

## **INFLUENCE OF SOCIAL CAPITAL ON INCUBATED MSMEs’ ACCESS TO NON-FORMAL FINANCE. A CASE OF TANZANIAN INCUBATED MSMEs**

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### **Abstract**

**Purpose:** The purpose of this study was to investigate whether social capital of incubatees and incubator managers contribute to the incubatees’ access to non-formal finance in Tanzania. Also, to understand the types of social networks that have significant influence on incubatees’ access to non-formal finance.

**Design/methodology/approach:** Quantitative research approach was adopted in this study where data collection was conducted through the self-administered questionnaire. A stratified sampling technique was used because of the diversity of the business incubation programs and a sample of 141 incubated MSMEs was selected out of 593 incubated MSMEs in Tanzania. PLS regressions analysis method was employed to test the impact of bonding, bridging and linking social capital of both incubatees and incubator managers on incubatees’ access to non-formal finance.

**Findings:** The results indicate that incubatee’s bonding and bridging social capital and incubator manager’s linking social capital have positive impact on incubatee’s access to non-formal finance. But incubatee’s linking social capital and incubator manager’s bonding and bridging social capital have insignificant impact on incubatee’s access to non-formal finance. These results suggest that incubatees’ family members, neighbours, close and distant friends and secondary groups play a significant role in helping incubatees access finance from non-formal financiers. Similarly, incubator managers’ connections to influential people in private sector, civil society organisations, and government and public representatives have significant influence on incubatees’ access to non-formal finance.

**Research/practical implications:** This paper creates awareness to incubatees to utilize their bonding and bridging network links, to increase their non-formal financial accessibility. The incubatees are also motivated to utilize the incubator managers’ connections in the civil society organizations, private sector, government agencies and public representatives. Based on these results, policy makers should adopt group guarantee strategy which is being applied among secondary groups to facilitate financial accessibility. Also, policy makers can focus on how to maximize utilization of incubator manager’s connections to key people in civil society organizations, private sector, government agencies and public representatives.

**Originality/value:** The paper begins with an overview of previous researches in area of MSMEs’ access to finance and then moves on to show the role of social capital in incubated MSMEs’ access to non-formal finance. The paper then suggests the type of social capital/social networks that have a significant impact on incubated MSMEs’ access to non-formal finance.

**Keywords:** Financial accessibility, non-formal finance, incubatee’s social capital, incubator manager’s social capital

**JEL Codes:** L26, L53, G23

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## **Introduction**

Micro, Small and Medium Enterprises (MSMEs) form a crucial component of a strong and vibrant economy in both developing and developed countries (Ngowi & Milanzi 2006). They are important to the promotion of enterprising culture and to the creation of jobs within the economy contributing to around 60 to 80 percent of newly created jobs (Ou 2006). However, despite their importance to the economic development, MSMEs experience relatively high failure rates (IFC 2009). Most of the MSMEs point out financing as the foremost obstacle for their growth (Schiffer & Weder 2001). In Tanzania, various interventions have been put in place to address the problems which face MSMEs including limited access to finance. Some of the interventions are the business incubators which have been established to support MSMEs at their infancy stage. One of the objectives of business incubators is to facilitate the incubated MSMEs' access to finance. The literature indicates that business incubators significantly promote incubated MSMEs' access to finance (Wanyoko 2013), but it is not clear what aspects lead to business incubators' significant promotion of incubatees' access to finance. It should also be noted that due to weak finance sectors, developing countries like Tanzania are dominated by non-formal finance (Denis 2004) which is highly influenced by social networks (Swierczek 1994). Based on the fact stated above, it is therefore important to investigate the role of social capital on the incubated MSMEs' access to non-formal finance.

This paper examines specifically the impact of incubatee and incubator manager's social capital on the incubatee's access to non-formal finance in Tanzania. It enhances the existing incubated MSMEs financing literature and contributes to the field by revealing the role played by both incubatee and incubator manager's social capital on the non-formal finance.

## **1 Literature review and hypotheses**

### **1.1 Conceptual review**

#### **Incubatee's social capital**

Social capital refers to the benefits arising from mutual understanding, trust and shared values and behaviours that bind members in communities and human networks and make cooperative action possible (Putman 2001). In this paper incubatee's social capital implies to incubatee's benefits that are derived from preferential treatment and cooperation with his/her groups and individuals. Incubatee's social capital has been categorised into three categories i.e. bonding, bridging and linking social capital. Incubatee's bonding social capital entails the incubatee's benefits derived from his/her links to people based on the sense of common identity such as

family, close friends, neighbours and people of the same culture or ethnicity. Incubatee's bridging social capital refers to the benefits derived from the links to people who are beyond the sense of identity (Babaei et.al 2012) i.e. people such as distant friends, colleagues and members of secondary groups. Incubatee's linking social capital refers to the incubatee's benefits derived from his/her links to the people with key positions in civil society organizations, government agencies, representatives of the public and the private sector.

### **Incubator manager's social capital**

This involves the incubatees' benefits that are derived from preferential treatment and cooperation by groups and individuals to incubator manager. In other ways, it is the incubator manager's social contacts which influence positively the productivity of incubatees. Incubator manager's social capital is also categorized into three categories i.e. incubator manager's bonding, bridging and linking social capital. Incubator manager's bonding social capital suggests the incubatees' benefits derived from the incubator manager's links to people based on the sense of common identity such as family, close friends, neighbours and people of the same culture or ethnicity. Incubator manager's bridging social capital refers to the incubatee's benefits derived from the incubator manager's links to people who are beyond the sense of identity. It is incubator manager's links with people such as his/her distant, colleagues and members of secondary groups. Incubator manager's linking social capital implies to the incubatees' benefits derived from the incubator manager's links to the people with key positions in civil society organizations, government agencies, public representatives and the private sector.

### **Non-formal finance**

Non-formal finance is a type of finance that is provided by financiers who are not licensed by the central bank (Hyuha et.al 1993). In Tanzania, non-formal finance is categorized into informal and semi-formal finance. Semi-formal finance constitutes the finance provided by financiers who are regulated by authorities other than Central bank of Tanzania. Currently the notable regulatory authorities include Ministry of Home Affairs, Ministry of Finance (MoF) and Registrar of Cooperatives under Ministry of Agriculture, Food Security, and Co-operatives. Ministry of Finance regulates NGOs by reviewing external audits prior to authorizing disbursement of funds provided by Government or donors to the NGOs and granting accreditation to them. Organisations like Poverty Africa, PRIDE Tanzania, YOSEFO, SIDO, CREW, SELFINA, FINCA, Tanzania Gatsby Trust and Mennonite Economic Development

Association fall in this category. Informal finance involves finance accessed from all institutions and/or individual financiers which are virtually outside the control of the established legal framework (Hyuha et.al 1993). Institutions and individuals such as rotating savings and credit associations (ROSCAs), Accumulated Savings and Credit Association (ASCAs), moneylenders, landlords, relatives and neighbours fall under the category of informal financiers.

## **1.2 Empirical literature review and hypotheses**

In relation to the empirical evidence, Calice et.al. (2012) have summarized studies that show the financing gap as the main barrier towards business growth particularly among the MSMEs. To address the problem of financing gap among MSMEs, a reasonable number of researchers argue that business incubators are some of the successful interventions. According to Wanyoko (2013) and Bruneel et.al (2012), business incubators contribute to the incubatees financial accessibility. However, most of the reviewed studies have focused on the business access to formal finance and it should be noted that majority of MSMEs in developing countries access non-formal financing (Hyuha et.al. 1993, Ellis et.al. 2010). On the other hand, several researchers have argued that social capital has a significant influence on the business' access to finance. Guiso et.al. (2000), and Barr (2000) argue that social capital has positive impact on business financing. Based on the above reviewed literature, we are motivated to find out the impact of incubatee and incubator manager's social capital on the incubatees' access to non-formal finance. From the reviewed literature above, the following hypotheses were formulated.

*H<sub>1</sub>: Incubatee's bonding, bridging and linking social capital have significant impact on incubatee's non-formal financial accessibility.*

*H<sub>2</sub>: Incubator manager's bonding, bridging and linking social capital has a significant impact on incubatee's non-formal financial accessibility.*

## **2 Data and Empirical Results**

Our analysis in this study was based on 141 incubatees who secured loan from non-formal financiers. The distribution of data was tested by Shapiro and Wilk test which showed that data was non-normally distributed, and therefore PLS regressions analysis method was employed. Our dependent variable is MSMEs financial accessibility (MFA) and was measured through the level of satisfaction on the following dimensions: amount of loan obtained, interest rate, the loan repayment term, general credit contract agreements, required collateral, necessary managerial background, credit processing procedures and credit processing time. MFA was

calculated as an average of the above indicators which are ordinal data i.e. respondents replied by ranking the indicators in 1-5 Likert scale. The independent variables are incubatee's bonding social capital (IBS), incubatee's bridging social capital (IRS), incubatee's linking social capital (ILS), incubator manager's bonding social capital (MBS), incubator manager's bridging social capital (MRS) and incubator manager's linking social capital (MLS). IBS was measured through level of support received by incubatees from their family members, close friends and neighbours. IRS was measured through level of support from incubatee's distant friends and colleagues in secondary groups. ILS was measured through level of support from incubatee's people with key positions in civil societies organisations, private sector, government agencies and public representatives. MBS was measured through level of support received by incubatees from incubator manager's family members, close friends, and neighbours. MRS was measured through incubatees' level of support from incubator manager's distant friends and colleagues in secondary groups. MLS was measured through incubatees' level of support from incubator manager's people with key positions in civil societies organisations, private sector, government agencies and public representatives. In the Table 1 below, IBS, IRS, ILS, MBS, MRS, MLS and MFA constructs were presented and all of them have Cronbach's alpha values above 0.60 which is a minimum acceptable Cronbach's alpha value for a construct reliability.

**Tab. 1: Descriptive results for IBS, IRS, ILS, MBS, MRS, MLS and MFA**

Variable	Indicator			Construct			
	Mode	Mean	S.D	Mode	Mean	S.D	Cronbach's Alpha
<b>IBS Incubatee's bonding social capital</b>				<b>3.00</b>	<b>2.91</b>	<b>0.87</b>	<b>0.73</b>
Financial advice from family members	3.00	3.16	1.45				
Financial support from family members	3.00	2.81	1.34				
Financial advice from close friends and neighbours	3.00	3.02	1.20				
Financial support from close friends and neighbours	3.00	2.78	1.33				
Financial advice from people of the same ethnicity	3.00	2.87	1.30				
Financial support from people of the same ethnicity	3.00	2.85	1.29				
<b>IRS - Incubatee's bridging social capital</b>				<b>3.00</b>	<b>2.87</b>	<b>0.86</b>	<b>0.65</b>
Financial advice from distant friends and colleagues	3.00	2.84	1.25				
Financial support from distant friends and colleagues	3.00	2.52	1.13				
Financial advice from fellow members in secondary groups	3.00	2.97	1.32				
Financial support from fellow members in secondary groups	4.00	3.17	1.28				
<b>ILS - Incubatee's linking social capital</b>				<b>1.00</b>	<b>2.26</b>	<b>1.46</b>	<b>0.88</b>
Financial advice from people with key positions in CSOs & PS	2.00	1.82	1.65				
Financial support from people with key positions in CSOs & PS	3.00	2.87	1.58				
Financial advice from people with key positions in GAs & PRs	2.00	1.60	1.73				
Financial support from people with key positions in GAs & PRs	3.00	2.76	1.76				
<b>MBS - Incubator manager's bonding social capital</b>				<b>3.00</b>	<b>2.88</b>	<b>0.76</b>	<b>0.69</b>
Financial advice from manager's family members	3.00	3.08	1.33				
Financial support from manager's family members	3.00	2.74	1.44				
Financial advice from manager's close friends and neighbours	4.00	2.81	1.28				
Financial support from manager's close friends and neighbours	4.00	3.08	1.18				
Financial advice from manager's people of the same ethnicity	3.00	2.78	1.15				
Financial support from manager's people of the same ethnicity	3.00	2.75	1.13				
<b>MRS - Incubator manager's bridging social capital</b>				<b>3.25</b>	<b>2.88</b>	<b>0.98</b>	<b>0.73</b>
Financial advice from manager's distant friends and colleagues	3.00	2.95	1.24				
Financial support from manager's distant friends and colleagues	2.00	2.69	1.16				
Financial advice from manager's secondary groups members	4.00	2.99	1.34				
Financial support from manager's secondary groups members	3.00	2.91	1.47				
<b>MLS - Incubator manager's linking social capital</b>				<b>3.00</b>	<b>2.97</b>	<b>0.88</b>	<b>0.75</b>
Financial advice from manager's people in CSOs and PS	3.00	3.08	1.34				
Financial support from manager's people in CSOs and PS	3.00	2.74	1.15				
Financial advice from manager's people in GAs and PRs	3.00	3.03	1.10				
Financial support from manager's people in GAs and PRs	3.00	3.05	1.06				
<b>MFA - MSMEs non-formal financial accessibility</b>				<b>3.50</b>	<b>2.98</b>	<b>0.74</b>	<b>0.84</b>
Level of satisfaction regarding interest rate agreed	3.00	2.97	1.07				
Level of satisfaction regarding loan repayment term	3.00	3.08	0.91				
Level of satisfaction on overall conditions of credit contract	3.00	2.98	0.88				
Level of satisfaction regarding requirement of collateral	3.00	2.74	1.19				
Level of satisfaction on requirement of managerial background	3.00	2.81	1.24				
Level of satisfaction on financier's credit services procedure	3.00	3.01	1.04				
Level of satisfaction on length of the credit processing time	4.00	3.16	1.10				
Level of satisfaction regarding amount of credit obtained	3.00	3.07	1.13				

CSOs = Civil Society Organisations, PS = Private Sector, Gas = Government Agencies, PRs = Public Representatives

As shown in the Table 1 above, incubatees received the highest support from incubator manager's connections with influential people in the society in their (incubatees) process of accessing finance from non-formal financiers. But they received the lowest support from their

own connections with influential people in the society. These results can be reflected in table 2 below which shows that ILS impact on MFA is insignificant.

**Table 2: Results – PLS regressions analysis**

Dependent: MSMEs non-formal financial accessibility(MFA)

	Non-formal finance		
	Model 1	Model 2	Model 3
IBS – Incubatee’s bonding social capital	0.331**		
IRS – Incubatee’s bridging social capital		0.595**	
ILS – Incubatee’s linking social capital			0.028
MBS – Incubator manager’s bonding social capital	0.012		
MRS – Incubator manager’s bridging social capital		-0.086	
MLS – Incubator manager’s linking social capital			0.210*
BAG – Business Age	-0.058	-0.021	-0.078
BCP – Business Capital	0.035	0.090	-0.016
IPD – Incubation Period	0.035	-0.009	0.078

\*p < 0.05, \*\*p < 0.01

Table 2 above presents results for three PLS regression models. Model 1 analyses the impact of IBS, MBS and control variables i.e. BAG, BCP and IPD on incubated MSMEs’ access to non-formal finance (MFA). The results suggest that IBS has a significant positive impact on MFA, while MBS has insignificant impact on MFA. Likewise, model 2 results indicate that IRS has a significant positive impact on MFA, while MRS has insignificant impact on MFA. Model 3 indicates that ILS has insignificant impact on MFA, while MLS has significant positive impact on MFA. Based on these findings, both two hypotheses are partially accepted. The results partly concur and partly contradict with the findings by Guiso et.al. (2000) and Barr (2000) who found that social capital has a significant positive relationship with financial accessibility. They concur by revealing that in Tanzania, incubatees’ bonding and bridging social capital significantly influence their access to non-formal finance. incubatees’ family members, neighbours, close and distant friends provide advice to them on how to access finance from non-formal financiers and in some cases, they even guarantee the incubatees to the financiers. Some of these close people provide loans to the entrepreneurs under incredibly favourable conditions. Also, incubatees’ secondary groups provide guarantee to group members i.e. a member with no collateral is guaranteed by his/her group members. This facilitates incubatee’s access to finance because as a member of a group can be guaranteed by the group to the financiers. The findings have also revealed that incubator managers’ connections with

key people in civil society organizations, private sector, government agencies, and public representatives positively influence the incubatees' access to non-formal finance.

On the other hand, the results contradict the reviewed literature above as they suggest that incubatee's connections with influential people in the society have no any significant contribution to the incubatee's non-formal financial accessibility. This is mainly due to a big interaction gap between incubatees and people with key positions in civil societies organisations, private sector, government agencies and public representatives. Similarly, incubator manager's family members, close and distant friends, neighbours and secondary groups have insignificant influence on incubatees' access to non-formal finance.

### **3 Conclusion**

Incubatees' social networks related to family members, neighbours, close and distant friends, colleagues and secondary groups play an important role to their access to non-formal finance. Correspondingly, incubatees with high support from incubator manager's connections in civil society organizations, private sector, government agencies, and public representatives can easily access non-formal finance. These results create awareness for incubator managers and other stakeholders to motivate the incubated MSMEs to expand and utilize their bonding and bridging social networks, to increase their non-formal financial accessibility. The incubated MSMEs are also motivated to effectively utilize the incubator managers' connections in the society.

Regarding these findings, the following suggestions can be made: Firstly, the governments and other stakeholders should still put much efforts in supporting business incubators to enable them to incubate more MSMEs to facilitate their financial accessibility. Secondly, business incubators and other interventions can adopt the group guarantee strategy which is being applied among secondary groups. This strategy can be adopted and institutionalized by the business incubators to eliminate the obstacle of lack of collateral, a problem that has been singled out by MSMEs as the most burning obstacle towards financial accessibility. Thirdly, business incubators can also put emphasis on the incubator manager's links to key people in civil society organizations, private sector, government agencies, and public representatives as another aspect to be utilized for promotion of incubated MSMEs financing. This strategy brings the incubatees much closer to many non-formal financiers which without incubator managers they could have not accessed them.

Lastly, since this study is confined only to incubatee and incubator manager's social capital impact on access to non-formal finance, the future research may be extended to include the formal finance. It may focus on understanding the influence of incubatee and incubator manager's social capital on the incubated MSMEs' accessibility to formal finance as well.

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