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Abstract

Small hospitality businesses such as hotels and restaurants are not only necessary for the development of these industries as whole but also have the potential of contributing to the economic development of sub-Saharan African nations. However, recent studies show that availability of financing remains a critical obstacle for such businesses in sub-Sahara region. This paper presents a descriptive analysis of evidence from Tanzania to highlight factors that are possibly leading to market failure for small hotel financing. Implications on policy interventions and industry practice are explored to counter such obstacles.

Introduction

Small hospitality businesses, particularly hotels, are important for Africa's economic progress. However locally owned businesses face obstacles in financing investment projects and day-to-day operations. Recent studies have identified that financing is a critical obstacle for small hotels in Tanzania to improve their efficiencies, profitability, and contribution to national gross domestic product. Although small businesses in general could be facing similar challenges in Tanzania and other sub-Sahara African nations, hospitality businesses, since recently, have gained importance in these nations as tourism becomes and important source of economic progress (Tradepoint Tanzania, n.d.). The Government of Tanzania and the United Nation's Development Program (UNDP) have also emphasized the importance of small and medium sized businesses towards economic progress and poverty reduction (UNDP, 2007). Even though financing exist for micro enterprises, and small and medium sized businesses, small hotels practically get excluded from any of these economy wide classifications. Furthermore, even though the Government of Tanzania has recognized the importance of small and medium sized

businesses, the current policies and institutional framework may not be completely aligned to ensure that financing for small businesses such as hotels is effectively available. The purpose of this paper was to present a descriptive evaluation of small hotel financing activities in Tanzania based on recently completed field work in the country's three largest cities: Arusha, Dar-es-Salaam, and Mwanza. Furthermore, this paper assessed whether markets are failing in Tanzania to provide financing for small hotels. Implications of such possibilities are discussed along with characterization of small hotel financing activity. Evidence from this paper may also be applicable to other sub-Saharan African nations.

Small hospitality businesses in sub-Saharan Africa

Economic literature has suggested that small businesses are an important source of economic development and an important link to entrepreneurial activity, innovation, and job creation (Acs, 1992; Audretsch, 1995; Thurik & Wennekers, 2001). In addition to economic progress small businesses also provide diversity in the number and types of firms, and shift from a managed to an ownership economy (Cohen & Klepper, 1992; Audretsch & Thurik, 2001). Similarly, other potential impacts of small businesses have been theorized (Schmitz, 1989) yet few have been empirically observed; these include lower orientation towards exports; higher demand for capital, consultancy, and related services; and increased variety of supply of products and services (Acs, 1992). Meanwhile, there appears to a global shift of industry structures tending towards an increased role of small businesses (Carree, van Stel, Thurik & Wennekers, 2001). However, this shift is heterogeneous and highly dependent on country-specific factors.

Researchers believe that countries that are lagging in small business activity (and therefore in entrepreneurship) will pay a penalty through lower economic growth (Thurik & Wennekers, 2001).

In hospitality and tourism literature the analyses of small businesses, surprisingly, remains in its infancy. This can be largely attributed to the availability of quality data and statistics. Yet, anecdotal evidence suggests that small businesses may represent as much as 70% of these industries. In developing nations, these numbers could be higher (Christie & Crompton, 2002). The limited literature in hospitality and tourism on small businesses has studied various operational aspects including financial performance, linkages of financial performance and investments in fixed assets, operational aspects, and human resource issues (Romer, 1986, 1990; Poorani & Smith, 1995; Kaufman et al., 1996; Glancey & Pettigrew, 1997; Zhang et al., 2002; Worsfold & Griffith, 2003). Previous studies have also shown that hospitality and tourism industries contribute significantly to Tanzania's economic growth (MIGA, 2002; Thurlow & Wobst, 2003). More recently Sharma (2006) studied the impact of small hotels and found that these businesses contribute as much as a third of the total contribution of hospitality and tourism industries towards Tanzania's gross domestic product (GDP). This study also suggested that enhanced pricing of products and services could maximize small businesses' potential to contribute towards Tanzania's GDP. Sharma & Upneja (2006) followed up on the previous studies and confirmed that small hotels in Tanzania may be operating inefficiently. Amongst the causes of operational inefficiencies identified was the lack of product and service quality due to which these businesses were unable to maximize their pricing and marketing potential. Discussions with small business owners

revealed that lack of financing was a major obstacle to investing in their businesses to enhance product/service quality. These recent studies suggest that financing remains a critical obstacle for small hotels (and many other small businesses) in Tanzania and that it could be hurting their ability to effectively contribute towards the nations' GDP.

Lack of financing for small businesses such as small hotels is not entirely an isolated phenomenon. Christensen et al. (2006) studied key obstacles that sub-Saharan African countries face in developing an effective financial services sector. They highlighted weak institutional and legal environments, high real lending interest rates, and attractiveness of providing funds to the government compared to the private sector. Amongst the solutions that have been observed to counter these obstacles have been the creation of micro finance institutions, diversification of the financial sector to include non-bank financial institutions, establishment of government financial institutions and stock markets, and improving the operating environment especially through the use of technology. In spite of these steps the authors conclude that still significant work needs to done to enhance financial services sector in these countries, particularly by reducing the restrictions and state directions on these institutions. Sacerdoti (2005) also studied the same issues and focused mainly on small business financing, particularly for the agriculture sector. The conclusions of this study were also comparable with that of Christensen et al. (2006) emphasizing the weak institutional and legal framework as a key obstacle in promoting the development of financial services sector. Fleisig (1996) evaluated the issues related to collateral in many developing countries. Essentially to bring a piece of real estate as a collateral the person must either own that real estate or be able to place its use in the hands of the lenders. The current state of legal affairs in many developing countries is

such that the real estate is commonly leased to individuals without any ownership rights. As a consequence the borrowers are unable to get secured loans. This implies that the only loans available to them are unsecured which usually are at higher interest rates and of lower amounts. The solutions to these obstacles are widely known and appreciated, in essence legal reforms, creation and maintenance of public record systems, and effective enforcement of laws.

Berger and Udell (1998) provided an extensive discussion on various aspects of small business finances in the US. An issue relevant to current discussion was that small businesses have the following sources of financing available: financial institutions such as commercial banks, non-financial institutions and government sources (or other lenders), and personal sources such as credit cards, family and friends, and their own savings. Three largest sources of small business financing were personal sources, commercial banks, and trade credit. The authors suggested that in venture capital markets, particularly angel financing, there is a certain level of market failure.

Previous studies clearly indicate that sub-Saharan countries are unable to effectively provide financing for small businesses. Studies in hospitality and tourism confirm that small hotels also suffer from lack of access to financing for investments. Is it possible that capital markets in sub-Saharan countries such as Tanzania, have failed to provide financing for small businesses, particularly hotels?

Market failure revisited

Market failure refers to inefficiencies that occur in the market due to one or more of the following reasons: first, an economic agent could gain market power that results in imperfect competition; second, an agent's action could result in externalities that impact others in the market; and finally certain types of economic transactions could experience transaction costs, agency problems, or asymmetric information, all of these leading to market failure (Bator, 1958). While there have been a number of studies to assess market failure in varied economic settings, both descriptive and analytic, this area of study remains fragmented. Keneley (2005) studied the Australian life insurance sector and concluded that regulatory environment fit the case of market failure through externalities created by regulatory processes that we less focused on issues related to this sector. Within financial and economic contexts, Birner & Gunaweera (2001) studied the crop and livestock sectors and concluded that lack of property rights were creating externalities that we leading to crop grazing by livestock as an obstacle to sustainable land use. Simtowe & Zeller (2006) showed that increased access to credit to constrained households increased adaptation of maze cultivation. One of the solutions to reducing credit constraints was that micro finance corporations should scale up their loan sizes to include a higher number of households. Sinclair (1998) provided an extensive review of tourism literature in context of global economic development highlighting issues related to demand and supply uncertainties of hospitality and tourism products/services and how these specific characteristics may lead to market failure resulting in poor quality, low demand, and low prices. Berger & Udell (2001) was amongst the few studies that suggested financial services for small businesses may be suffering from market failure in

the US commercial banking sector due to information opacity. Still, analysis of market failure for small businesses, particularly in context of capital markets, is limited.

Research purpose

The purpose of this paper is to present a descriptive evaluation of small hotel financing activities in Tanzania, and to assess whether there is a case of market failure. In addition to adding to small business literature, this study adds another perspective to small hotel financing in developing countries. As stated earlier, both the analyses of small hospitality businesses and their financing activities remain understudied.

Tanzania's hospitality industry – Arusha, Dar es Salaam, and Mwanza

Recently, the government of Tanzania recognized the role of small businesses. Therefore, this study is timely and contributes to understanding the nature of small hotel activity in Tanzania. The tourism industry contributed 16% of Tanzania GDP in 1999 and was the second highest foreign exchange earner, after agriculture (Tradepoint Tanzania, n.d.). Leisure travelers accounted for 80% of all arrivals by land and air in 2004 (World Bank Group/Multilateral Investment Guarantee Agency [MIGA], 2006). Data for this study were collected from the Arusha, Dar es Salaam, and Mwanza city regions that comprise the largest hospitality and tourism business activities in the country.

Methodology and data

The research purpose was accomplished through a case study analysis of evidence from two previous studies conducted by the researcher in Tanzania. Data for these two

previous studies was collected through two successive field studies of small hospitality businesses in Tanzania's three largest cities: Arusha, Dar-es-Salaam, and Mwanza. Total of 58 small hotels and restaurants participated in these two studies. A sample of small hospitality business (hotel, restaurant, and tour company) operators, doing business in three cities of Tanzania (Arusha, Dar es Salaam, and Mwanza) participated in the two studies. Researchers recruited local hospitality business operators by working with local volunteers from the Tanzania Hotel Association, Tanzania Tour Operators Association, and Tanzania Apex Association for the Hospitality and Tourism Industry. Most participants represented small hotels (over 50% of respondents). Therefore this paper presents analysis of small hotel responses only.

During the first field trip data was gathered using a one-on-one semi-structured interview format. The survey instrument questions were developed based on past literature and the World Bank's Regional Private Enterprise Development instrument (World Bank, 2004). This process resulted in mostly qualitative data based on respondent discussions and the basis for developing more reliable survey instruments for the second field trip. Participants in the first field trip included 23 small hotels, 6 national banks, international development agencies, government departments, and wherever possible key supplier groups to small hotels. The second field trip followed the first after a gap of less than 12 months. A novel form of data collection was developed for use in this study. A 6-hour workshop was conducted in each of the three cities, and data collection was woven into the workshop format. This approach was taken in an effort to provide an educational opportunity for participants, provide clarification for the data collected, and increase

participation and response rate. The workshop was conducted in an area hotel. Approximately three hours of instruction was given, and lunch was provided as an incentive. An additional three hours of instruction was given in the afternoon, and certificates of participation in the workshop were distributed upon completion.

The criterion used to define small hotels in these studies was properties with 50 or less rooms because the data on number of employees was not available in any government records. Therefore, it was not feasible to sample businesses by the number of employees, which is usually the practice in small business studies. As it happens, the average number of employees in properties surveyed was below 20, which is the most common generic criterion for classifying small businesses in the U.S. The average size of participating hotels was approximately 25 rooms.

The responses from the second field study were statically analyzed and integrated with qualitative responses from both the first and second field studies. Therefore, while the statistical analyses presented in this paper represent responses from the second field study, the qualitative and descriptive analyses represent interview contents from both the field studies.

Financing small hotels in Tanzania

Description of participants shows that most of the respondents represented sole proprietorship (Table 1). Arusha had the highest representation but this was expected as it remains an important hospitality and tourism hub of the nation. The respondents were asked to provide the percentage of funds that they used from various sources (personal funds, bank loans, other lenders, and family & friends) for different operational uses in new investments, working capital, renovations, and investment in equipments and other capital projects. Summary of these findings are presented in Table 2. Clearly, personal funds were used more often than any of the other sources. The averages of these results were also compared to see if average spending on various types of operating activities as well as average sources of funding were significantly different between the categories. Analysis of variance revealed that while there was a significant difference between the averages of funding from different sources for each type of uses of funds, the averages across the funding sources were not significantly different (Table 3 and 4).

Insert Tables 1, 2, 3, and 4 about here

A critical challenge, as stated earlier, in studying small businesses continues to be availability of data and its completeness. To emphasize this limitation missing value analysis was conducted. Results of this are presented in Table 5. Missing value patterns show that personal funds as a source had the least missing values compared to the other three sources of funding. 'Other lenders' category had the highest missing values suggesting the limited options of financing for small businesses. Missing value patterns

of the ‘Bank Loan’ category were interesting in that they only show extreme value categories, lower than 40% or higher than 80%. Other value categories did not exist in the responses. Interview discussions also supported this result that only few operators were able to get bank loans. Of these even fewer were able to get their entire funding from the bank, more often only a small share of the financing came through bank loans. These results are consistent with those of previous studies that suggest that for the most part small businesses must rely on personal funds followed by commercial banks as a close second. Previous studies have also found that while some commercial banks are open to funding small businesses, most are wary of such activities.

Insert Table 5 about here

Business owner perspective

Discussions with small hotel owners highlighted that shortages in working capital remained a critical challenge for these businesses. None of the hoteliers were able to obtain lines of credit from their local commercial banks. Furthermore, most raw materials were bought on cash basis and suppliers did not like to give long credits (usually no longer than 30 days). In fact, only very few hoteliers were able to work with trade credits. Most others paid cash. Larger loans for investments and refurbishments were hard to get. Even if the banks agreed to give loans these were for small amounts and at high interest rates. For instance, an average loans of Ts. 500,000 (Tanzania Shilling (TS) 1000 = $1 at the time of the study) for 6 months cost 12.5% rate of interest from a leading national

microfinance bank. As a consequence, most hoteliers agreed that it was usually not easy to payback loans and interests payments due to irregularity of revenues.

Amongst the reasons cited by respondents for lack of commercial banks' support was that loan application process was lengthy and tedious. Banks required borrowers to provide past personal and business financial information. However, through discussions with these owners it appeared that most either did not maintain proper financial statements or were unwilling to share this information with the banks. This was partly because past financial information did not exist in appropriate details required by the banks and partly also because owners were apprehensive that banks will share that information with government tax authorities. The issue of lack of transparency in Tanzania's business taxation has been identified by previous studies (Sharma & Olsen, 2005) and was found consistent with these findings. Another reason why owners were unable to get bank loans was that they were unable to meet collateral requirements. The land used for their personal homes and businesses was leased from the government and therefore they did not have an ownership title on this land. Therefore this land could not be bought to commercial banks as collateral.

Other reasons cited by business owners for their inability to get banks loans included the general unwilling of banks to give loans to hotel and restaurant projects, high interest rates on local currency loans (US Dollar loans needed to be larger requiring higher collaterals); and no lines of credits available for small entrepreneurs.

Another option for hoteliers was to seek out loans offered by international development agencies such as the International Financial Corporation (IFC). While IFC had a committed small business financing division, until recently their small business loans were of a minimum $1 million US dollars. Therefore, at that level, IFC's small business loan program, by definition, excluded most of the small hotels, and even many small businesses in other such service sectors. Another challenge that owners identified in applying for the IFC loans was their lengthy and tedious loan process. In fact, the IFC process was identified as even more tedious than that of the local and national commercial banks.

Banks and financial institutions

Interviews with local and national commercial banks were also conducted during the first field trip to incorporate their perspective in evaluating the financing opportunities for small hotels. Bank officials felt that small hotel owner loan applicants were unable to provide sufficient information regarding investment projects, whether these were new investments or existing property refurbishments. The purposes of using loan funds were usually not clear and the supportive business arguments also not explained in these applications. Furthermore, no previous financial performance data were usually made available to justify return on investments. In general, the banks were concerned that investors did not file the applications professionally. They also felt that most hoteliers applying for hotel investment project loans were unable to provide proof of technical expertise and sufficient industry experience to ensure operating risks were manageable. Therefore banks have been unwilling to increase their loan portfolio allocations towards

hotels, and other hospitality businesses. As a consequence they felt that managing small amounts of handful of hotel and restaurant loans was expensive.

Government and international development agency supported initiatives

As stated earlier, the World Bank and International Financial Corporation supported loan programs have traditionally been for a minimum of one million US dollar investment projects. This essentially excluded most small to medium sized hotel and restaurant operations. The micro enterprise loan programs supported by United Nation's Development Program (UNDP), the Government of Tanzania and other Non-Government Organizations (NGOs) were for much smaller loan amounts. For instance, some of these loans were for a maximum of $500 to $1000. Such small amounts were insufficient for hotel and restaurant investment and even most renovation projects. Moreover micro enterprise loans had yet to explore hospitality industries as potential recipients of financial assistance. Other then the international development agency supported schemes or NGO activities there were no other Government supported initiatives to provide small business financing.

In addition to direct loan programs, the Government of Tanzania also provided initiatives such as tax and import duty exemptions. However, most of these initiatives were aimed at increasing the flow of foreign direct investment (FDI) to the country. As a consequence, small and medium sized businesses, especially those owned by local investors could not avail these benefits.

Discussion and implications

The purpose of this paper was to present a descriptive evaluation of small hotel financing activities in Tanzania, and to assess whether there is a case of market failure. Earlier, sources of market failure were identified as either when an economic agent gains market power that results in imperfect competition; when an agent's action result in externalities that impact others in the market; and/or if certain types of economic transactions could experience transaction costs, agency problems, or asymmetric information, all of these leading to market failure. Given the descriptive evaluation of financing opportunities for small hotels in Tanzania, is there a case for market failure? Before answering this question, it may help to summarize the key characteristics of financing behavior and market conditions within which small hotels were operating in the three largest cities in Tanzania.

Consistent with previous studies, small hotels in these three cities of Tanzania also sourced most of their funds through personal sources and some through commercial banks. However, what was different in Tanzania was that besides these two main sources, there were no other practical options for small hotels to get financing. For instance, trade credit was only available to few operators and even that for no more than 30 days. In fact very few operators got such trade credit terms. Most others paid on a cash basis. While there were Government and international development agency supported small business programs most of these either by definition did not include small hotels or were unwilling to explore hospitality businesses as potential recipients of their financing schemes. Even though commercial banks could be an important source of financing, most banks were

unwilling to lend to small hotels, largely due to information opacity, lack of collaterals, and lack of professionalism. This finding is also consistent with previous studies. Finally, although the Government of Tanzania has been emphasizing their verbal commitment to small businesses, actionable activities were found to be lacking, especially in the provision of small business financing and fiscal benefits.

While some of these findings were supportive of previous studies, others appear to be context specific to business and institutional environment such as that in Tanzania. However, does this imply any type of market failure? There certainly appears to be inefficiencies in the commercial bank loan process to small hotels. Part of these inefficiencies can be attributed to information opacity that exists between the lenders and the banks, and other part to the fact that banks at best have a very small portfolio of hotel loans thereby increasing transaction costs. Reasons for such information asymmetries are partly because borrowers are unwilling to share personal and business financial information. It is also because many of the owners and managers are not trained to properly compile and present appropriate information for the purposes of seeking loans and other financial assistance. Therefore, the strongest evidence that was found to support possible failure of commercial banks to provide financial assistance to small hotels would be the potentially high transaction costs of lending to small hotels and information opacity between lenders and borrowers.

Government and international development organization supported programs are either providing exemptions to promote FDI or focusing on the micro-enterprise level. The

limited (partly) market driven loan programs of international organizations such as the IFC are aimed at such small businesses that, by operating standards, exclude most small hospitality businesses. As a consequence there does appear to be a lack of financing instruments that would support organizations larger than micro enterprises but smaller than typically defined ‘small businesses’ in context of industries such as manufacturing and mining. Given that Tanzania is a particularly interested in developing its tourism sector, lack of such financing instrument could present challenges for small businesses to prosper. Similar to previous studies, it is possible to argue that the Government has been formulating policies for the hotel industry based on the general outlook of the economy rather than on the realities that face this industry, particularly its small businesses. From that point of view there may be an argument in favor of market failure. Government’s land-control policies have been a focus of previous studies. This study also reconfirmed Tanzania, like many other sub-Sahara African nations, needs to revise and review its land ownership rights.

Based on the current evidence it is obviously premature to conclude that markets are failing for financing small hotels in Tanzania’s three largest cities. However, information opacity and transaction costs in the commercial bank sector, and government’s policies towards developing effective financing instruments for small and medium sized businesses by industry and sector definitions and a conducive business and institutional environment definitely could be areas for further investigations. Other practical considerations for industry can also be identified through this analysis. For instance, skills of small businesses owners could be improved so that they can properly maintain

financial information and appropriately present and share it when applying for financial assistance. The general level of professionalism and operational skill development will also help these owners instill confidence in lenders to take appropriate risks. As the industry evolves, small business owners will also gain the necessary experiences. The financial institutions, like commercial banks, will also eventually begin to explore hospitality businesses as potential borrowers. However, an effort to educate the lenders regarding the operational risks of these industries may encourage lenders to view these businesses fairly as part of their lending portfolios.

Conclusions

This paper presented a descriptive characterization of small hotel financing activity based on evidence from the three largest cities in Tanzania. While certain characteristics of small hotels in these cities were found to be similar to other small businesses (based on studies in North America) there were other characteristics that were possibly context specific to business and institutional environment in Tanzania. Although it cannot be concluded that markets are failing to provide financing to small hotels, other critical issues have surfaced in this evaluation for policy formulation and industry practice. Given the similarities of business and institutional environment in other sub-Saharan nations to that of Tanzania, it may not be far fetched to suggest that small hotels (and other hospitality businesses) in other sub-Saharan countries may also be facing such financing obstacles.

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Table 1. Characteristics of businesses and participants (N=58)

Characteristic	n
Location of businesses	
Arusha	30
Dar es Salaam	18
Mwanza	10
Ownership	
Sole proprietorship	42
Partnerships	12
Publicly-held	2
Franchise/management contracts	2

Table 2. Financing for small hotels in Tanzania (percent of total)

Sources of Financing	**Personal funds**		**Bank Loans**		**Other Lenders**		**Family and Friends**	
Uses of Funds	Mean	*SD*	Mean	*SD*	Mean	*SD*	Mean	*SD*
New investments*	70%	*35%*	31%	*39%*	0%	*0%*	3%	*8%*
Working Capital*	49%	*49%*	18%	*40%*	0%	*0%*	0%	*0%*
Renovations*	76%	*41%*	2%	*4%*	0%	*0%*	0%	*0%*
Investments in equipment*	71%	*44%*	7%	*16%*	0%	*0%*	0%	*0%*

* Total financing may not equal to 100% due to missing values and omission of categories by respondents.

Table 3. Analysis of Variance between uses of funding

		Df	F	Sig.
New investment	Between Groups	3	9.063	.000
	Within Groups	24		
	Total	27		
Working capital	Between Groups	3	3.185	.042
	Within Groups	24		
	Total	27		
Renovations	Between Groups	3	15.817	.000
	Within Groups	20		
	Total	23		
Equipment	Between Groups	3	11.034	.000
	Within Groups	20		
	Total	23		

Table 4. Analysis of Variance between uses of funding

Sources of Funds		**df**	**F**	**Sig.**
Personal Funds	Between Groups	3	0.79624	0.504
	Within Groups	33		
	Total	36		
Bank Loans	Between Groups	3	1.17631	0.342
	Within Groups	21		
	Total	24		
Other Lenders	Between Groups	3	.	.
	Within Groups	16		
	Total	19		
Family and Friends	Between Groups	3	0.681818	0.574
	Within Groups	18		
	Total	21		

Table 5. Missing value analysis

	Missing Patterns[a]					Personal Funds[c]									Bank Loans[c]						Other Lenders[c]	Family & Friends[c]	
Number of Cases	Personal Funds	Bank Loans	Other Lenders	Family and Friends	Complete if ...[b]	.00	5.00	10.00	20.00	40.00	60.00	80.00	90.00	100.00	.00	10.00	20.00	40.00	80.00	100.00	.00	.00	20.00
20					20	6	0	0	0	0	0	1	1	12	16	1	1	0	0	2	20	20	0
4			X	X	24	0	0	0	0	1	2	0	1	0	0	2	0	2	0	0	0	0	0
125	X	X	X	X	164	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
12		X	X	X	37	2	1	1	1	0	0	2	0	5	0	0	0	0	0	0	0	0	0

Patterns with less than 1.0% cases (2 or fewer) are not displayed.

a. Variables are not sorted.

b. Number of complete cases if variables missing in that pattern (marked with X) are not used.

c. Frequency distribution at each unique pattern