Maximizing Returns: A Deep Dive into the Financial Strategies of SMEs in Morogoro Municipality

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Abstract
This study investigates the determinants of Return on Investment (ROI) among Small and Medium Enterprises (SMEs) in Morogoro Municipality using a cross-sectional research design and a multiple linear regression model. The analysis reveals that the capital structure, comprising private savings, bank credit, reserved earnings, non-bank loans, equity, and trade credit, plays a crucial role in influencing the financial performance of these businesses. The results indicate that private savings, non-bank loans, and trade credit are the most significant contributors to higher ROI, with coefficients of 0.305, 0.353, and 0.296, respectively, all significant at $p<0.01$. Bank credit also positively impacts ROI, though to a lesser extent, with a coefficient of 0.095 ($p<0.05$). However, reserved earnings and equity were not found to significantly affect ROI, suggesting that their effectiveness in enhancing profitability may depend on specific business strategies and resource allocation. The study suggests that SMEs should focus on leveraging private savings, non-bank loans, and trade credit to optimize their financial performance. Finally, it recommends that policymakers and financial institutions support SMEs in accessing diverse and flexible financing options to enhance their profitability and ensure sustainable business growth.

1. Introduction

Small and Medium Enterprises (SMEs) are pivotal to national development and economic growth, driving entrepreneurship, job creation, and income distribution, which contributes to poverty alleviation (Etuk et al., 2014; Makorere, 2014). Globally, SMEs significantly impact Gross Domestic Product (GDP) and employment, contributing 55% to GDP and 65% to employment in developed nations, 60% to GDP and 70% to employment in developing countries, and 70% to GDP and over 95% to employment in middle-income nations (Manzoor et al., 2021).
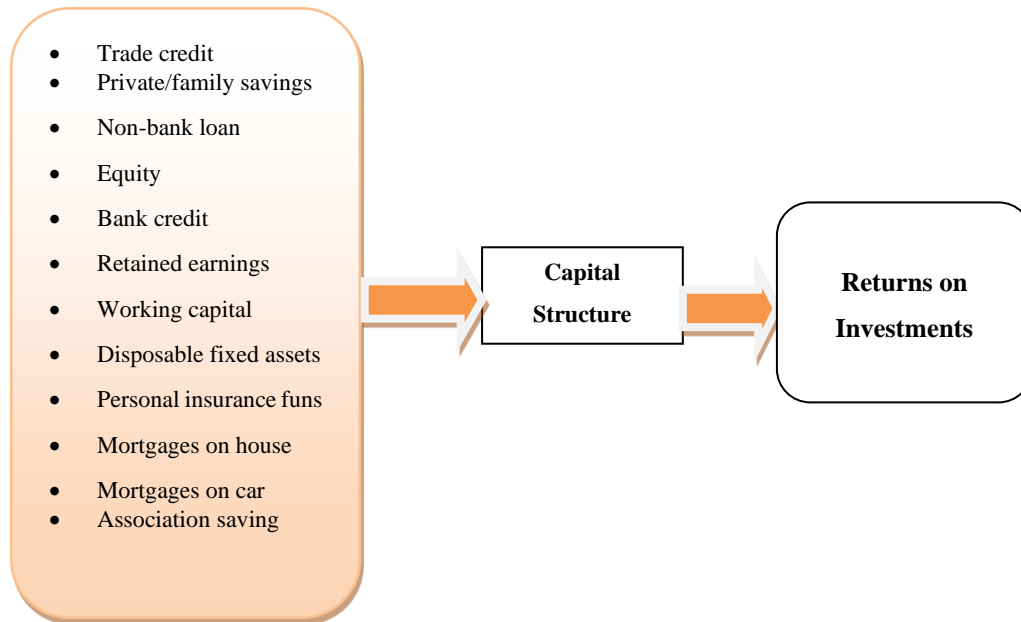
The significance of SMEs varies regionally. In the European Union, they account for over 99% of enterprises and employ more than 90% of the workforce (Zafar & Mustafa, 2017). In the United States, SMEs generate approximately 50% of new jobs annually and make up over 99% of businesses (Osano & Languitone, 2016; Utoh & Kitole, 2024). Similarly, in Asia, SMEs constitute more than 90% of registered businesses, such as in Japan, where they represent 99% of enterprises and contribute 50% to GDP (Bashir & Ondigo, 2018). Even in Russia, SMEs are rapidly expanding, contributing 22% to GDP by 2017 (Etuk et al., 2014; Raude et al. 2015). In Africa, SMEs constitute about 90% of firms and employ 60% of the workforce (Manzoor et al., 2021; Neagu, 2016).

In East Africa, SMEs are equally critical, representing more than 90% of businesses and contributing 29% of GDP (Manzoor et al., 2021). For instance, Kenya's approximately 7.41 million SMEs create 80% of employment and contribute about 40% to GDP (Manzoor et al., 2021). Similarly, in Uganda, SMEs employ over 2.5 million people (NSBSU, 2015; Aguwamba & Ekienabor, 2017), and in Rwanda, they account for 98% of businesses and 41% of private sector employment (RDB, 2020). In Tanzania, SMEs employ 3 to 4 million people, contributing 20% to 30% of the workforce and 35% to 40% of GDP (Anderson, 2017). The "Tanzania Development Vision (TDV) 2025" recognizes the SME sector as a key driver of long-term development, with over 3 million enterprises contributing 27% of GDP, many in the agricultural sector and predominantly owned by women (Kitole et al. 2024; Manzoor et al., 2021).

Despite their crucial role, the Return on Investment (ROI) of SMEs is heavily influenced by their capital structure. The capital structure, comprising various sources such as equity, debt, retained earnings, and bank credit, is essential in determining ROI (Taiwo et al., 2016; Chalmers et al. 2020). However, SMEs, particularly in underdeveloped regions, face challenges in securing bank credit due to high default risks and imperfect economic conditions (Alvarez1 et al. 2021; Khan et al. 2015). Additional obstacles such as inadequate financial records, poor revenue networks, and lack of collateral further hinder their investment performance.

Existing research presents varied conclusions on the relationship between capital structure and ROI. Some studies suggest that components like bank credit may not always enhance ROI, while others find it beneficial to investment returns (Ibrahim, 2017; Li, 2016). Furthermore, access to funds is critical for SME growth and success (Serrasqueiro et al. 2016; Yeboah & Koffie, 2016), but SMEs often encounter greater financing challenges compared to larger enterprises (Sorin& Nucu, 2021). Therefore, while previous research has primarily focused on bank credit, other components such as private savings, trade credit, and non-bank loans have received less attention. This study seeks to fill this gap by examining the capital structure of SMEs in Morogoro Municipality, analyzing the influence of each component, and evaluating their collective impact on investment returns.

Figure 1: Conceptual Framework

- Trade credit
- Private/family savings
- Non-bank loan
- Equity
- Bank credit
- Retained earnings
- Working capital
- Disposable fixed assets
- Personal insurance funs
- Mortgages on house
- Mortgages on car
- Association saving

→ Capital Structure → Returns on Investments

Source: Researcher's construct 2024.

2. Methodology

This study, conducted in Morogoro Municipality, Tanzania, examined the effect of capital structure on investment returns among SMEs. Morogoro was chosen due to its high concentration of SMEs. The study focused on five wards—Sabasaba, Magadu, Mafiga, Mazimbu, and Kihonda—selected for their significant number of SMEs with capital under 250 million TZS.

A cross-sectional research design was employed, utilizing quantitative approaches to systematically gather primary data. The study targeted SMEs registered with the Morogoro Municipal Council, characterized by low capital. A sample size of 212 SME owners was determined using Slovin's formula, ensuring representativeness. Data was collected through structured and unstructured questionnaires, allowing for both open-ended and closed responses.

Descriptive and econometric methods were used for data analysis. Descriptive analysis included frequencies, means, and standard deviations, while quantitative data was analyzed using statistical techniques, including multiple linear regression. The regression model assessed the relationship between various components of capital structure—private savings, bank credit, retained earnings, non-bank loans, equity, and trade credit—and Return on Investment (ROI). The analysis was conducted using STATA software, testing the influence of each capital structure component on investment returns.

4. Results and Discussions

The study reveals a diverse demographic landscape among SME owners in Morogoro Municipality. The age distribution indicates that the majority of SME owners are young adults, with those aged 26-36 making up the largest group at 37.74%. This suggests that entrepreneurship is particularly strong among young adults, with a significant presence of even younger individuals

aged 15-25, who constitute 29.72% of the respondents. The older age groups, particularly those between 37-47 and 48-58, represent smaller portions of the SME owner population, indicating a potential generational shift in business ownership and management.

Table 1: Description of respondents' characteristics

Variables	Attributes	Frequency	Percent
Age levels	15-25	63	29.72%
	26-36	80	37.74%
	37-47	49	23.11%
	48-58	20	9.43%
Total		**212**	**100.00%**
Gender	Male	100	47.17%
	Female	112	52.83%
Total		**212**	**100.00%**
Education level	No schooling	18	8.49%
	Primary education	35	16.51%
	Secondary education	110	51.89%
	College/University education	49	23.11%
Total		**212**	**100.00**%
Marital status	Married	161	75.94%
	Single	51	24.06%
Total		**212**	**100.00**%
Wards	Sabasaba	44	20.75%
	Magadu	42	19.81%
	Mafiga	42	19.81%
	Mazimbu	42	19.81%
	Kihonda	42	19.81%
Total		**212**	**100.00**%

Source: (Field data, 2024)

Gender distribution among the respondents is relatively balanced, with a slight majority of women (52.83%) over men (47.17%). This balance suggests a strong participation of women in the SME sector, reflecting possibly changing gender dynamics in entrepreneurship within the region. The educational background of the respondents shows that most SME owners have at least secondary education, with 51.89% holding this level of education. Additionally, 23.11% have pursued higher education at college or university levels, which may contribute positively to their business management skills. However, a small portion of respondents, 8.49%, have no formal schooling, highlighting a segment of the SME population that operates with limited educational backgrounds, which could pose challenges in business operations.

The majority of respondents are married, accounting for 75.94% of the sample. This high percentage suggests that marital status might play a role in the stability and decision-making processes within these businesses. The even distribution of respondents across the five wards—Sabasaba, Magadu, Mafiga, Mazimbu, and Kihonda—indicates that SMEs are fairly well-represented throughout Morogoro Municipality. Each ward contributes roughly 20% of the total sample, reflecting a broad geographic spread of SME activities within the municipality.

4.2 Description of monetary values

The descriptive statistics of SMEs in Table 2 provide insights into the financial structure and return on investment (ROI) among the SMEs studied. The Return on Investment (ROI) has a mean value of 53.24%, with a standard deviation of 25.82%. This indicates that on average, the SMEs have a moderate ROI, but there is considerable variation among them, with some SMEs experiencing very low or very high returns (ranging from 0% to 100%).

Private savings among SMEs show a mean value of approximately 2.27 million TZS, with a standard deviation of about 1.24 million TZS. This suggests that while private savings vary significantly among SMEs, most have relatively modest amounts saved, ranging from a minimum of 550,000 TZS to a maximum of 7.1 million TZS. Moreover, Bank credit has a much higher mean value at around 15.66 million TZS, but with a very large standard deviation of 21.22 million TZS. This wide variation indicates that some SMEs have accessed substantial bank credit (up to 87.5 million TZS), while others have much less (as low as 750,000 TZS).

Table 2: Descriptive Status of SMEs

Variable	Obs	Mean	Std. Dev.	Min	Max
Return on Investment	212	53.24	25.817	0	100
Private saving	212	2,269,056.6	1,243,834.9	550,000	7,100,000
Bank credit	212	15,664,823.0	21,220,330	750,000	87,500,000
Reserved earnings	212	2,911,712.3	3,245,927.9	300,000	35,000,000
Non-bank loans	212	2,367,735.8	1,002,310.4	750,000	4,200,000
Equity	212	2,569,174.5	1,426,777.1	500,000	6,700,000
Trade credit	212	4,678,773.6	2,216,027.9	1,000,000	9,000,000

Source: (Field data, 2024)

Reserved earnings average around 2.91 million TZS, with a standard deviation of 3.25 million TZS. The large standard deviation relative to the mean suggests that while some SMEs have accumulated significant reserved earnings (up to 35 million TZS), others have much smaller reserves, with a minimum of 300,000 TZS. Moreover, non-bank loans average about 2.37 million TZS, with a standard deviation of approximately 1 million TZS. The range of non-bank loans is narrower, from 750,000 TZS to 4.2 million TZS, indicating more consistent borrowing behavior outside of traditional banking channels.

Equity investments among SMEs have a mean of approximately 2.57 million TZS, with a standard deviation of about 1.43 million TZS. The range of equity investments varies from 500,000 TZS to 6.7 million TZS, suggesting varying levels of owner investment in the businesses. Lastly, trade credit shows a mean value of approximately 4.68 million TZS, with a standard deviation of about 2.22 million TZS. The range of trade credit extends from 1 million TZS to 9 million TZS, indicating that while trade credit is a significant source of capital, it also varies considerably among the SMEs.

4.3 The determinants of the return on investments.

The results of the multiple linear regression analysis provide valuable insights into the factors that significantly influence the Return on Investment (ROI) among SMEs in Morogoro Municipality. The analysis reveals that the capital structure of SMEs, which includes various sources of financing such as private savings, bank credit, reserved earnings, non-bank loans, equity, and trade credit, plays a crucial role in determining the financial performance of these businesses. The overall model explains approximately 31.8% of the variation in ROI, indicating a moderate level of explanatory power, and suggesting that other unexamined factors may also contribute to investment returns.

Private savings emerge as one of the most influential factors, with a positive and highly significant impact on ROI. The coefficient of 0.305 indicates that a 1% increase in private savings is associated with a 0.305% increase in ROI, holding other variables constant. This finding underscores the importance of personal financial resources in driving business success. In contexts where access to external financing may be limited or costly, the ability to leverage private savings can provide SMEs with the necessary capital to invest in opportunities that yield higher returns. The significance level ($p<0.01$) further reinforces the reliability of this result, suggesting that SMEs with stronger private savings are better positioned to achieve higher profitability. This relationship highlights the critical role of individual financial discipline and the accumulation of savings as foundational elements for sustainable business growth.

Table 3: Multiple linear regression results on determinants of return on investments

Ln of Return of Investment	Coef.	St. Err.	t-value	p-value	[95% Conf Interval]		Sig
Ln of Private saving	0.305	0.073	4.15	0.000	0.16	0.45	***
Ln of bank credit	0.095	0.043	2.21	0.028	0.01	0.18	**
Ln of reserved earnings	-0.068	0.055	-1.24	0.217	-0.176	0.04	
Ln of non-bank loans	0.353	0.095	3.73	0.000	0.167	0.54	***
Ln of equity	0.004	0.076	0.05	0.958	-0.146	0.154	
Ln of trade credit	0.296	0.074	3.99	0.000	0.15	0.442	***
Constant	-8.565	1.626	-5.27	0.000	-11.77	-5.359	***
Mean dependent var		3.803	SD dependent var				0.716
R-squared		0.318	Number of obs				210
F-test		15.746	Prob> F				0.000
Akaike crit. (AIC)		388.18	Bayesian crit. (BIC)				411.613

*** $p<.01$, ** $p<.05$, * $p<.1$

Source: (Field data, 2024)

Bank credit also plays a significant role in enhancing ROI, albeit to a lesser extent compared to private savings. The coefficient of 0.095 suggests that a 1% increase in bank credit leads to a 0.095% increase in ROI. This positive relationship indicates that access to formal financial institutions and the ability to secure bank loans are important for SMEs in scaling their operations and improving their profitability. However, the smaller effect size compared to other variables might reflect the challenges SMEs face in accessing and effectively utilizing bank credit, such as stringent loan requirements, high-interest rates, or limited financial literacy. Nonetheless, the significance of bank credit ($p<0.05$) indicates that it remains a valuable resource for SMEs, particularly for those that can navigate the complexities of the banking sector to secure and deploy credit efficiently.

In contrast, reserved earnings, which represent retained profits that are reinvested into the business, show a negative coefficient (-0.068), though this result is not statistically significant (p=0.217).

This lack of significance suggests that, within the context of this study, reserved earnings may not be a reliable predictor of ROI. One possible explanation for this finding is that the effectiveness of reserved earnings in enhancing ROI may depend on how these funds are allocated within the business. If reserved earnings are not strategically invested in growth-oriented initiatives or are used to cover operational costs without generating additional revenue, their impact on ROI could be minimal or even negative. This result implies that while reserved earnings are an important component of a business's internal financing, their role in driving returns may vary depending on the specific financial strategies and decisions made by SME owners.

Non-bank loans, which include financing from sources other than traditional banks, such as microfinance institutions, peer-to-peer lending, or informal loans, have a strong positive and significant impact on ROI. The coefficient of 0.353 indicates that a 1% increase in non-bank loans is associated with a 0.353% increase in ROI, making it one of the most effective sources of capital for SMEs. The significance level ($p<0.01$) highlights the robustness of this finding, suggesting that non-bank loans provide SMEs with the flexibility and access to capital that they might not obtain from traditional banking institutions. This result could be attributed to the more flexible terms, lower barriers to entry, or community-based support systems associated with non-bank lending. These characteristics may enable SMEs to invest in opportunities that offer high returns but require quick or less conventional financing, thus driving profitability more effectively than other forms of capital.

Equity, representing the owner's investment in the business, shows an insignificant and negligible effect on ROI, with a coefficient of 0.004 ($p=0.958$). This result suggests that within this sample of SMEs, equity does not have a meaningful impact on ROI. There could be several reasons for this finding. In some cases, equity might be used primarily to establish the business or maintain operations rather than to fuel growth, leading to a minimal effect on profitability. Additionally, the lack of significance may indicate that equity investments in these SMEs are relatively small or insufficient to drive substantial returns, or that the owners may not be actively seeking to increase their equity stakes in the business, focusing instead on other sources of financing that offer more immediate or substantial returns.

Trade credit, which allows businesses to obtain goods or services with deferred payment, also shows a positive and significant impact on ROI. The coefficient of 0.296 indicates that a 1% increase in trade credit is associated with a 0.296% increase in ROI, with a significance level of $p<0.01$. This result underscores the importance of trade credit as a critical tool for managing cash flow and sustaining operations, particularly for SMEs that may face liquidity constraints. By leveraging trade credit, SMEs can maintain or increase their inventory, support ongoing production, and fulfill customer orders without immediately depleting their cash reserves. The strong positive relationship between trade credit and ROI suggests that this form of credit is highly effective in enabling SMEs to optimize their working capital and generate higher returns, especially in environments where access to other forms of financing may be limited.

The constant term in the regression model is negative and significant, which could indicate that in the absence of the explanatory variables, the expected ROI would be considerably lower. This finding emphasizes the critical role that these financial components play in enhancing SME profitability. Without access to these sources of capital, SMEs might struggle to achieve positive returns, highlighting the importance of a well-structured capital base in driving business success.

Therefore, the regression analysis provides a detailed understanding of the financial determinants that influence ROI among SMEs in Morogoro Municipality. Private savings, non-bank loans, and trade credit are identified as the most significant contributors to higher ROI, with bank credit also playing a positive role, albeit to a lesser extent. Reserved earnings and equity, on the other hand, do not show significant effects on ROI, suggesting that these forms of capital may be less effective in driving profitability for SMEs in this context. The findings underscore the importance of diversifying the sources of capital and strategically managing financial resources to maximize returns on investment in the SME sector.

4.3.1 Multicollinearity test

The Variance Inflation Factor (VIF) results indicate that multicollinearity is not a concern in the regression model, as all VIF values are well below the threshold of 10, ranging from 1.08 to 1.77. The low mean VIF of 1.35 further confirms that the independent variables are not highly correlated, ensuring that the regression coefficients are stable and the interpretations of their effects on Return on Investment are reliable.

Table 4: Variance Inflation Factor

Variable name	VIF	1/VIF
Ln of Private saving	1.21	0.827726
Ln of bank credit	1.77	0.565073
Ln of reserved earnings	1.74	0.576151
Ln of non-bank loans	1.24	0.807278
Ln of equity	1.08	0.924002
Ln of trade credit	1.08	0.923827
Mean VIF	**1.35**	**.**

(Source: (Field data, 2024)

5. Discussion

The findings of this study provide critical insights into the determinants of Return on Investment (ROI) among SMEs in Morogoro Municipality, with a particular focus on the role of different components of capital structure. The results underscore the importance of private savings, non-bank loans, and trade credit in enhancing SME profitability, while also highlighting the limited impact of reserved earnings and equity on ROI.

The positive and significant relationship between private savings and ROI aligns with previous research that emphasizes the role of internal financial resources in business success. Private savings offer SMEs a degree of financial independence, allowing them to invest in growth opportunities without relying on external debt, which often comes with stringent repayment terms and interest costs (Bashir & Ondigo, 2018). This finding is particularly relevant in the context of developing economies, where access to external financing can be constrained by underdeveloped financial markets (Chalmers et al. 2020). The significant impact of private savings on ROI suggests that policies encouraging personal savings among entrepreneurs could be beneficial in fostering SME growth.

Non-bank loans also show a strong positive effect on ROI, which is consistent with studies that have highlighted the flexibility and accessibility of non-traditional financing sources for SMEs.

Unlike bank credit, non-bank loans often come with less stringent requirements, making them a viable option for SMEs that may not meet the criteria set by formal financial institutions (Manzoor et al. 2021). The significant contribution of non-bank loans to ROI indicates that these financing options are crucial for SMEs, especially in contexts where formal banking services are limited or inaccessible. This result suggests a need for further support and development of alternative financing mechanisms to bolster SME performance.

The positive impact of trade credit on ROI is also noteworthy. Trade credit, which allows businesses to obtain goods and services with deferred payment, serves as an essential tool for managing working capital and sustaining operations. Previous research has documented the importance of trade credit in enhancing liquidity and enabling SMEs to smooth out cash flow fluctuations, particularly in environments with limited access to external credit (Taiwo et al. 2016; Chalmers et al. 2020). The significant effect of trade credit on ROI in this study reaffirms its role as a critical component of capital structure that supports SME profitability.

In contrast, the insignificant impact of reserved earnings and equity on ROI suggests that these sources of capital may not be as effective in driving investment returns for SMEs in Morogoro Municipality. Reserved earnings, while important for maintaining business stability, may not always be reinvested in ways that generate substantial returns. This finding is consistent with research indicating that the allocation of retained profits can vary widely, depending on the strategic priorities and financial management practices of SME owners (Taiwo et al. 2016, Li, 2016). Similarly, the negligible impact of equity on ROI could be attributed to the possibility that equity investments in these SMEs are relatively small or that owners are not actively expanding their equity base, focusing instead on leveraging other forms of capital that offer more immediate returns.

The presence of heteroscedasticity in the model, as indicated by the heteroscedasticity test, suggests that the variance of the residuals is not constant across observations. This issue, commonly encountered in cross-sectional data, can lead to inefficiencies in standard errors and affect the reliability of the regression estimates (Sorin et al. 2021; Theodory & Kitole, 2024; Wooldridge, 2016; Dimoso & Andrew, 2021). To mitigate this, robust standard errors or alternative estimation techniques should be employed in future analyses to ensure the robustness of the results.

Overall, the findings of this study contribute to the growing body of literature on SME finance by highlighting the critical role of diverse financing sources in enhancing profitability. The significant impact of private savings, non-bank loans, and trade credit on ROI underscores the need for policymakers and financial institutions to create an enabling environment that supports access to these forms of capital. Additionally, the study suggests that SME owners should consider a strategic approach to capital structure, prioritizing financing sources that offer the greatest potential for return on investment while also managing risks associated with external debt and equity financing.

6. Conclusion

The findings of this study underscore the critical role of private savings, non-bank loans, and trade credit in driving the profitability of SMEs in Morogoro Municipality. These forms of capital have demonstrated a significant impact on Return on Investment (ROI), indicating their importance in the financial strategies of small businesses. On the other hand, reserved earnings and equity

showed limited influence on ROI, suggesting that these traditional sources of capital may not be as effective in the context of SMEs within this region. The presence of heteroscedasticity in the data further complicates the interpretation, highlighting the need for careful consideration of underlying data complexities in financial analysis.

Given these insights, there is a clear need to promote and enhance access to the most impactful forms of capital. Encouraging personal savings among entrepreneurs should be a priority, as this not only provides a reliable source of funding but also fosters financial independence. Similarly, strengthening the availability and accessibility of non-bank financing options, such as microfinance and peer-to-peer lending, can offer SMEs the flexibility they need to grow. Trade credit also emerges as a powerful tool for managing cash flow and sustaining business operations, and efforts should be made to help SMEs better leverage this form of credit. In contrast, the limited impact of reserved earnings and equity suggests that SMEs might benefit from strategic guidance on how to more effectively reinvest retained profits and utilize equity to drive growth.

Overall, the study's results point to the importance of a diversified and strategic approach to financing for SMEs. By focusing on the most effective sources of capital, SMEs can optimize their financial performance and enhance their long-term sustainability. Policymakers, financial institutions, and SME owners should collaborate to create an enabling environment that supports access to these key resources while also providing the necessary education and tools to maximize their impact. Moreover, future research should continue to explore the complexities of SME financing, using robust analytical techniques to uncover additional factors that influence ROI and further refine our understanding of what drives SME success.

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