in helping businesses grow from the bottom level of the pyramid to the second level, but that more focus is required to assist businesses to move further beyond this point.

### III. Observations

In this section, we summarize our observations on the impact of SIDO's activities according to its four main objectives as well as other general considerations.

#### **OBJECTIVE 1: To Facilitate SMEs Innovative Capacity, Access to Technology, Infrastructure and Technical Services**

According to our visits to regional offices, it appears that SIDO is pursuing this objective through provision of machinery and advisory services/training, industrial estates, the incubator programme in seven regions and the Technology Development Centres (TDCs).

##### Training and Advisory Services

The training and advisory services appear to be quite important and relevant to SMEs. SIDO is able to help with identifying which machines to purchase, acquiring the machine, installation, repair and maintenance. These advisory services appear to be especially relevant to businesses in their early stages, who are acquiring machinery for the first time. It is clear that there is limited information about the function of and market for machinery among SMEs; therefore it is important for SIDO's training and advisory to continue bridging that gap.

##### Incubator Programme

However, the incubation programme does not appear to be having its desired effect. The objective of the programme appears to be helping to develop firms with innovative products into viable enterprises that can stand on their own after three years. The main benefit firms receive is free working premises and subsidized utilities such as power and water, along with regular advisory services, training from SIDOs Technical and Business Development Officers and linkages to other services providers. However, very few of the incubated firms have graduated or are on track to graduate. The proportion of firms that graduate appears to be between one third and one half in most regions. One region, which has seen only 4 out of 15 incubatees graduate on time, is planning to evict the firms that have overstayed and start afresh. Nevertheless, the incubator has produced some success stories, such as a manufacturer of banana wine, an entrepreneur who received a patent for making electrical cables out of wood, and another who makes bicycle-powered battery chargers.

We observed a number of factors that could explain the poor overall performance of the incubator programme. The most apparent factor is that firms do not have real incentives to graduate from the incubator programme since they see SIDO's estate as a more desirable place to operate than private premises. This is because the free rent and cheap utilities they receive are a major subsidy. However, allowing firms to continue receiving this subsidy after three years is either keeping afloat firms who could not otherwise succeed in the open market or freely providing market-ready firms with a service they can afford.

Another challenge inherent to the programme is the focus on “innovative” products. These products are inherently riskier than other products, and many of the incubatees we interviewed are either not able to perfect their production process or find a market for their products. On the other hand, many regions have only three or four incubatees despite having the capacity for fifteen because there are few entrepreneurs with products that could be considered innovative. While encouraging entrepreneurs to test new ideas and learn by doing is not a bad idea in itself, it is not beneficial to either SIDO or the entrepreneur to subsidize an unviable idea.

Finally, a major challenge facing the incubatees with potential is lack of specific funding. Although we learned that a separate incubator fund was planned for the programme, it was only ever implemented in Dar es Salaam. A successful incubatee should have faster growth and thus greater appetite for credit than ordinary firms; therefore, it would make sense for them to be able to access more than the Tsh 5-6m that are available from NEDF/RRF. We observed a number of firms who had developed a solid production process but were unable to finance the machinery required to implement it. However, incorporating credit into the incubator programme can only work if the firms with potential to succeed can be identified; otherwise, SIDO will only be increasing the resources it spends on keeping firms who are unable to sufficiently grow afloat.

Therefore, it appears that SIDO needs to think about which firms it wants to target with the incubator programme and how to create an environment where firms are pushed forward rather than encouraged to remain where they are.

## Industrial Estates

Industrial estates are a very important component of SIDO’s services, as they provide firms with decent and affordable working premises and access to reliable power and water in most cases. Working premises are also essential for businesses to be able to obtain TBS and TFDA certification. In other regions, SIDOs working premises enable the development of clusters that create significant economies of scale, particularly for rice in Mbeya as well as palm oil in Kigoma and sunflower in Singida. While further research would be needed to quantify the exact benefits of clusters, they appear to be creating economies of scale and scope, facilitating market access, enabling technology transfer between firms, and reducing the cost of SIDO’s service delivery by concentrating the beneficiaries.

On the other hand, more clarity and transparency is required in terms of firms accessing the industrial estates and how SIDO interacts with them. While rent in SIDO estates can be as little as one third of the rate for an equivalent space in town, it is unclear how many of the firms currently occupying the premises actually require such a level of subsidy. The subsidised rent may be quite important for firms in the start-up phase, but after a few years of growth, they should be able to pay to most if not all of the market rate. Moreover, many firms in the estates do not interact with SIDO at all besides from renting their premises. While some of them are quite established and do not require SIDO’s services, others actually have significant demand for SIDO’s services but were either not aware of what SIDO offers or have not been able to access them.

While firms should not be required to use other SIDO services in order to access premises, the well-established firms also most likely do not need subsidized rent. This means SIDO is losing out on significant revenue. However while many of the firms in the estate do not have use for the service SIDO currently offers, many firms of all types still faced issues that SIDO could help them overcome through the type of regular interaction that should be easy given their proximity. This connects with our observation that SIDO is not doing enough to serve the needs of SMEs who are beyond the point of requiring basic training and small loans but still face significant challenges to continued growth, which will be discussed in the following section.

SIDO and the Government of Tanzania (GoT) appear to have already recognized the benefits of industrial estates, as Tsh 4bn out of a total of 6bn has been allocated towards further development of SIDO estates across the country. However, SIDO should consider how these estates can best be developed and managed in order to get the maximum impact from those funds. Essentially, this can be done by providing quality infrastructure to firms that would not otherwise be able to access them and taking advantage of the benefits of agglomeration in areas where there is significant production of a marketable product.

## TDCs

During the scoping exercise, the TDCs in Arusha, Iringa, Kilimanjaro, Mbeya, Mwanza, Mosi and Kigoma were visited. The TDC programme as a whole appears to be at a crossroads, both in terms of what its objectives are and its efficiency in achieving them. The question in this case is how much, if at all, should the TDC be willing to sacrifice in profitability in order to provide services to SMEs. To some degree, all of the TDC staff interviewed perceived the TDC to be somewhat like a company, in that it is supposed to generate enough revenue to sustain itself. However, this does not appear to be the case in any of the TDCs.

One of the main reasons for this is that the TDCs are using outdated machinery that has not been upgraded since it was installed in 1973, most of which is in disrepair in some regions. Neither a private company nor a government institution can function efficiently in this kind of state. The TDCs currently operating are either not profitable or are making small revenues that are not sufficient to develop the machinery that they have. Some TDCs have resorted to selling goods such as furniture to offset their losses, which creates competition with the SMEs SIDO is trying to serve.

The next question to address is what value the TDCs would have the potential to add, even with a full range of functional machinery. The answer depends on the development of the private market for machinery- namely whether SMEs would be able to access machinery of a similar quality at a similar price. Based on our visits, the answer to this question is not yet clear. TDC staff recognize that the TDC has a small market share compared to local fabricators and importers of machines from China and India. However, they believe that the TDC caters to the small subset of SMEs that are willing to pay a premium for high quality machines, for which they believe there is little local capacity. This may be problematic for a number of reasons: One is that there may simply not be enough demand for high quality machines to meet the TDC's cost of production; less than half of the SIDO firms we interviewed who used machines bought them from a TDC. Another is that the TDC may actually be crowding private firms that can supply those types of machines out of the market. One firm that works closely with SIDO in Morogoro is

able to produce those types of machinery and even has the capacity to export to neighboring countries. While we did not observe comparable firms in other regions, they may still exist or be able to emerge. Also while the TDCs appear to add value in terms of repair, spare parts and technical advisory, most of these services could be done through the regional offices' technical staff.

Therefore, SIDO should conduct a more detailed analysis of the private sector's capacity to supply SMEs with appropriate technology and whether the TDCs can produce machines that the private sector cannot, whether the TDCs are crowding out private firms from providing this technology, or whether the TDC is making the machinery market more competitive and keeping prices affordable.

If after making this analysis SIDO decided there is still a justification for the TDC programme, then SIDO should still consider reducing its costs and enhancing its efficiency. One way to do this might be to consolidate the TDC programme into one large manufacturing centre, which could produce all of the machinery and transport it to the regions. This would almost certainly be cheaper than refurbishing or replacing all the defunct machinery on top of the operating costs of 7 different TDCs. The remaining TDCs could then be downsized and used for assembly, repairs, and advisory.

To briefly summarize SIDO's provision of technical services and infrastructure, it provides important services to some firms, but also consists of many inefficient and unnecessary subsidies and costs that could be scaled back. Firms should be supported to access infrastructure and technology at an affordable cost in their early stages, but once they have had the chance to grow, subsidies should be removed in order for them to truly stand on their own and to avoid SIDO paying to keep them in limbo. Likewise, SIDO should also recognize that its clients are both producers and consumers and only justify its large expenditures on technologies that its clients cannot reliably access elsewhere.

## **OBJECTIVE 2: To Facilitate Business Skills Development for SMEs' Growth and Competitiveness**

The clearest impact of SIDO seems to come through training of early-stage SMEs on basic elements of business management and production. Through these trainings, along with small loans, SIDO appears to be effective in helping entrepreneurs who are at the bottom of the pyramid or just starting their business to ascend to the next level. With the help of SIDO, these businesses are able learn or professionalise their production process, start keeping basic records, register, qualify for SIDO loans and in some cases access TBS or TFDA.

A large share of these entrepreneurs are women from regional towns or peri-urban areas who are starting a business for the first time. These businesses often start with very low capital and household-level production but many of them manage to grow into viable, permanent enterprises. Common industries that benefit from such programmes are small scale food processing, tailoring, soap making, and poultry. These firms are the ones who are able to acquire machinery for the first time, hire employees, formally register, and get SIDO credit. Many but not all of them start keeping written records of various quality and write business plans, although for some less educated clients this is done entirely by SIDO staff. Despite helping their businesses, many of these firms' records and business plans are not of a high enough quality

to be acceptable to banks. A few of the more successful entrepreneurs (31% of applicable firms we interviewed) were able to get TBS. Other small scale firms in carpentry, metalworking and other products also benefit similarly from these trainings.

Advisory services, whether formal or ad hoc, also appear very helpful to businesses but are not evenly provided across regions. This is due to different levels of constraints on time, financial and human resources. In some regions, the professional staff were able to reach a large number of firms with advisory services, which was helpful not only for the firms but also for SIDO's monitoring and evaluation.

In short, SIDO appears to be very helpful in taking an entrepreneur from the beginning or micro-level to the small level. However, we have observed that SIDO has a much more limited capacity to help firms develop beyond this level. These businesses can be considered members of the "in-between sector", which means that while they are SMEs, they are as productive as larger firms, hire employees, keep records, and are fully registered. Some of these firms have reached this level through SIDO, while others started at this level or reached independently. Nevertheless, they still face a number of challenges that SIDO's programmes do not appear equipped to address, since their requirements are different than those of less developed SMEs.

For example, these firms largely have an appetite for loans of much more than Tsh 5m- typically between Tsh 15 and 50m. Moreover, rather than general trainings on basic record keeping and food processing, these firms require more specialized advice on issues relating to their specific firm. For example, many firms mentioned that they were require assistance in obtaining packaging materials, navigating the legal system to settle debts and enforce contracts and upgrading their machinery. Many also mentioned that they were interested in the broader topics that SIDO covers, such as organizational management and business plan development, but at a more advanced level than the trainings are currently conducted at.

While SIDO does provide advisory services for some of these firms, they appear to be missing many potential clients. For example, many of them were not aware of SIDO at all, or only knew that it was engaged with firms at lower levels of development than them and were not relevant to their needs. This even was visible on many of SIDO's industrial estates, where some of the more established tenants were not aware of the services that SIDO were offered or though it was meant for less sophisticated firms. Rather than criticizing these firms for refusing to come to SIDO, SIDO could instead institutionalize and market services targeted to relatively advanced SMEs. This could include trainings on topics such as use of business software like QuickBooks and Tally, intermediate and advanced business planning, or preparing to export complimented by personalized advisory services. Similarly, SIDO could use its existing capacity to market itself more as a consulting firm to these businesses. To do this SIDO will need to be attentive to its systems for following up with firms and try to systemise relationship building exercises with firms. For example, there is an established model of government provided firm support, being implemented in Ethiopia and Tanzania's investment promotion bodies. In this model the government organ actively builds relationships with firms, with the aim of building rapport and trust between government and partner firms, thus increasing the degree to which government can provide support to firms.

To summarize briefly, the trainings on business skills, entrepreneurship and basic production appear significantly helpful in getting businesses on track for success, but once businesses reach a certain level there is a gap in what (they perceive) SIDO is able to offer them. Therefore, SIDO should continue what it is doing with the smaller, newer SMEs but also enhance its programme to target and reach out to larger, relatively more sophisticated SMEs.

### **OBJECTIVE 3: To Facilitate SMEs' Access to Markets and Information**

While marketing facilitation appears to be the smallest component of SIDO's work, it is nonetheless having a significant effect on a number of SMEs. While most of the activities center around trade fairs and exhibitions, a greater impact may be coming from the ad hoc advisory services and recommending firms to buyers along with SIDOs support to gain certification from TBS and TFDA.

We had a chance to spend a day with SIDO's delegation to the Nanenane exhibition in Mwanza, in which we observed how these events give firms a chance to market their products. While we did not obtain figures on the total sales businesses got at Nanenane, many businesses have found links to their main buyer or supplier at similar events. One challenge than an entrepreneur mentioned is that sometimes SIDO's regional exhibitions get low attendance because they are not marketed well enough and people believe that there is a cost of entry even when it is free.

SIDO also appears to be using its institutional capacity to link firms directly to buyers to some degree, though more could likely be done. For firms that make products with further processing potential, such as oil and flour mills, tanneries and timber producers, SIDO could reach out to large firms in order to link them to contracts with SMEs. SIDO could also help firms take advantage of a renewed government focus on local procurement from SMEs by liaising with GSPA.

However, the main way SIDO appears to be helping with marketing is by helping firms to get TBS and TFDA certification. While many of the larger firms we talked to were able to obtain these certifications without assistance from SIDO, the process is a lot more difficult for smaller firms, whom SIDO appears to help significantly. First of all, TBS and TFDA can represent a turning point for a firm's market access, as it unlocks a much broader array of shops and markets that are willing to stock their products. In some regions, police have even been known to inspect markets and throw out any product not bearing the TBS label. Yet navigating such a process is especially difficult for small firms, who require SIDOs advice both on the technical aspects of getting their products to comply and with navigating the protracted and costly administrative process. This is a clear example of an important bottleneck facing firms that SIDO helps them to overcome.

However, one bottleneck facing SMEs that SIDO has addressed in its CSP is providing affordable packaging material. This is one of the most commonly mentioned needs facing SMEs, especially food processing firms, across the country. Quality packaging materials are required to attract customers but are very costly and often only available for purchase in bulk quantities beyond what a firm can produce. The new packaging center in Dar es Salaam may help alleviate some of these issues, but SIDO should monitor demand for packaging around the country as the center begins its operations to ensure that SMEs

demands are being met. Moreover, given the size of the demand for packaging it's possible that even if the centre operates effectively there may still be need for additional packaging production.

#### OBJECTIVE 4: To Facilitate SMEs' Access to Finance

Perhaps SMEs' biggest critique of SIDO, which almost all SIDO staff agree with, is that the loan sizes they offer are too small. Repayment rates also vary greatly by region but are below the targets everywhere but in Ruvuma and Singida, although they have mostly been improving over time. SIDO's credit programme in Ruvuma is considered a major success story with a loan portfolio of over Tsh 1bn, although we unfortunately were unable to visit there during our exercise.

Like SIDO's trainings, the loans appear to be generating a positive impact among SMEs in the early stages, particularly those with low capital requirements, but not those with more advanced, high-potential enterprises. For example, the loan ceiling of Tsh 5m for NEDF and Tsh 6.5m for RRF is well suited to a small-scale, predominantly rural business such as tailoring, soap-making or poultry farming. These firms, who use the loans for both working and fixed capital, do benefit significantly from SIDO credit, although many of them repay late or not at all. It also appears that receiving technical and business trainings from SIDO positively impacts the loan performance, although this is a hypothesis that we would like to formally test. However, the total demand for such loans from industries is generally between 50-70% of the loan portfolio in most regions. The remainder of the funds are then lent out to petty traders, who according to some regional managers pay back the loans more reliably but are outside of SIDO's industrial mandate and do not create the employment opportunities and multiplier effects that manufacturing firms do.

However, such loans of Tsh 6.5m or below do not make sense for more advanced businesses in these sectors, or engineering and milling firms. These firms have demand for loans ranging from Tsh 15-50m, although some of the owners may have overstated their demand during the interviews. Nevertheless, there appears to be a significant "missing middle" in terms of access to finance: firms that have outgrown the loan sizes offered by SIDO but are not able to access formal financial institutions. In some regions, many of these firms have resorted to taking Tsh 5m from SIDO multiple times, paying back the loan quickly and repeating.

The main reason these missing middle firms cannot access bank loans appears to be collateral issues, resulting in banks' requirement of land as collateral, which is difficult to formally register. Other issues preventing SMEs from accessing bank loans include poor record keeping and business planning, lack of formal registration and the high cost of processing loans, in some cases both above and under the table. While a number of firms who are eligible for bank loans still prefer SIDO loans because of the lower interest rates and more lenient terms, the number of firms who cannot access bank loans but would like to is far greater. Therefore, there is a significant missing middle in terms of SME financing that, while caused by an uncompetitive financial sector, SIDO needs to help SMEs address.

One attempt to do so that has been largely unsuccessful up to now has been the credit guarantee scheme with CRDB. While the guarantee from SIDO is supposed to substitute for the collateral required by

CRDB, the bank has been refusing to accept it according to SIDO officers. The only firms that are able to access these loans are the ones who have registered collateral and would thus be eligible for a bank loan anyway. In region, only 2 out of 80 loan applications were disbursed. Moreover, the programme is only targeting a few regions and focusing on agribusiness. Negotiations between SIDO and CRDB to revive the programme are ongoing, but as of now, this has not been the answer to the missing middle that it was hoped to be.

Unless this programme can be revived or another alternative found, SIDO itself would be best positioned to help clients overcome financial exclusion by increasing its loan ceiling. In addition to helping SIDO to better serve SMEs, it would also allow SIDO to manage its portfolio more efficiently. This is because it is likely that the larger and more established SMEs are much less risky customers than the small enterprises that are currently receiving the loans and defaulting at high rates. Moreover, since demand from these firms is less than the money available, a higher loan ceiling would enable SIDO to lend larger amounts to clients from whom most of the demand is coming from, and avoid lending to traders to keep the fund flowing. Lending larger amounts to fewer firms could also greatly reduce SIDO's transaction costs, which are significant given that they need to reach clients across the entire region despite limited, time, vehicles, fuel and staff.

This is perhaps the most urgent recommendation that we will make in this report.

## Cross-Cutting Considerations

### Rural vs. Urban

Although our exercise did not involve any visits to rural areas, it is quite clear that SIDOs services are heavily concentrated in urban areas. Regional managers typically estimated that between 80 and 85% of their clients are in urban areas. Although the majority of SMEs in Tanzania are rural, it makes sense that those who are large and growth-oriented enough to be attracted to SIDO would be concentrated in urban areas. However, we observed that most regional offices had little capacity to reach SMEs outside of the regional capital, whether in rural areas or other towns. As part of the scoping exercise, we visited some of these towns as well as the capitals of new regions where SIDO had not yet established its office. While SIDO had been reaching a few SMEs in these areas, there was very little overall awareness of SIDO or its programmes among SME owners in these areas. The main explanation for this was constraints in terms of human resources, time, vehicles and funds. SIDO's solution for increasing its presence in towns and rural areas is to work more closely with district authorities to arrange for trainings to be held locally and to connect SMEs to SIDO. However, it is not clear what effect this approach is having.

### Other projects

In addition to SIDO's four main objectives, it also implements a number of related projects that are funded by donors. A major example of this is the Muunganisho Ujasiramali Vijijini (MUVI) project funded by IFAD, although we also observed projects funded by Oxfam, Tools for Self Reliance, and others. Such projects are important for providing SIDO with additional funding to carry out activities related to SME development in Tanzania. However, to some extent, these programmes may create a tradeoff with SIDO's own objectives while also reallocating SIDO staff's time and infrastructure towards

other objectives. For example, we observed that SIDO staff in regions that were implemented externally funded projects were much less able to regularly visit and monitor their clients not participating in the donor's programme. While external projects also help SIDO to increase its outreach to rural areas during the course of the funding, SIDO is unable to provide continued monitoring and support to these clients when the funds run out. One particular example of this is the Oxfam project with sisal growers in Kishapo, Shinyanga region, who ended up leaving sisal for petty trade before many of the businesses collapsed. Therefore, while donor funding is likely to remain important for SIDO, care should be exercised to ensure that the programmes are aligned with SIDO's objectives and do not compromise its capacity to fulfill them.

## IV. Key Ideas

In this section we present some key ideas, which come from feedback from SIDO clients and staff as well as our own observations. The overarching theme behind these key ideas is for SIDO to better define the clients it wants to reach and the impact it wants to have in order to more efficiently target its resources towards achieving those goals.

### Clientele

#### Attracting Growth-Oriented Firms

SIDO's mandate is to support the growth and development of small industries. As such, if it is successfully delivering on its mandate, small firms and entrepreneurs should be attracted to SIDO and its services. In other words, the firms that have demand for SIDO services would come to SIDO by their own initiative and SIDO would not need to recruit firms beyond basic advertising and removing physical barriers to accessing services.

However, an alternative understanding of SIDO's role is that firms should be compelled to use SIDO services, and that firms not approaching SIDO indicates a failure on behalf of the firms. This mentality is best represented by instances where firms are required to work with SIDO to acquire necessary services such as business licenses or TBS certification. The problem with compelling firms to use SIDO services is that it makes work with SIDO an added requirement, and therefore potential an additional challenge for firms to overcome. It also makes it difficult for SIDO to assess the value of its products and services if firms are compelled to participate, as arguably the best indication of a good service is high demand for it.

Moreover, there are many firms which do not require SIDO's support, either because their needs are outside of what SIDO can provide or their requirements for training, technology and credit are already being met. These instances do not represent a failure on behalf of SIDO but rather are representative of the heterogeneity of small enterprises. By compelling firms to work with SIDO, the organisation will be spending scarce resources on firms who may not need or be able to benefit from the services.

Given these observations, we believe SIDO is likely to best deliver on its mandate if it sees its work as providing quality services to interested firms who participate freely. The degree of engagement from firms is then an indicator of the quality of the services, and SIDO will not be creating barriers for other firms who do not need their services.

### Services to More Advanced MSMEs

One of the reasons touched on above is that SIDO's services are not relevant to the somewhat more advanced MSME who have moved beyond basic training and loans of less than 5 million but still require substantial support to further grow. These firms may require advisory when it comes to packaging materials, improving the efficiency of their production processes, managing workers, developing comprehensive export plans, and dealing with regulatory issues among others. Many of the more advanced small firms and medium firms who thought SIDO was irrelevant to their needs reported that these services would be quite helpful to them. SIDO also could consider implementing some intermediate and advanced trainings, for example on more sophisticated business planning and the use of business software such as QuickBooks and Tally.

### Encouraging Graduation

SIDO's aim to support small firms, the success of SIDO's work is measured in part by the degree to which firms can operate independently after using SIDO services. As such SIDO needs to be attentive to whether firms are graduating from their programmes and showing the ability to operate as independent enterprises after receiving SIDO support.

This is particularly notable for firms in the incubation programme, where firms are remaining in the SIDO estate beyond the end point of the programme. The concern is that rather than helping firms launch after an intense period of support, the programme will create a set of firms dependent on SIDO support. Likewise with the other support programme, firms should eventually acquire the means to operate without the provided services. This point is further elaborated upon in the discussion of subsidies below.

### Judicious and Clearly Defined Use of Subsidies

Many of the firms that we spoke to were using the SIDO estate, where the rates were below general market rates. Also, other programmes, specifically the incubator programme provided subsidised utilities to participants. In another instance of this, the TDC's saw themselves as operating like private sector firms and even though premises were subsidised as was their capital and labour.

Subsidies and other forms of direct or indirect financial support for firms can be an important part of firm support programmes; however it is important to be clear where there are subsidies, what their purpose is, and how they contribute to achieving SIDO's goals. Subsidies might be extended for a short period to help overcome some barrier at which point the subsidy can then be removed. This could be useful in the case of the incubator programme for example, where we observed that some firms were reluctant to graduate after the three-year period because there was no incentive to give up the free rent and subsidized power supply they were receiving. A better alternative would be to gradually increase the rent and reduce the subsidy on power in each year of the incubator programme, and to make this clear when firms first join the programme.

Alternatively, subsidies can be extended to an entity producing an output or service which has a particular social value and which would not be provided without the subsidy. The TDC programme is an example of

this. However, there is a possible concern for instances in which the same service or product could be provided without the subsidy. While TDC officers claim that the machines they produce are of a higher quality than others available in the regions, some SMEs, such as Intermech in Morogoro, are able to produce similar machinery. Although we did not observe such firms in all the regions with TDCs we visited, in these cases, the TDC would actually be competing with a firm that it has a mandate to serve. Moreover, in a number of regions, the TDC was producing ordinary goods such as furniture; while it is important for the centres to use their operational capacity, they are at the same time producing goods also produced by SIDO clients. SIDO should pay attention to where the TDCs are adding value by producing quality goods that would not be locally available (at a competitive price), and where local firms already have such capacity. Perhaps this would entail the TDC focusing on more sophisticated machines that local engineering firms do not have the capacity to produce.

The key point here is that if a subsidy is being extended, there should be a clear purpose for which the money is being spent. SIDO should be attentive to subsidies which perpetually subsidise firms that should be growing out of needing subsidies, or subsidising activities which the market provides elsewhere at a lower cost.

## Industrial Estates

SIDO may also want to apply the same approach to rent for premises on its industrial estates, since many of the tenants are not at all affiliated with SIDO apart from renting the space. If the goal is to encourage these businesses to graduate and acquire premises elsewhere, then a permanent subsidy (through rent below the market rate) is a disincentive for this. If the goal of cheap rent is to encourage early-stage growth for different entrepreneurs, then these enterprises should eventually be able to grow to the point where they can afford the market rate for rent. When it is charging a low rate for firms that could afford rent elsewhere, SIDO is also forgoing revenue that could be used for other important services. Therefore, SIDO should aim to strike a balance between providing affordable working premises, which appears to be extremely important, to firms who need them while avoiding unnecessary subsidisation.

A majority of firms mentioned access to an appropriate premise for their business as a challenge. Firms already on the estate mentioned it as a key form of support, whereas those not in the state often expressed a desire to gain access to the industrial estate. As such the estates are clearly an important means for SIDO to provide firm support and are highly demanded. Our observation is that SIDO needs to ensure that there are clear procedures for accessing the estate and the estates are a clear element of their strategy for supporting firms. As much as is possible securing reliable utility supply and access to other government services in the estates for as many firms as possible is likely to be a key way in which SIDO can support firm growth.

## M&E

From our visits to SIDO offices and HQ, it was clear that the M&E being done only tracks programmatic indicators i.e. how many trainings were conducted, how many beneficiaries were there, etc. but there is little information available about what the actual impact of the programs are.

For example in some regions there have been templates developed for a database that would keep track of key firm indicators, such as turnover, costs, and employment although these templates are not heavily utilized. However, in most regions there is no systematic attempt to keep track of impact. SIDO HQ and the regional offices are interested in knowing these kinds of things but the main challenge is lack of time, funds and human resource to systematically collect data. Another potential problem would be SME owners' reluctance to reveal accurate information. Nevertheless, having such a database would not only be useful within SIDO for tracking the impact and enabling it to improve its service delivery, but the data collected could also present a stronger case for increased funding to SIDO, whether from government or donors.

## V. Conclusion and Next Steps

This report has presented a number of observations made during a scoping visit to SIDO's regional offices funded by the IGC. The scoping visit was for the purpose of preparing a proposal for an evaluation. This report does NOT present the results of an evaluation, nor is it the study proposal, but rather it should be seen as a summary of some reoccurring themes observed during the trip, and presented on the request of SIDO staff participating in the visit.

During the scoping trip the researchers visited 15 SIDO centres and spoke with over 100 firms. It is clear that there are many firms who value the services that SIDO provides and who feel that the operations of their enterprises have been improved through working with SIDO.

Firstly, it is clear that the SME sector is large and varied. The aims of the entrepreneurs, size and growth potential of firms, and needs and interests for support vary hugely between firms. For example, within the set of firms we met, the expressed demand for credit varied from less than 1 million, to in excess of one billion TSH. Also, some firms are operating at or just above subsistence level with little desire or possibility of growth where as others, the in-between sector, are high growth potential firms with entrepreneurs driven to expand their firms. These different firms will have different needs from SIDO, but also the likely outcome from supporting firms varies by the type of firm. Research in Tanzania and elsewhere suggests that the greatest possibility for employment growth, industrialization and private sector growth is through supporting high growth potential firms.

In the course of the visit it became clear that the regional offices had few systems or capacity to monitor the impact of their work or measure systematically the desirable outcomes in partner firms. In the course of this scoping visit the researchers were unable to find any data collected or stored by SIDO staff on firm outcomes such as employment, revenue, capital etc. In the event where SIDO staff had collected data it was for outputs, such as the numbers of trainings conducted, number and size of loans and so forth. As such, it is not possible to use existing data to track firm outcomes, much less assess the impact of firms. Our understanding is that SIDO is looking to introduce a monitoring system, we strongly support this effort.

This report also outlines a number of other operational points. For example, it is clear that SIDO provides a number of different subsidies to firms, and it is not always clear where the subsidies are or what their purpose is. Also, it is not clear how many firms are graduating from SIDO programs as opposed to persistently relying on SIDO support and products. Many of these points have already been observed by SIDO staff, though it remains to be seen what can be done to address the concerns.

One of the most notable observations from the scoping visit was the importance of credit to SMEs and the inadequacy of the current NEDF and RRF funds. The vast majority of firms states that their demand for credit exceeded the 5 million maximum loan amount (6.5 for the RRF). The loan celling is limiting the growth of growth orientated firms (in-between sector) that do not have access to formal financing.

### Next steps

The primary aim of the scoping visit was to collect information to help prepare a proposal for a further study. This proposal is currently being prepared. The hope is to run an evaluation that allows SIDO to offer loans of Tsh 20m-50m to firms that demonstrate significant growth potential and have excellent track records in repaying SIDO loans. These firms would be SIDO's clients who require larger loans that SIDO can offer but cannot yet access them from a formal financial institution. A tentative research question would be "What impact does access to sufficient finance have on high-potential financially excluded firms in terms of firm performance, growth, and entry into the formal financial sector?" By comparing firms that received different levels of training from SIDO, the evaluation could also answer the question "What impact does receiving SIDO services have on loan performance and utilization of credit for firm growth?"

By answering these questions, SIDO could obtain a solid evidence base as to how much offering larger loans would benefit their clients. Moreover, it is likely that refocusing its loan portfolio towards larger loans to high-potential firms rather than many loans to small firms and petty traders would reduce delinquency and default rates. This evaluation would also include a database development exercise, in which SIDO would be supported with capacity development and finance in order to for them to collect the necessary data from their clients, or at least firms who might be eligible for loans under the project (i.e. having repaid loans of the maximum size offered in the past 5 years). Such data would include basic firm information, sales, costs, capital and employment over time, the type of services businesses have received from SIDO and other stakeholders, and their performance with SIDO loans. SIDO would then be supported to create an effective reporting system from the regions to the head office and to develop a centralized database.

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