



Impacts of microfinance institution in improving SMEs in Zanzibar. Case study of BRAC micro finance

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Abstract: The study aimed to explore the impact of microfinance institution (MFI) services on the improvement of Small and Medium Enterprises (SMEs) in Zanzibar, with a specific focus on BRAC Microfinance. SMEs play a critical role in driving employment creation, poverty reduction, and local economic development in Zanzibar; however, many continue to face challenges in accessing formal financial services. The research employed a descriptive quantitative design, utilizing structured questionnaires administered to 240 SME owners in the Urban District of Zanzibar. Data were analyzed using descriptive statistics and presented through frequency tables and figures to capture respondents' perceptions of microfinance accessibility, training, and loan conditions. The findings revealed that BRAC's microfinance services are generally accessible, with a majority of respondents agreeing that institutions are located within reasonable distances and that information about services is readily available. Training programs were found to significantly enhance SME owners' financial management, business planning, and marketing capabilities, leading to improved operational efficiency. Despite these positive outcomes, challenges related to high interest rates, short repayment periods, and collateral requirements continue to constrain SME growth and sustainability. The study concludes that BRAC's interventions have positively influenced SME development in Zanzibar by combining financial access with entrepreneurial training. It recommends that microfinance institutions and policymakers strengthen client-centered financial products, simplify loan processes, and continue investing in capacity-building programs to enhance the long-term viability of SMEs.

Keywords: Microfinance, SMEs, Business Growth, Accessibility, Training, Loan Terms, Zanzibar, BRAC.

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1 | INTRODUCTION

SMEs are widely recognized as key drivers of economic development in the Urban district of Zanzibar, contributing to employment creation, poverty reduction, and local economic transformation. However, access to formal financial services remains a significant obstacle to the growth and sustainability of SMEs in the Urban district of Unguja. i.e., fragmented support, inconsistent targeting, and exclusion of vulnerable SMEs, loan mismanagement, a large market remaining underserved, costly borrowing, low uptake, and poor strategy adjustment. Microfinance institutions (MFIs), such as BRAC Tanzania, have been providing financial services, including microloans, savings, and entrepreneurship training, to fill the identified gap.

Nevertheless, the Revolutionary Government of Zanzibar (RGoZ) has taken significant steps to promote the sustainability of SMEs through policy reforms, such as the Zanzibar Enterprise Development Policy (ZEDEP, 2020). Institutional changes, Zanzibar Economic Empowerment Agency (ZEEA, 2022), funding programs such as the Establishment of the Zanzibar Enterprise Fund (ZEF), and capacity-building initiatives. Programs are offered through the Ministry of Trade and Industrial Development and vocational training centres (VTCs), all of which are aimed at supporting SME development. RGoZ has introduced the new SMEs Policy of 2020, aiming to create a vibrant and dynamic competitive SME sector that will effectively transform the national endowment into national wealth. However, the effectiveness of these interventions depends on improved coordination, continued investment in youth and women, and stronger linkages between microfinance institutions and SME development strategies. However, one of the key issues is linking microfinance to SME support, particularly in terms of access to finance and financial management. In a similar vein, BRAC has reached thousands of People in the urban district, and according to Khamis & Hamad (2022), it has highlighted that BRAC in Zanzibar, particularly in the urban district, has made significant improvements in SMEs' financial services, which have influenced their sustainability. Similarly, the study by Lieberman et al. (2020) suggested that MFIs have been crucial in promoting the growth of SMEs, not only by providing financial services but also by offering various entrepreneurial training programs.

However, the efforts made so far have lessened the challenges faced by SMEs. Currently, there are no empirical studies that offer insights into the factors affecting MFIs' ability to support SMEs in Zanzibar. Therefore, this study aims to investigate the factors influencing the microfinance services provided by BRAC in developing SMEs in Zanzibar's urban district. By analysing these factors and identifying areas for improvement, the research seeks to give policymakers, financial institutions, and development partners practical insights to promote the growth and economic development of SMEs in Zanzibar.

The idea for the study while in Zanzibar SMEs are widely recognized as key drivers of economic development in the Urban district of Zanzibar, contributing to employment creation, poverty reduction, and local economic transformation. However, access to formal financial services remains a significant obstacle to the growth and sustainability of SMEs in the Urban district of Unguja. i.e., fragmented support, inconsistent targeting, and exclusion of vulnerable SMEs, loan mismanagement, a large market remaining underserved, costly borrowing, low uptake, and poor strategy adjustment. Microfinance institutions (MFIs), such as BRAC Tanzania, have been providing financial services, including microloans, savings, and entrepreneurship training, to fill the identified gap. Nevertheless, the Revolutionary Government of Zanzibar (RGoZ) has taken significant steps to promote the sustainability of SMEs through policy reforms, such as the Zanzibar Enterprise Development Policy (ZEDEP, 2020). Institutional changes, Zanzibar Economic Empowerment Agency (ZEEA, 2022), funding programs such as the Establishment of the Zanzibar Enterprise Fund (ZEF), and capacity-building initiatives programs are offered through the Ministry of Trade and Industrial Development and vocational training centers (VTCs), all of which are aimed at supporting SME development. RGoZ has introduced the new SMEs Policy of 2020, aiming to create a vibrant and dynamic competitive SME sector that will effectively transform the national endowment into national wealth. However, the effectiveness of these interventions depends on improved coordination, continued investment in youth and women, and stronger linkages between microfinance institutions and SME development strategies

Microfinance services refer to the provision of financial services in limited amounts to low-income persons and small informal businesses. (Bernard, 2020). This is increasingly being offered by a variety of formal financial institutions, including banks and non-banks, either as their core business or part of a diversified portfolio. The role of microfinance is to provide financial services and a substantial flow of funds to the economically marginalized populations often neglected by the formal financial sector. Badugu, (2019). In East Africa, microfinance institutions play roles of financial inclusion, poverty alleviation, job creation, women's empowerment, rural development, and financial education, whereas in Tanzania, microfinance plays roles of economic stability and innovation. Mahmoud, (2022). One of the key issues is linking microfinance to SME support, particularly in terms of access to finance and financial management. In a similar vein, BRAC has reached thousands of People in the urban district, and according to Khamis & Hamad (2022), it has highlighted that BRAC in Zanzibar, particularly in the urban district, has made significant improvements in SMEs' financial services, which have influenced their sustainability. Similarly, the study by Lieberman et al. (2020) suggested that

MFIs have been crucial in promoting the growth of SMEs, not only by providing financial services but also by offering various entrepreneurial training programs. Despite the presence of MFIs, SMEs growth the efforts made so far have decreased the challenges faced by SMEs. Therefore, this study aims to investigate the Impact of microfinance institution services provided by BRAC in improving SMEs in Zanzibar. By analyzing this impact and identifying areas for improvement.

2 | LITERATURE REVIEW

This part presents the theoretical literature and empirical Literature review. The empirical literature review cites research conducted in the same area, and the identified research gap resembles the gaps found in other studies.

2.1 | The financial accessibility in the importing SMEs

Their businesses such as banks and should have to have better access to finance. The study by Azzuwut et al. (2023) posited that small and medium-sized enterprises (SMEs) have had a difficult time accessing banking services, especially when trying to acquire external financing. They encounter several difficulties. This is due to a low level of financial literacy among SMEs owners and Managers. SMEs in Nigeria's Plateau State make up the study population. According to SMEDAN's estimates from 2021, there were 14558 registered SMEs in Nigeria's Plateau State. The study employed a survey research approach, in which 316 questionnaires were utilized to collect primary data using the convenience sampling technique. The study particularly used a multivariate regression model. The results of the research assessing the impact of financial accessibility on the profitability of small and medium enterprises (SMEs) showed a strong positive correlation between the profitability of SMEs and loan, overdraft, collateral requirements, and size.

The study by Victor et.al (2022) investigated the financial accessibility and the growth of SMEs in Jos Bukuru metropolis of Plateau State, Nigeria. The study adopts a survey method approach. Primary data was collected using self-administered questionnaires issued to owners/managers of the SMEs (bakeries and eateries). A sample size of 194 respondents was selected. Theoretically, the study hinged on the pecking order theory, while respondents were selected through a non-probability sampling method. The multiple regression method was used to evaluate the data with the aid of the Statistical Package for Social Sciences (SPSS version 21.0). The findings of H1 show that there is a significant relationship between Entrepreneur Characteristics (EC) and the growth of SMEs in Jos-Bukuru metropolis. Statistically, 37% (Ad R2= 0.037) of bakeries and eateries' profits, liquidity, and ability to employ is explained by the character of the owner/manager/CEO, & the findings of H2 show there is a significant relationship between Firm Characteristics (FC) and the growth of SMEs. Statistically, 14% (Ad R2=.140) of bakeries and eateries' profits, liquidity, and ability to employ are explained by the organization's characteristics.

According to Ambrose (2021) studied on the relationship between financial accessibility and performance of SMEs in Kabale Municipality was studied. A cross-sectional survey research design using both qualitative and quantitative approaches was used. A sample size of 200 participants was determined from a target population of 360 subjects using both simple random sampling and purposive sampling techniques. Data was collected using interview and questionnaire methods. Data was analyzed using both descriptive (mean and standard deviation) and inferential (correlation and regression) statistics. The findings indicate collateral security as the major determinant of financial accessibility. Low investment potential is the major challenge affecting the performance of SMEs in Kabale municipality. There is a moderate positive and significant relationship between financial accessibility and performance of financial accessibility, contributing as low as 17.4% of the level of performance of SMEs in Kabale municipality.

2.2 | The influence of training provided by MFIs on improving SMEs

Juma & Bwana (2025) employed a mixed-methods research design, combining both quantitative and qualitative approaches to gain a comprehensive understanding of the research problem. The study employed a mixed-methods approach, comprising a quantitative survey of 400 agri-business owners, as well as qualitative focus group discussions and interviews. Data were analyzed using statistical regression and thematic analysis. Sample Size: 400 small-scale agri-business owners were selected through a multi-stage random sampling technique from four districts in the Mbeya region. Area of the Study: The research was conducted in the Mbeya Region of Tanzania, focusing on the rural districts of Mbeya Rural, Rungwe, Mbozi, and Kyela. The study found high adoption rates but low business use: while 85% of respondents used mobile money, it was mostly for personal transactions such as remittances. Increased Profitability: Businesses that

used mobile money for core operations (payments, savings) experienced an average profit increase of 23%.

The study by Karlan & Valdivia (2011) evaluates the impact of business training provided by a microfinance institution to its clients. The study uses a quantitative methodology, specifically a Randomized Controlled Trial (RCT). The sample size consisted of approximately 1,000 clients from FINCA Peru. The study reports the following key findings: Business training significantly improves clients' business knowledge and practices, including maintaining separate financial records. However, the training did not, on average, lead to a significant increase in sales or revenue for the businesses. The effects were highly dependent on the individual client; those with higher innate motivation and entrepreneurial traits experienced positive impacts on profits and sales. The training also benefited the MFI through higher client retention and better repayment rates. The study by Omri, et al. (2024) investigated the impact of strategic agility and digital transformation on the sustainable performance of Small and Medium Enterprises (SMEs) in a post-pandemic context. The study employed a quantitative methodology, using a cross-sectional survey design. The sample size was 357 managers and owners of Tunisian SMEs. The study provided the following key findings: Both strategic agility (the ability to adapt quickly) and digital transformation significantly and directly improve the sustainable performance of SMEs. Digital transformation acts as a partial mediator, meaning that investing in digital technologies also enhances a firm's strategic agility, which in turn further boosts sustainable performance.

2.3 | The effects of the loan terms and conditions on improving SMEs in Zanzibar

The study by Msellem ET. al. (2023) examined the specific loan conditions that influence the financial performance of Small and Medium Enterprises (SMEs) in Zanzibar, Tanzania. The study employed a mixed methods approach, combining quantitative surveys with qualitative interviews. The sample size was 250 SME owners and managers from various sectors in Zanzibar. The study provided the following key findings: High-interest rates were identified as the most significant barrier, severely eroding profitability and hindering business expansion. Stringent Collateral Requirements disproportionately excluded viable SMEs, especially those owned by women and youth who often lack formal asset titles. Complex Application Procedures and lengthy approval times delayed access to crucial funds, causing missed business opportunities.

Conversely, SMEs that had access to loans with relatively longer repayment periods and grace periods demonstrated better performance and stability, as this allowed them to invest in medium-term growth strategies. The study by Khamis et al. (2024) posits an analysis of the impact of microfinance loan terms on the growth and sustainability of Small and Medium Enterprises (SMEs) in Zanzibar. The study employed a mixed-methods research approach, combining quantitative surveys with qualitative in-depth interviews. The sample size consisted of 300 SME owners from the Unguja and Pemba regions of Zanzibar. The study provided the following key findings: High-interest rates were identified as the primary constraint, with over 70% of respondents citing loan costs as a significant barrier to business expansion. Short Repayment Periods were found to create cash flow pressures that forced SMEs to prioritize immediate loan repayment over long-term business investments. Collateral Requirements excluded many viable SMEs from accessing formal credit, particularly women-owned enterprises and start-ups.

The study by Khamis & Suleiman (2023) examined the impact of microfinance loan conditions on the growth of small and medium enterprises in Zanzibar. The study employed a mixed-methods approach, combining quantitative surveys with qualitative interviews. The sample size was 215 SME owners from various districts in Zanzibar. The study provided the following key findings: High interest rates were the most significant barrier to SME growth and sustainability. Stringent collateral requirements excluded many viable SMEs from accessing credit. Short repayment periods created cash flow challenges for businesses with longer production cycles. Lack of financial literacy among borrowers led to poor loan utilization and repayment challenges.

3 | METHODOLOGY

The current study employs a quantitative research design, which is descriptive in nature, as it offers significant merit for examining the factors that influence the improvement of microfinance services for SMEs in Zanzibar. The approach addresses the research questions and tests. The study relies on quantitative data for several reasons. First, quantitative research emphasizes objectivity (Mann, 2003). It enhances the credibility and reliability of the findings, supporting the making of precise and valid inferences about the population based on the sampled data (Creswell & Creswell, 2017). The current study is a statistical numerical data approach. It

provides a structured framework for analysis, enhancing the research's replicability. Replicating the same research procedure in other settings or organizations adds to the external validity and reliability of the study (Bryman, 2012). The researchers presented the quantitative research outcomes straightforwardly and unambiguously through statistical results. In brief, using a quantitative research approach ensures the collection of robust and objective data.

A probability sampling technique was applied through simple random sampling. Simple random sampling is a type of probability sampling in which the researcher randomly selects a subset of participants from a population. Each member of the population has an equal chance of being selected. In this study, therefore, the researcher applied this technique in the data collection tools using a questionnaire in the field, where 240 respondents were involved. According to (Singh & Masuku, 2014), the Lottery Method of Sampling is a form of random sampling. The population was given a different number, and everyone is assigned a unique number. The numbers are then thoroughly mixed after the researcher puts them in a bowl and shakes it. Then, without looking, the researcher selects numbers. The population members or items that were assigned that number were then included in the sample. Different departments within the organization were involved in identifying respondents who would provide the required information, based on the study's objectives. This method facilitated the exercise and, at a high level, contributed to reducing a bias towards getting a sample size in the study. Data collected through firsthand experience is known as primary data. Primary data has not been published yet and is more reliable, authentic, and objective. Primary data has not been changed or altered by human beings; therefore, its validity is greater than secondary data. Importance of Primary Data. Sajjad Kabir (2016). In statistical surveys, it is necessary to get information from primary sources and work with primary data. Primary data were collected directly from selected SMEs and MFIs. Whereby 240 filled the supplied questionnaires. In this study, the quantitative data from the respondents were verified, compiled, and summarized before being analyzed by using SPSS. Windows software is used to make a realistic inference based on the study sample.

4 | RESULT AND DISCUSSION

Objective One: To examine the accessibility of microfinance services to SMEs in the Zanzibar

In the survey questionnaire, respondents were provided with instructions on how to complete the required information accurately. There were five sentences indicated in this objective, which utilized survey questionnaires with multiple-choice questions in the Likert scale format, i.e., 1. Strongly agree, 2. Agree, 3. Neutral, 4. Disagree, 5. Strongly disagree. The questions related on the Likert scale where Microfinance institutions are located within a reasonable distance. The process of applying for loans is simple and understandable. Information about microfinance services is easily accessible. I have received timely services from microfinance institutions. The requirements for accessing loans are suitable for my business. The following is a summary of the results.

The figure 1 below illustrates respondents' perceptions of accessibility to microfinance services provided by BRAC in Zanzibar across five key dimensions: location convenience, simplicity of the loan application process, information accessibility, timeliness of services, and suitability of loan requirements.

Overall, the visual trend indicates a strongly positive perception of accessibility among SMEs. The majority of respondents selected "Agree" and "Strongly Agree" across all statements, highlighting a widespread acknowledgment that BRAC's services are both reachable and user-friendly. Specifically, the highest frequency was observed in the item "MFIs are located within a reasonable distance," with 104 respondents strongly agreeing and 81 agreeing, demonstrating that physical proximity to financial institutions is not a major barrier for SMEs. Similarly, "Information about services is easily accessible" (97 strongly agree, 58 agree) and "Loan requirements are suitable for my business" (91 strongly agree, 58 agree) suggest that communication and procedural transparency are effective.

On the other hand, the lower frequencies in the "Strongly Disagree" and "Disagree" categories across all dimensions (mostly below 10 respondents) reveal minimal dissatisfaction. The area showing relatively higher neutrality was "The process of applying for loans is simple," where 53 respondents remained neutral, suggesting that while accessibility is generally satisfactory, procedural complexity still affects a segment of SMEs.

These findings align with the results presented in the paper, which state that 78.8% of respondents reported reasonable proximity to microfinance institutions and over 65% acknowledged easy access to information and services. Hence, the figure supports the conclusion that BRAC has succeeded in ensuring geographical and procedural accessibility to its services in

Zanzibar, reflecting a well-established presence and an inclusive approach that facilitates SME participation in financial programs.

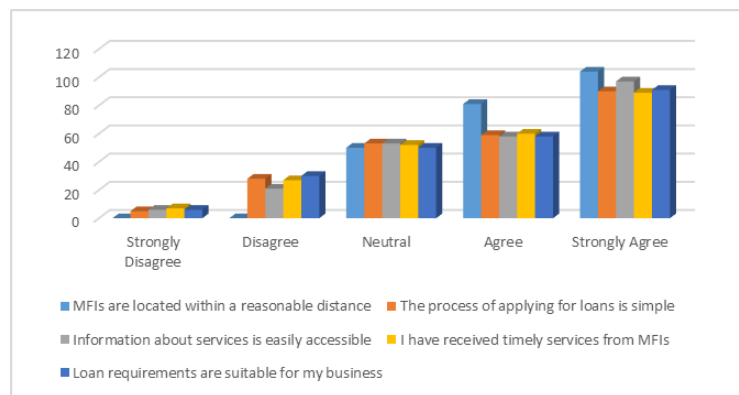


Figure 1. SME Perceptions on Microfinance Service Accessibility in Zanzibar

Source: field survey (2025)

Objective Two: The influence of training provided by BRAC in improving SMEs in Zanzibar

In this objective, the aim is to examine the accessibility of microfinance services to SMEs in the Urban District. Several questions were asked of the students and the parents/caregivers. In the survey questionnaire, respondents were provided with instructions on how to complete the required information accurately. There were five sentences indicated in this objective in which the survey questionnaires were used with multiple-choice questions in the Likert scale format. The training significantly improved understanding of bookkeeping and financial management. I am now confident in creating a formal business plan, SMEs members learned effective strategies for marketing Collateral requirements, I now consistently keep records of my sales and expenses. I actively use the customer management techniques I learned. Have successfully separated my personal and business finances. My business sales have increased since applying the training. The following is the summary obtained in the field for further illustration

Objective three: Effects of the loan terms and conditions on improving SMEs in Zanzibar.

In this objective, the aim is to examine the accessibility of microfinance services to SMEs in the Urban District. Several questions were asked of the students and the parents/caregivers. In the survey questionnaire, respondents were given instructions on how to complete the required information accurately. There were five sentences indicated in this objective in which the survey questionnaires were used with multiple-choice questions in the Likert scale format. The interest rate on my loan is affordable for my business. The interest rate terms were clearly explained to me before I took the loan. The collateral requirements for obtaining the loan were reasonable. I found it challenging to provide the required collateral. The loan repayment period is sufficient for my business to generate enough income. The time taken to disburse the loan after approval was reasonable.

The figure 2. below illustrates how respondents evaluated the effectiveness of BRAC's training programs across five key dimensions: financial management, business planning, marketing, record-keeping, and customer management. Overall, the data reveal a strongly positive perception among SME owners toward BRAC's training initiatives.

A majority of respondents selected "Agree" and "Strongly Agree" across all training aspects, demonstrating that BRAC's capacity-building programs significantly enhanced entrepreneurial competencies. The highest endorsement was for "Improved understanding of bookkeeping and financial management" with 104 respondents strongly agreeing and 58 agreeing, indicating that financial literacy training has been particularly effective in empowering SME owners to manage their finances better. Similarly, "Confidence in creating a formal business plan" (99 strongly agree, 58 agree) and "Learned effective marketing strategies" (99 strongly agree, 61 agree) suggest that training improved business planning and promotional skills key areas influencing competitiveness and sustainability.

The dimensions "Consistently keep records of sales and expenses" and "Actively use customer management techniques learned" also recorded high agreement levels (97–99 strongly agree), implying that participants are successfully applying acquired skills in operational management and

customer relations. Very few respondents disagreed or remained neutral, reflecting broad satisfaction and relevance of the training content.

5 | BUSINESS IMPLICATIONS OF THE FINDINGS

Enhanced Financial Discipline: The strong agreement on improved bookkeeping and financial management skills implies that SMEs are now better positioned to maintain transparent and accurate financial records. This increases their credibility with lenders and investors, facilitating easier access to credit and growth capital.

Strategic Business Planning: Increased confidence in business plan development means entrepreneurs are better equipped to forecast revenues, control costs, and align their operations with market opportunities. This can enhance business sustainability and strategic decision-making.

Market Competitiveness: The widespread adoption of marketing and customer management techniques indicates that SMEs are becoming more customer-oriented and market-driven. Such improvements can strengthen brand loyalty, attract new clients, and boost profitability in competitive local markets.

Institutional Impact for BRAC: The positive feedback underscores BRAC's role as a capacity-building catalyst rather than a mere microcredit provider. These results support continued investment in non-financial services like business mentorship, digital marketing skills, and entrepreneurship coaching to complement financial support.

Policy and Program Implications: Policymakers and microfinance institutions should integrate training-based support models into financial inclusion frameworks. Linking loan access to mandatory entrepreneurial training could significantly improve repayment performance, reduce default rates, and create a more resilient SME sector in Zanzibar.

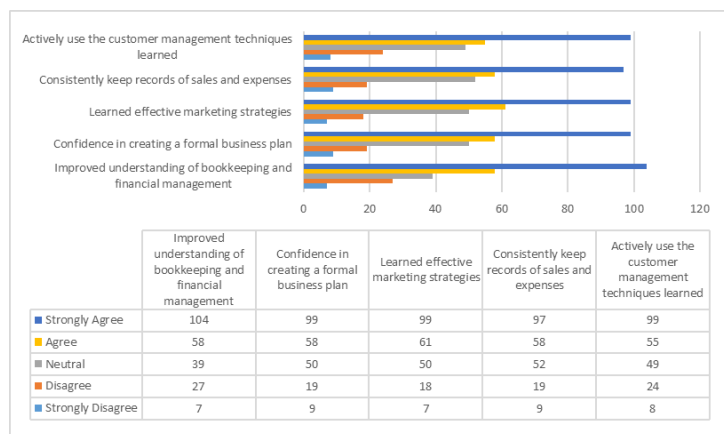


Figure 2: SME Perceptions on Microfinance Loan Terms and Accessibility in Zanzibar.

6 | CONCLUSION AND RECOMANDATION

This study confirms that the services offered by BRAC, a microfinance institution, significantly contribute to the enhancement of Small and Medium Enterprises (SMEs) in Zanzibar. The analysis reveals that three core elements—accessible services, capacity-building training, and favorable loan conditions—are pivotal drivers of SME performance and sustainability. The regression analysis highlights the distinct influence of each factor. Loan Terms and Conditions ($\beta = 0.880$) emerged as the most powerful predictor, emphasizing that affordable and flexible credit is fundamental for business investment and stability. This was closely followed by the strong impact of Training ($\beta = 0.373$), which equips entrepreneurs with the necessary skills to manage their enterprises effectively and utilize funds productively. Furthermore, Accessibility ($\beta = 0.260$) proved to be a significant enabler, ensuring that SMEs can readily reach and utilize financial services without prohibitive procedural or geographical barriers. In essence, the findings demonstrate that microfinance's success hinges on a holistic model. While providing financial access is crucial, its true transformative potential is only realized when coupled with entrepreneurial education and client-centric loan products. For microfinance to fully serve as an engine for sustainable economic growth, job creation, and poverty reduction in Zanzibar, ongoing refinement of these three interconnected components is essential. Based on the findings, the following actions are recommended for SMEs and supporting institutions:

For SMEs:

1. **Prioritize Skill Development:** SME owners should actively engage in training opportunities provided by MFIs and other agencies to strengthen their capabilities in financial management and business strategy.
 2. **Establish Financial Credibility:** SMEs should work towards formalizing their operations and maintaining transparent financial records. This builds a track record that increases their credibility and eligibility for larger, growth-focused loans.
 3. **Engage in Collective Advocacy:** SMEs are encouraged to form or join business associations and cooperatives. These groups can collectively negotiate with MFIs for more favorable loan terms, customized financial products, and targeted training programs.
- For Policymakers and MFIs (like BRAC):
1. **Optimize Loan Products:** Continuously refine lending policies to ensure they are flexible, affordable, and tailored to the unique cash flow cycles of different SMEs.
 2. **Enhance Training Quality:** Invest in developing high-quality, practical training modules that address the real-world challenges faced by local entrepreneurs.
 3. **Expand Service Outreach:** Broaden the physical and procedural accessibility of services to reach underserved entrepreneurs, particularly in remote areas, by simplifying application processes and decentralizing offices.

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