FACTORS INFLUENCING DEBT FINANCING ACCESS BY SMALL AND MEDIUM-SIZE ENTERPRISES (SMEs) IN KAMPALA

By

KADDU EMMANUEL

15/U/5404/PS

A RESEARCH PROPOSAL SUBMITTED TO THE SCHOOL OF STATISTICS IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF BACHELOR’S DEGREE IN BUSINESS STATISTICS
DECLARATION

I, KADDU EMMANUEL, do declare that the work herein is presented in its original form and has not been presented to any other university or institution for any academic award whatsoever.

Sign........................................

KADDU EMMANUEL

Date........6/08/2018...........
This dissertation has been submitted for examination with the approval of my academic supervisor.

Signature ........................................

NAME: DR. TUYIRAGIZE RICHARD

Date: ..............................................
ACKNOWLEDGEMENT

I would like to formally recognize the support of all those persons who have contributed to the production and completion of my Research project. In particular, I would like to appreciate my supervisor, Dr. Tuyiragize Richard for his commitment and effort in reviewing my progress reports for the study in a timely manner. I would also like to appreciate my former and current work mates, for their guidance and support towards the completion of this project. Special thanks go out to all my siblings and friends for their emotional and spiritual support without which swift completion of this report would have been rather hard.

Finally, I wish to convey my gratitude to my parents, Mr. Ssengooba Matia and Mrs. Namatovu Josephine for holding my hand through thick and thin until this very remarkable moment of my academic and professional career.
MAY GOD BLESS YOU ALL
DEDICATION

This dissertation is dedicated to my family and friends whose love and tolerance encouraged me to accomplish this academic project.
# TABLE OF CONTENTS

DECLARATION ........................................................................................................... i
APPROVAL .................................................................................................................. ii
ACKNOWLEDGEMENT ............................................................................................. iii
DEDICATION .............................................................................................................. iv
ABBREVIATIONS ...................................................................................................... vi
LIST OF TABLES ........................................................................................................ vii
ABSTRACT ................................................................................................................ viii

CHAPTER ONE .......................................................................................................... 1
1.1 Introduction ......................................................................................................... 1
1.2 Background of the study .................................................................................... 1
1.3 Statement of the problem ................................................................................... 2
1.4 Purpose of the study ........................................................................................... 2
1.5 Objectives of the study ....................................................................................... 3
1.6 Research questions ............................................................................................ 3
1.7 Research Hypotheses ......................................................................................... 3
1.9 Significance of the study ................................................................................... 3
1.10 Conceptual framework .................................................................................... 4
Figure 1: Conceptual Framework ........................................................................... 4

CHAPTER TWO .......................................................................................................... 4
2.1 Introduction ......................................................................................................... 5
2.2 Theoretical Review ............................................................................................ 5
2.3 Conceptual Review ............................................................................................ 6
2.4 Contextual Review: Factors influencing Debt financing of SMEs ................... 9
2.4.2 Collateral requirements and access to debt financing by SMEs ................. 9

CHAPTER THREE .................................................................................................... 11
METHODOLOGY ....................................................................................................... 11
3.0 Introduction ....................................................................................................... 11
3.1 Research Design ............................................................................................... 11
3.2 Sample Size ...................................................................................................... 11
3.3 Data Collection Methods ............................................................................... 12
3.4 Data Analysis ................................................................................................... 12
3.5 Pre-testing (Validity and Reliability) ................................................................. 13

CHAPTER FOUR ...................................................................................................... 14
4.1 Introduction ....................................................................................................... 14
4.2 Response Rates of respondents ....................................................................... 14
4.4 Empirical results: Influencing factors of access to debt financing by retail SMEs ........................................................................................................ 18

CHAPTER FIVE ......................................................................................................... 25
5.1 Introduction ....................................................................................................... 25
5.2 Summary of Findings ....................................................................................... 25
5.3 Discussion of Findings ..................................................................................... 28
5.4 Conclusions ...................................................................................................... 29
5.5 Recommendations ........................................................................................... 30
5.6 Limitations of the study .................................................................................. 32
5.7 Contributions of the study .............................................................................. 32
5.8 Recommendations for Further Research ....................................................... 32

REFERENCES .......................................................................................................... 33
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>African Development Bank</td>
</tr>
<tr>
<td>CBR</td>
<td>Central Bank Rate</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poorest</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>KCCA</td>
<td>Kampala Capital City Authority</td>
</tr>
<tr>
<td>ICBERF</td>
<td>Invest Climate and Business Environment Research Fund</td>
</tr>
<tr>
<td>INSEE</td>
<td>Institute of Statistics and Economic Studies</td>
</tr>
<tr>
<td>MFI</td>
<td>Micro Finance Institutions</td>
</tr>
<tr>
<td>MoFPED</td>
<td>Ministry of Finance Planning and Economic Development</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-Operation and Development</td>
</tr>
<tr>
<td>SNE</td>
<td>Small and Medium-sized Enterprises</td>
</tr>
<tr>
<td>UIA</td>
<td>Uganda Investment Authority</td>
</tr>
</tbody>
</table>
LIST OF TABLES

Table 1: Response rates to the study .................................................................14
Table 2: Retail SMEs General Information: Frequency Distribution .........................15
Table 3: Unmerged responses about the influencing factors of access to debt financing by retail SMEs ........................................................................................................19
Table 4: Summary of responses to interest rates’ assertions .....................................20
Table 5: Summary of responses to collateral assertions .............................................22
Table 6: Summary of responses to assertions of Age of the SME .............................23
Table 7: Summary of responses to assertions of Profitability....................................24
ABSTRACT

Unquestionably, access to finance from financial institutions is essential for the profitability and sustainable growth of the small and medium enterprises sector (SMEs). The purpose of the study was to ascertain the factors influencing access to debt finance by SMEs in Rubaga, Kampala, Uganda with a view to establishing a coherent model directed at improving SME access to debt finance. The study adopted the cross-sectional/correlational design and intrinsically it was hypothesized that age and trading/borrowing experience of the business, collateral and interest rates positively influence access to debt finance by SMEs with the financial life cycle theory used in conceptualizing this relationship. The study used a respondent sample of 130 SMI_ operating in Rubaga, Kampala whose owners were the unit of enquiry. The Pearson Ran' correlation coefficient and regression analysis were used for data analysis. The findings revealed strong positive correlation between interest rates, collateral requirements for debt acquisition age/trading experience and the access to debt finance by retail SMEs in Kampala. The correlation coefficients were 0.601, 0.600 and 0.644 respectively. The results also indicated that age/trading experience of the SMEs influences debt finance highly since a unit increase in age and trading/borrowing experience of the business improves debt financing access of SMEs by 0.274 units, which is averagely 0.1 units higher than collateral (0.191) and interest rates (0.177).

Correspondingly, in view of the latter observation and the realization that financial needs for small businesses change as they grow and gain experience, the study recommends that financiers need to organize regular and comprehensive financial literacy programmes that target growth-specific operations of SMEs and financial statement analysis, among others, would beneficial in that regard.
CHAPTER ONE
INTRODUCTION

1.1 Introduction
According to Bataa (2008), the role of Small and Medium-size Enterprises (SMEs) in the development process remains at the forefront of policy deliberations in developing countries as in developed countries. Bataa seems to believe that the advantages claimed for SMEs are various, including the encouragement of entrepreneurship; the greater likelihood that SMEs will utilize labour-intensive technologies and thus have an immediate impact on employment generation; they can usually be established rapidly and put into operation to produce quick returns; and that, they may well become a countervailing force against the economic power of larger enterprises. Indeed, Deakins (2008) submitted that the development of SMEs accelerates the achievement of wider socio-economic objectives, including poverty assuagement.

1.2 Background of the study
SMEs have been recognized as being great contributors to national economies offering both employment and platform for innovative ideas. They form a larger percentage of the businesses that operate in especially developing countries. They are however faced by many constraints that hinder their profitability and, consequently, their growth. One of the main constraints that have been highlighted over the years is the financial constraint. The need for finance is of paramount importance for the success of any firm, be it big or small (IMF, 2007 and 2008). In attempting to gain access to financial services, SMEs continue to face constraints caused by many factors. For instance in Norway, about 60 per cent of small companies (120 employees) die within 5 years, although during this period a significant number of the companies grow out of this category, employing between 20 and 100 persons. A very small share, 0.2 per cent, display remarkable profitability and employ more than 100 after 5 years (Fjose, 2010).

In Africa, however, ADB (2012) pointed out that the major challenge facing many developing countries, especially in Saharan Africa, is coming up with suitable development strategies that will capture the financial services’ requirements of Small and Medium Enterprises (SMEs) which constitute about 70 per cent of the business sector in the region. Several studies have established that the commonest influencing factors of debt finance
access in Africa are the firms’ profiles such as ownership structure; size of the firm; business type; and age of the business (Musamali and Kipkirong, 2013). Others have proposed that interest rates, collateral requirements, sales and the declared strategies for operations, profits, growth and exports also influence SMEs’ access to finance (Xiang, Worthington and Higgs, 2011).

In Uganda, although there is a high rate of business start-ups, the country is also among those with the highest number of SMEs that perform poorly and close business before the end of the first year (UIA, 2013; Namatovu et al., 2010). Expectedly, SMEs in Uganda are presently being faced with many serious difficulties such as shortage of capital for expanding and renovating equipment, low productivity and competitiveness, lack of experience in terms of marketing, production management, and financial management (Turyahweba, 2013). The difficulty of meeting the specified collateral requirements by banks has been cited as a major cause of these financing problems, coupled with misuse of funds meant to assist SMEs grow into sustainable ventures (Mwangi, 2011). This study was aimed at providing an insight into the debt financing access problem for Ugandan SMEs and how debt financing can be gainfully utilized in facilitating the profitability and growth of SMEs.

1.3 Statement of the problem
According to enterprise-level data collected by the World Bank (2011), SMEs in Sub-Saharan Africa are more financially constrained than in any other developing region. Only 20 per cent of SMEs in Sub-Saharan Africa have a line of credit from a financial institution compared, for example, with 44 per cent in Latin America and the Caribbean, and only 9 per cent of their investments are funded by banks versus 23 per cent in Eastern Europe and Central Asia. In Uganda, a number of obstacles have continued to constrain the financiers’ further engagement with the SME segment.

1.4 Purpose of the study
The purpose of this study was to examine the factors influencing access to debt financing as a tool for accelerating the growth and improvement of the profitability of Small and Medium Enterprises (SMEs) in Uganda.
1.5 Objectives of the study
The study was guided by the following objectives:
1. To establish the effect of prime lending rates on debt financing access by SMEs in Kampala;
2. To examine the association between collateral requirements and debt financing access by SMEs in Kampala;
3. To find out how age/trading experience of the business affects debt financing access by SME in Uganda

1.6 Research questions
1. What is the effect of prime lending rates on debt financing access by SMEs in Kampala?
2. Is there a relationship between collateral requirements and debt financing access by SMEs in Kampala?
3. To what extent do age/trading experience of the business affect debt financing access by SMEs in Kampala?

1.7 Research Hypotheses
The study sought to study the following hypotheses:
1. Low prime lending rates significantly boost debt financing access by SMEs in Kampala.
2. Complex collateral requirements significantly affect debt financing access by SMEs in Kampala.
3. Age/trading experience of the business significantly affects debt financing access by SMEs in Kampala.

1.9 Significance of the study
1. Traders and financial institutions: The findings of the study are expected to empower the financial institutions in critiquing some of the policies governing debt financing and gauge whether they are generating the intended results. This in the long term will provide such users a base on which to modify these policies to suit the demands of the different stakeholders.
2. **Government**: The study was also aimed at aiding the Central Government in ascertaining the different avenues it can take up as a measure to enhance and boost the growth of SMEs in Uganda in relation to debt financing.

3. **Researchers**: The research findings and analysis are of great significance to those who purpose to do further research on this topic. This research is also expected to add to the existing literature on debt financing and SME profitability.

### 1.10 Conceptual framework

**Figure 1: Conceptual Framework**

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Influencing factors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Prime lending rates</strong></td>
<td>• Administrative costs</td>
</tr>
<tr>
<td></td>
<td>• Operational costs</td>
</tr>
<tr>
<td></td>
<td>• Returns to the lender</td>
</tr>
<tr>
<td><strong>Collateral requirements</strong></td>
<td>• Loan size</td>
</tr>
<tr>
<td></td>
<td>• Feasibility of requirements</td>
</tr>
<tr>
<td><strong>Age/Trading experience of the business</strong></td>
<td>• Information and Financial</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Dependent variable</th>
<th>Access to debt finance by SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth</strong></td>
<td>• Diversification</td>
</tr>
<tr>
<td></td>
<td>• Market expansion</td>
</tr>
<tr>
<td><strong>Profitability</strong></td>
<td>• Sales revenue</td>
</tr>
</tbody>
</table>

### 1.11 Scope of the study

The study to establish the factors that influence debt financing accessibility by SMEs in Kampala considered debt financing experiences of SME owners for a period of 5 years from 2010 to 2014, a period that was beleaguered with a high degree of inflexibility of market interest rates and macroeconomic instability.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction
In this chapter, the researcher gives an account of what has been published on factors influencing debt financing and the profitability of SMEs. It specifically reviewed how influencing factors of debt financing accessibility by SMEs and its effect on the growth and profitability of SMEs have evolved theoretically and conceptually. An actual review of the objectives of the study was also done in this chapter.

2.2 Theoretical Review
2.2.1 The Financial Life Cycle Theory by Franco Modigliani
The stage model or firm life cycle approach describes the development of the firm as a linear sequential process through a number of stages. The number of stages is not standardized. A model based on three phases of growth and five-stage evolution-revolution models have been proposed. The financial life cycle model incorporates elements of trade-off, agency, and pecking order theories, and describes sources of finance typically advanced by funders at each stage of a firm’s development.
At start-up, the commonly held view is that firms have difficulty accessing debt finance due to information opacity, low asset base and inexperience (Fjose, 2010). The most important and commonly-used sources of finance at this stage are personal savings of the firm owner, and finance from friends and family members (Gompers, 2010). The contribution of the firm owner in nascent firms is not confined to equity, but commonly includes the provision of quasi-equity in the form of personal assets used as collateral to secure business debt (Calice, 2012). Whilst a firm may obtain sufficient capital to initiate trading, a lack of planning may lead to problems of undercapitalization in the earliest stages. In extreme cases, particularly in the face of competition, the firm may not be able to continue in business (Gompers, 2010).

Firms requiring large amounts of external equity are characterized by the pursuit of a high profitability and growth strategy, and may be involved in the development of products or services based on new technology (Frasch, 2013). A consequence of the sale of firm equity for the owner is loss of control and managerial independence, although a number of authors indicate that this outcome may be compatible with the firm owner’s goals (La Rocca, 2011).
2.2.2 Life Cycle Model: Application and Criticisms

The financial growth life cycle model (Berger and Udell, 1998) presents firms on a size/age/information continuum, and describes the increasing array of financing options available to the firm as it grows. The model incorporates changes in availability of information and collateral in describing sources of finance available to firms over time (Gompers, 2010). The model thus conceptualizes the sequencing of funding over the life cycle of the firm centred on information opacity and following a financial pecking order. Smaller firms with pitiable information management practices are depicted to the left side of the continuum relying on initial insider finance, trade credit, and/or angel finance. As firms advance along the continuum, they gain access to increased sources of external debt and equity capital (Nofsinger, 2011). Ultimately, firms may access greater amounts of capital in public debt and equity markets. Similar to earlier approaches, the model does not specify age categories for each stage of development, nor does it consider truncation at any point in the life cycle (Gompers, 2010).

2.3 Conceptual Review

2.3.1 Small and Medium-size Enterprises

To date there is no commonly acknowledged definition of small and medium enterprises (IFAC, 2011).

The definition varies across countries and industries. According to the World Bank, Small and Medium Enterprises are officially defined on the basis of both the number of people employed and the annual turnover of the enterprise (World Bank, 2011). The Ministry of Finance, Planning and Economic Development defines a small enterprise as an enterprise employing a minimum of 5 people and a maximum of 50 people; and/or has an annual sales/revenue turnover of a maximum of Ugandan Shillings 360 million and total assets of a maximum of Ugandan Shillings 360 million, while a medium enterprise is defined as an enterprise employing between 50 and 100 people; and/or has an annual sales/revenue turnover of more than Ugandan Shillings 360 million and total assets of more than Ugandan Shillings 360 million (MoFPED, 2008)
2.3.2 Role and benefits of SMEs

There is a general consensus that the performance of SMEs is important for both the economic and social development of developing countries (Kira, 2013). From the economic perspective, SMEs provide a number of benefits. SMEs have been noted to be one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low-income countries. These enterprises have been recognized as the engines through which the growth objectives of developing countries can be achieved (Mwangi, 2011). They are potential sources of employment and income in many developing countries and they seem to have advantages over their large-scale competitors in that they are able to adapt more easily to market conditions, given their broadly skilled technologies. Additionally, they are able to withstand adverse economic conditions because of their flexible nature (Maziku, 2012).

2.3.3 Debt Financing of SMEs in Uganda

Debt financing is the practice of borrowing funds from outside an organization from such institutions as commercial banks, money lenders, micro-finance institutions and SACCOs. It includes long-term debt (loans repayable in more than a year) and short-term loans (loans repayable within a year) (Frasch, 2013). This study was guided by the perceptions of SME owners on banking and micro-finance debt financing accessibility. These are conceptualized as below.

a) Banking Sector Debt Financing: Commercial banks constitute the main providers of financial services for enterprises. In Africa, they used to be dominated by foreign banks, but since the 1980s, a significant number of private-owned banks have developed in most countries. Commercial banks offer a wide range of financial services including savings, deposits, credits, transfers, insurance arrangements, and even leasing. The main lending mechanism is short-term working capital; however, the availability of other financial services depends on the nature of the deposits that are being used for funding, as well as the demand for it (Mwangi, 2011). Given their profit-making principles, banks find it difficult to provide financial services to SMEs because SMEs are considered high-risk clients (Fjose, 2010)

b) Micro-financing: This industry has proved to be a reliable delivery vehicle for financial services to SMEs. They consist of licensed institutions, NGO co-operatives as well as a large collection of associations ranging from women and youth clubs to...
loosely organized bodies. They offer savings, payments and insurance services to their clients (Mwangi, 2011). The strength of MFIs is that they serve the rural areas at low costs. Their service delivery is flexible, which makes it easy for weak SMEs to access financial services from them. Their weaknesses, though, lie in their weak operational and management information systems, poor internal controls, limited access to technical assistance, and dependence on donor funding (Mashenene, 2014).

2.3.4 Factors that influence debt financing of SMEs
Financing of SMEs’ viable projects have an important implication on sustainability and growth of the SMEs but the factors influencing the access to debt financing to firms are many and complex. For the purpose of this study, the researcher adopted the following factors and is conceptualized as below.

2.3.4.1 Interest rates/prime lending rates
Interest Rate also known as the Cost of Finances (COF) is the cost and interest and other charges involved in the borrowing of money to build or purchase assets. Whited (2010) in his contemporary study on rural finance argues that the cost of money is intended to compensate a contractor for the capital cost of employing certain facilities in the performance of contract.

2.3.4.2 Collateral requirements for debt acquisition
Bougheas et al. (2005) argue that collateral is an important factor for SMEs in order to access debt finance.
Collateral reduces the riskiness of a loan by giving the financial institution a claim on a tangible asset without diminishing its claim on the outstanding debt. Coco (2000) points out that collateral requirement are the lender’s second line of defense.

2.3.4.3 Age and the trading/borrowing experience of the business
According to Villalonga (2004) the age of the firm has implications on financial access and as such the link between age of the firm and growth or profitability has been given attention in the industrial organization literature. For example, Cooley and Quadrini (2001) are of the view that firm growth decreases with firm age while Chandler (2009) believes that age of the firm can affect performance by inducing organizational inertia and by impairing firms’ ability to perceive valuable signals.
2.3.5 Profitability and Growth of Small and Medium Enterprises
The aim or goal of any firm is to make profits and later grow or expand its operation (Mashenene, 2014). The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state. The growth of a firm can be determined by supply of capital, labour and appropriate management and opportunities for investments that are profitable (Fjose, 2010).

2.4 Contextual Review: Factors influencing Debt financing of SMEs
Researches on the SME sector have attracted attention from researchers, policy makers, and practitioners due to their contributions to economic growth. In spite of the potential it has on economic development and growth the sector is facing a serious challenge arising from lack of financing services.

2.4.1 Cost of debt finance/interest rates and access to debt financing by SMEs
Zecchini and Ventura (2009) argue that currently, there’s widespread agreement that for various financial institutions to operate profitably and sustainably, there’s need for them to keep their costs as low as possible by levying proportionate interest rates and fees high enough to cover those costs. However, inability to access finance may be one of the reasons why we do not see a robust correlation between SME prevalence and economic growth, and financial constraints are particularly preventing small firms from reaching their growth potential in terms of financial performance institutions constrain their efforts by levying high interest rates to cover the costs of their lending and other service (Wanjohi, 2009).

2.4.2 Collateral requirements and access to debt financing by SMEs
As the provision of collateral plays an indispensable role in easing SME access to debt finance, SMEs that have more fixed assets tend to utilize higher financial leverage (Nofsinger, 2011). The reason for this is that these firms can borrow at lower cost of debt finance/interest rates as their loans are secured with these assets serving as collateral. This explains why La Rocca (2011) describes collateral as the lender’s second line of defense. In his investigation of the role of collateral and personal guarantees using a unique data set from Japan’s SME loan market, Fatoki (2011) found that a positive relationship between the use of
collateral and the strength of the borrower-lender lending relationship results in easier SME access to debt finance.

2.4.3 Age (trading experience) and access to debt finance by SMEs

With regard to age and experience, as measured by the number of years in an industry, Abdulsaleh (2013) established that experience also enhances the availability of credit. In fact, Nofsinger and Wang (2011) hypothesized that the experience of the entrepreneur is one factor that explains the difference in debt financing levels available to SMEs. The findings of the study proved this hypothesis. They further explained that prior experience in the industry positively correlates with the share of debt financing in the firm and added that the cumulative experience of the owner-manager plays a crucial role in overcoming some of the problems that hinder SME access to debt finance, including information asymmetry and moral hazard. From the lender’s perspective, as experienced entrepreneurs are believed to be better performers than less experienced entrepreneurs, it is then rational to factor experience into the process of evaluating the creditworthiness of SMEs (Gompers, 2010).

2.4.5 Emerging gaps

A substantial amount of surveyed literature above, both in theoretical and conceptual contexts, emphasizes cost of debt finance/interest rates, collateral, age of the firm and trading experience as critical factors influencing access to debt financing by SMEs. In fact these studies have tended to group together the constraints regarding debt financing whether from MFIs or CBs (Turyahweba, 2013; Kira, 2013; Maziku, 2012 and Makoni, 2014). In reality, the conditions and requirements for debt financing from MFIs and CBs differ markedly. Moreover, this literature citation is rather generalist and does not specifically and singularly address itself to an assortment of variables influencing the profitability of SMEs with an out-of-character focus on Kampala District. Besides, the centre of interest of this literature does not include a broad continuum of financing types such as venture capital, leasing, and other financing avenues. This creates scope, methodological, content and geographical gaps that this study may not bridge.
CHAPTER THREE

METHODOLOGY

3.0 Introduction
This chapter presents a review of the research methods and design appropriateness besides discussing the population and sample configuration. In addition, the chapter explicates the methods that were used in the gathering of the data and the various stages the researcher went through to acquire the information. Likewise, it is in this chapter that the researcher particularizes the area of study, sample size determination, methods of data collection, data presentation, interpretation and analysis, measurement of variables and ethical considerations for the study.

3.1 Research Design
Sekaran (2009) defines research design as the scheme, outline or plan that is used to generate answers to a research problem. Sekaran also defines it as the master plan specifying the methods and procedures for collecting and analyzing the needed information.

A cross-sectional survey design was used to examine the experiences of the sampled SMEs’ proprietors about the factors influencing their access to debt financing and how it affects the profitability of their businesses in the long run. The design was chosen because it enabled the researcher to capture a lot of information in a short period of time.

3.2 Sample Size
It is defined as a segment of the population selected for investigation. Rubaga Sub County in Kampala has an estimated population of 194 retail SMEs as established earlier. The study considered any SME proprietor/ employee regardless of age and gender. This was done in order to minimize bias. The sample size was determined from the use of Cochran’s correlation formula as edited by Bartlett et al, 2000.

\[
\frac{N}{n} = \frac{\sqrt{\frac{1}{N} + \frac{1}{e^2}}}{2}
\]

Where
- \( n \) is the desired sample size
- \( N \) is population of the study
- \( e \) is the confidence interval of the study.

It therefore followed that
- \( = 194 / 1+194 (0.05)^2 \)
- \( = 194 / 1.485 \)
- \( = 130 \) respondents.
3.3 Data Collection Methods

3.3.1 Key Informants interviews
An interview guide is a set of questions that the researcher asks during the interview (Vogt, 2007). The researcher designed an interview guide that was used during the interview of the key informants. Questions that were asked in this section were technical and specifically intended to get methodical responses about the research questions which would otherwise not have been properly comprehended by the other respondents. Fifteen interviews were held with loans officers who were the key informants.

3.3.2 Questionnaire method
A questionnaire is a data collection instrument used to gather data over a large sample or number of respondents. This structured questionnaire was developed with the aid of suggested guidelines by Sekeran (2009). The first section of the instrument probed for background and demographic data, while the subsequent section delved into the respondents’ insights about the study objectives. In each section, the respondents were given clear instructions on how to complete the item. The questionnaire was refined during the piloting of the instrument. A total of 130 questionnaires were sent out and properly monitored to allow for a satisfactory response rate.

3.4 Data Analysis
The researcher performed both quantitative and qualitative data analysis. It involved drawing inductive inferences from data and distinguishing the phenomenon of interest from the statistical fluctuations present in the data as proposed by Amin (2005).

3.4.1 Qualitative Analysis
Data from key informants was analysed thematically and this involved condensing individual responses into similar themes and integrating them into interview schedule for easy analysis. Stand out respondents’ statements, comments or remarks were reported ‘as is’. The use of the qualitative design was aimed at giving deeper insights of the issues that were uncovered by the study.

3.4.2 Quantitative Analysis
The quantitative data analysis focused on the examination of numerical values aggregated from the study about which descriptions such as the mean and standard deviations were
made. Data collected was checked to ensure accuracy; this was useful in ensuring that the objectives of the study were being addressed (Sekeran, 2009). Analysis was done according to the objectives of the study.

3.4.3 Data processing
Data from the field was sorted, coded and organized in tables. Frequencies and percentages were also presented at this stage

3.5 Pre-testing (Validity and Reliability)
3.5.1 Validity of instruments
Validity of an instrument refers to the appropriateness of the instrument to measure what it intends to measure (Amin, 2005). To ensure validity, 5 key informants were requested to do a pretest of the instruments. To ensure greater chances of data validity, the questionnaire was reviewed with the research supervisor for expert input. Approval from the supervisor was obtained who then assented to conducting a field test with the 5 key informants. Several changes were made as appropriate, based on both the field test and expert opinion.

3.5.2 Reliability
Reliability is defined by Vogt (2007) as the consistency of either measurement or design to give the same conclusions if used at different times. The first step in ensuring reliability was by providing clear operational definitions of the variables under study. Thereafter, internal consistency was measured through internal consistency reliability (Sekeran, 2009) as well as split-half reliability using Cronbach’s alpha.

If the α (cronbach alpha) value is computed to be 0.7 and above, then the instrument is considered satisfactory (Cronbach, 1951 as cited by Sekeran&Bougie, 2010), using results from the pretested questionnaire. According to Zaiontz (2015), Cronbach’s alpha, α can be computed by running Excel’s Anova: Two Factor without Replication data analysis tool and computing:

$$\alpha = 1 - \frac{MS_E}{MS_B}$$

Where $MS_E$ is Mean square/MS Error while $MS_B$ is Mean square/ MS Rows
CHAPTER FOUR
PREMINARY ANALYSIS

4.1 Introduction
The study examined the factors influencing access to debt financing by retail small and medium-size enterprises (SMES) in Rubaga, Kampala. This chapter presents and discusses the findings of the study. The chapter also presents the analysis and interpretation of results. The presentations are done according to the specific objectives and hypotheses. The first section presents the response rates. The second section presents the background information of the respondents. The third section presents descriptive and inferential statistical results along the four study objectives.

4.2 Response Rates of respondents
A response rate is the percentage of people who respond to the survey. A low response rate can give rise to sampling bias if the non-response is unequal among the participants regarding exposure and/or outcome. Therefore a response rate of above 50% is considered acceptable (Survey monkey, 2015). In this study, the sample size was 130 retail SMES’ proprietors and 15 key informants but the study managed to interview only 88 proprietors and 12 loans officers as shown in the table below.

Table 1: Response rates to the study

<table>
<thead>
<tr>
<th>Category</th>
<th>Sample Size</th>
<th>Actual Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail SME owners</td>
<td>130</td>
<td>88</td>
<td>67.7</td>
</tr>
<tr>
<td>Loans officers</td>
<td>15</td>
<td>12</td>
<td>80</td>
</tr>
</tbody>
</table>

Consistent with the above table, out of the 130 questionnaires administered, 88 were returned fully completed, giving rise to a response rate of 67.7%. Out of 15 respondents targeted for key informants’ interviews, only 12 respondents were interviewed, giving rise to a response rate of 80%. The overall response rate of the respondents was thus 69%, which was considerably higher than the 50% rate suggested by Survey monkey (2015).
4.3 Background Information of the establishments

The proprietors were asked about their companies’ business type and company type, possession of trading licenses, age of the businesses/ duration of the firms in business, employee number, professionals employed, management’s education background, possession of business plans, start-up capital source and the average monthly turnover of the businesses. This information was required to ensure that the sample for the study had comparable distribution by characteristics to those of the population they were drawn from.

This was particularly advantageous in augmenting the representativeness of the sample on the whole.

**Table 2: Retail SMES’ General information: Frequency Distribution**

<table>
<thead>
<tr>
<th>Features</th>
<th>Category/code</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Company type</td>
<td>Private Limited Company</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td></td>
<td>Public Limited Company</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td></td>
<td>Partnership</td>
<td>6</td>
<td>7%</td>
</tr>
<tr>
<td></td>
<td>Sole Proprietor</td>
<td>63</td>
<td>71.6%</td>
</tr>
<tr>
<td></td>
<td>Family Owned Business</td>
<td>16</td>
<td>18.2%</td>
</tr>
<tr>
<td></td>
<td>Others</td>
<td>3</td>
<td>3.4%</td>
</tr>
<tr>
<td>2. Business Type</td>
<td>Food and Cash crops</td>
<td>10</td>
<td>11.4%</td>
</tr>
<tr>
<td></td>
<td>Catering/ restaurants</td>
<td>9</td>
<td>10.2%</td>
</tr>
<tr>
<td></td>
<td>Clothing and shoes</td>
<td>12</td>
<td>13.6%</td>
</tr>
<tr>
<td></td>
<td>General merchandise for retail</td>
<td>26</td>
<td>29.5%</td>
</tr>
<tr>
<td></td>
<td>Others</td>
<td>23</td>
<td>26.1%</td>
</tr>
<tr>
<td>3. Trading license</td>
<td>Yes</td>
<td>41</td>
<td>46.6%</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>47</td>
<td>53.4%</td>
</tr>
<tr>
<td>4. Duration in business</td>
<td>&lt; 1 year</td>
<td>2</td>
<td>2.3%</td>
</tr>
<tr>
<td></td>
<td>1 &lt; duration &lt; 5 years</td>
<td>21</td>
<td>23.9%</td>
</tr>
<tr>
<td></td>
<td>6 &lt; duration &lt; 10 years</td>
<td>41</td>
<td>46.6%</td>
</tr>
<tr>
<td></td>
<td>11 &lt; duration &lt; 15 years</td>
<td>16</td>
<td>18.2%</td>
</tr>
<tr>
<td></td>
<td>&gt; 15 years</td>
<td>8</td>
<td>9.1%</td>
</tr>
<tr>
<td>5. Employee number</td>
<td>&lt;= 1</td>
<td>33</td>
<td>37.5%</td>
</tr>
<tr>
<td></td>
<td>1 &lt; number &lt; 3</td>
<td>40</td>
<td>45.5%</td>
</tr>
<tr>
<td></td>
<td>3 &lt; number &lt; 6</td>
<td>11</td>
<td>12.5%</td>
</tr>
<tr>
<td></td>
<td>&gt;= 6</td>
<td>4</td>
<td>4.5%</td>
</tr>
<tr>
<td>6. Professionals</td>
<td>Yes</td>
<td>13</td>
<td>14.8%</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>75</td>
<td>85.2%</td>
</tr>
<tr>
<td>7. Qualifications</td>
<td>Primary</td>
<td>16</td>
<td>18.2%</td>
</tr>
<tr>
<td></td>
<td>Secondary</td>
<td>31</td>
<td>35.2%</td>
</tr>
<tr>
<td></td>
<td>Tertiary</td>
<td>31</td>
<td>35.2%</td>
</tr>
<tr>
<td></td>
<td>None</td>
<td>10</td>
<td>11.4%</td>
</tr>
<tr>
<td>8. Business plan</td>
<td>Yes</td>
<td>15</td>
<td>17.0%</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>73</td>
<td>83.0%</td>
</tr>
<tr>
<td>9. Capital source</td>
<td>Personal savings(1)</td>
<td>1</td>
<td>1.1%</td>
</tr>
<tr>
<td></td>
<td>Family/ relatives(2)</td>
<td>2</td>
<td>5.7%</td>
</tr>
</tbody>
</table>
Financial institutions(3) & 3 & 11 & 12.6% \\ Friends(4) & 4 & 1 & 1.1% \\ Others(5) & 2 and 3 & 34 & 38.6% \\ & 1 and 3 & 26 & 29.5% \\ & 1, 2 and 3 & 5 & 5.7% \\ & 3 and 4 & 5 & 5.7% \\ \hline \textbf{10. Monthly turnover} & \textbf{(x)} & & \\ \textless 1,000,000 & 45 & 51.1% \\ 1,000,000 < x \leq 5,000,000 & 40 & 45.5% \\ 5,000,000 < x < 10,000,000 & 2 & 2.3% \\ >10,000,000 & 1 & 1.1% \\

Source: Primary data (2016)

4.3.1 Interpretation of general background information

Company type & Business Type

Consistent with the results in Table 2, the majority, 63 (71.6%) of the Retail SMEs were owned by sole proprietors; 16 (18.2%) were family-owned businesses and 6 (7%) were partnerships. Expectedly, zero private or public limited Retail SMEs were recorded in this study. This shows that the majority of small and medium establishments are exclusively owned either by individuals or families. It also suggests that sole proprietorships are the most popular kind of Retail SMEs in Rubaga, a fact that can be attributed to their modest start-up costs and the autonomy with which the owners operate these businesses. Sole proprietorship should then again justify why the largest share 26 (29.5%) of the surveyed Retail SMEs are general merchandise retail establishments dealing in processed foods and drinks, cosmetics, airtime and mobile money. A number of 23 (26.1%) other small businesses (cited as carpentries, barbershops/saloons, electrical stations), were also surveyed. The number of food
and cash crop retailing establishments, hardware and catering places/restaurants were more or less the same at an average of 9 (10.2%) apiece.

**Trading licenses**

<table>
<thead>
<tr>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

**Duration in business**

- <1 year (duration < 5 years)
- 1 year (duration < 10 years)
- 6 years (duration < 15 years)
- 11 years (duration > 15 years)

The results in the table further show that although a reasonable number of Retail SMEs surveyed had trading licenses, 41 (46.6%), the majority 47 (53.4%) of the Retail SMEs, did not have trading licenses. This is the case regardless of the fact that the majority of the Retail SMEs in Rubaga have been in operation for over a year. Particularly, those that had been in existence for a period of between 6 and 10 years were the commonest, 41 (46.6%), while a significant number, 21 (23.9%) had been in operation for a period of between 1 and 6 years. Likewise, there were several businesses that had been around for over 11 years and these made up 16 (18.2%) of the surveyed businesses. The lack of trading licenses was particularly a problem for the Kampala Capital City Authority Revenue Collection unit because license revenue is ancillary income that is not being collected to further uplift public service delivery within the city.
The results also indicate that at the time of the survey, the majority, 40 (45.5%), of the surveyed Retail SMEs in Rubaga employed between one and three employees while those with one employee were also several, at 37.5%. Only 4 (4.5%) of the surveyed Retail SMEs had a labour force of six or more employees. This distribution is assumedly associated to the fact that because of their small size, not many Retail SMEs can bankroll large wage bills since, as observed, close to 97% of these Retail SMEs record monthly turnovers of not more than Five million Shillings. This is so in spite of the majority (98%) having been in business for more than 1 year. That alone explains the largely truncated labour sizes. In fact, the structure of the SME labor force is such that the majority, 75 (85.2%), have no professionals in managerial positions, while less than 36% (31) proprietors interviewed had attained a qualification from a University or any other degree awarding institution.

### 4.4 Empirical results: Influencing factors of access to debt financing by retail SMEs

Primary data sources were used in this study. Therefore primary data was entirely used in testing the assumed relationships. Primary data was used owing to the fact that they best represented the perceptions of Loans’ officers, SME owners and employees. Invariably, perceptions representing challenges to debt finance access identified from the perspectives of retail business owners did not exist in form of secondary data but a generalization for the entire SME sector. Respondents for this study were therefore required to assign a discrete value to a preferred level of agreement (see Table 3). The structured questionnaire was
designed to measure four main variables and also to record the perspectives of the key informants.

In this section, descriptive statistics were presented before computing inferential statistics. The descriptive statistics presented were measures of central tendency (median), frequencies and percentages. The median rather than the mean or standard deviation was used to estimate the extent to which a variable was perceived as restrictive to credit access and therefore ensuing profitability. This is because as a general rule, mean and standard deviation are invalid parameters for descriptive statistics whenever data are on ordinal scales, as are any parametric analyses based on the normal distribution. “Nonparametric procedures, based on the rank, median or range, are appropriate for analyzing these data, as are distribution free methods such as tabulations, frequencies, contingency tables and chi-squared statistics” (Elaine and Seaman, 2007).

Table 3: Unmerged responses about the influencing factors of access to debt financing by retail SMEs

| Variable | strongly | | | strongly | |
|----------|----------|---|---|----------|
| INTEREST RATES | Agree | agree | neutral | disagree | disagree |
| q1 Interest rates in Uganda are very high | 5 | 4 | 3 | 2 | 1 |
| q2 The loan repayment period impacts access to credit and increases interest | 33 | 49 | 5 | 1 | 0 |
| q3 Fluctuation in interest rates affects access to credit | 14 | 53 | 18 | 3 | 0 |
| q4 Amount of interest paid on loan sways credit access | 11 | 48 | 17 | 11 | 1 |
| q5 Banks set their interest rates on the basis of the Central Bank Rate | 9 | 54 | 7 | 12 | 6 |
| q6 Interest rates should be uniform across banks | 15 | 61 | 5 | 6 | 1 |
| q7 Islamic banking will become more popular than commercial banking | 23 | 50 | 9 | 4 | 2 |
| q8 Islamic banking is better than Commercial banking | 27 | 53 | 3 | 3 | 2 |

| COLLATERAL/ SECURITY | |
|----------------------|---|---|---|---|---|
| c1 Collateral requirements are very stringent | 29 | 56 | 0 | 1 | 2 |
| c2 I have ever been denied credit because of collateral complications | 20 | 44 | 16 | 7 | 1 |
| c3 Collateral should be fronted as one of the main requirements | 14 | 58 | 7 | 7 | 2 |
| c4 Maximum credit accessible is dependent on collateral | 14 | 44 | 10 | 18 | 2 |
| c5 Collateral requirements discouraged my interest in accessing credit | 12 | 57 | 8 | 3 | 8 |

<p>| AGE OF SME | |
|------------------|---|---|---|---|---|
| a1 My business' age has ever been a contentious issue for credit access | 16 | 48 | 7 | 14 | 3 |
| a2 Poor/ no credit history of the SMEs is a credit access challenge | 32 | 31 | 14 | 10 | 1 |
| a3 Credit history determines credit worthiness | 43 | 31 | 6 | 7 | 1 |
| a4 A firm’s financial management experience can determine its credit access | 30 | 25 | 2 | 22 | 9 |</p>
<table>
<thead>
<tr>
<th>PROFITABILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>p1 Credit raises asset levels and productivity</td>
</tr>
<tr>
<td>p2 Credit greatly increases sales revenue and profits</td>
</tr>
<tr>
<td>p3 Credit improves market expansion rates</td>
</tr>
<tr>
<td>p4 Credit improves diversification ability and facilitates product development</td>
</tr>
</tbody>
</table>

### 4.4.1 Merged responses

In this section, responses for ‘strongly agree and agree’ were merged into one classification of ‘in agreement’ while responses for ‘disagree’ and ‘strongly disagree’ were merged into ‘in disagreement’. The results in the tables hereunder are based on the respondents’ attitudes and perceptions about the study questions as detailed in Table 3 above. The subsequent parentheses are, in principle, based on the results shown in the tables below.

#### 4.4.1.1 Interest rates and access to debt financing by retail SMEs

**Table 4: Summary of responses to interest rates’ assertions**

<table>
<thead>
<tr>
<th>Variable</th>
<th>In agreement</th>
<th>Neutral</th>
<th>In disagreement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INTEREST RATES</strong></td>
<td><strong>Median</strong></td>
<td><strong>Freq</strong></td>
<td><strong>%age</strong></td>
</tr>
<tr>
<td>Interest rates in Uganda are very high</td>
<td>5</td>
<td>82</td>
<td>93.2</td>
</tr>
<tr>
<td>The loan repayment period impacts access to credit and increases interest</td>
<td>4</td>
<td>67</td>
<td>76.1</td>
</tr>
<tr>
<td>Fluctuation in interest rates affects access to credit</td>
<td>4</td>
<td>59</td>
<td>67.0</td>
</tr>
<tr>
<td>Amount of interest paid on loan sways credit access</td>
<td>3.5</td>
<td>52</td>
<td>59.1</td>
</tr>
<tr>
<td>Banks set their interest rates on the basis of the Central Bank Rate</td>
<td>4</td>
<td>63</td>
<td>71.6</td>
</tr>
<tr>
<td>Interest rates should be uniform across banks</td>
<td>4</td>
<td>76</td>
<td>86.4</td>
</tr>
<tr>
<td>Islamic banking will become more popular than commercial banking</td>
<td>4</td>
<td>73</td>
<td>83.0</td>
</tr>
<tr>
<td>Islamic banking is better than Commercial banking</td>
<td>5</td>
<td>80</td>
<td>90.9</td>
</tr>
</tbody>
</table>
The merged findings are broadly consistent as per responses for the majority of issues raised in this section. Most respondents (93.2%, 82, and 5) indicated agreement with the idea that Interest rates in Uganda are very high. In fact, according to Bank of Uganda (2016), the average commercial bank rates for January and February 2016 were 24.29% and 25.22% respectively; which were way above the Bank rate of 17% in February 2016. Similarly, many respondents (86.4%, 76 and 4) supported the idea that interest rates should be uniform across banks although banks like DFCU and Stanbic were lending at 26% and 25% respectively in February 2016 (DFCU, 2016 and Stanbic Bank, 2016). Loans officers suggested that the very high cost of debt finance were justifiable because of the recent economic downturn, yet retail business owners argue that it is because of the macroeconomic instability that they cannot afford to borrow at high rates.

Likewise, an overwhelming majority, 90.9% (80 and 5) of the respondents were in agreement with the idea that Islamic Banking is a preferred form of banking to commercial banking. One key informant explains that Islamic banking is preferable by debtors because it does not involve loan repayment at an interest. In fact, when asked whether Islamic banking, a new form of banking that has just been introduced in Uganda, will eventually become more popular; respondents were mostly in agreement (83%, 73 and 4). In view of this, it is hoped by many business owners that one would be able to access credit to multiply their profits rather than register losses as a result of high loan repayment levels due to high interest rates. However, opinion seemed to be divided with regard to responses about the effect of amount of interest paid and its effect on credit accessibility (median=3.5, in agreement =59.1%, in disagreement=27.3%, neutrals=13.6%).

Although there was a significant number of neutrals (20.5%) for responses to the impact of the loan repayment period to credit access and interest payable, a significant 76.1% (67 and 4) were in agreement with the idea that the amount of time in which a loan has to be repaid affects one’s access to credit and availability of capital in the business; this manner of responding was the same for responses to the impact of fluctuations in the interest rates on credit access. Key informants were quick to point out that borrowers are slashed drastically when banks increase their lending rates while they tend to register high numbers of borrowers when lending rates are reduced. They said that high lending rates suggest that the borrowers will be paying back significantly higher interest which affects their business profits in the long run.
4.4.1.3 Age/ trading experience of the business and access to debt financing by retail SMEs

Table 6: Summary of responses to assertions of Age of the SME

<table>
<thead>
<tr>
<th>Variable</th>
<th>In agreement</th>
<th>neutral</th>
<th>In disagreement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median</td>
<td>Freq</td>
<td>%age</td>
</tr>
<tr>
<td>AGE OF SME</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>My business’ age has ever been a contentious issue for credit access</td>
<td>4</td>
<td>64</td>
<td>72.7</td>
</tr>
<tr>
<td>Poor/ no credit history of the SMEs is a credit access challenge</td>
<td>4</td>
<td>63</td>
<td>71.6</td>
</tr>
<tr>
<td>Credit history determines credit worthiness</td>
<td>4</td>
<td>74</td>
<td>84.1</td>
</tr>
<tr>
<td>A firm's financial management experience can determine its credit access</td>
<td>3.5</td>
<td>55</td>
<td>62.5</td>
</tr>
</tbody>
</table>

The results suggest that the age and the trading/ borrowing of the business are decisive factors when applying for credit from financial institutions. A significant 72.7% of the respondents (64, 4) indicated that age of the business had been a contentious issue fronted by the lending institutions. Key informants pointed out that a business that has been in operation for a longer period would have a higher chance of being provided with a loan compared to young businesses.

On the other hand, the majority of key informants supported the belief that a history of book-keeping competences, which highlight the fact that financial performance of the business significantly determines whether a business can be given a loan or not. This perhaps explains why 62.5% of the respondents seemed to believe that their firms’ financial management experience could determine their credit accessibility. Informants claimed that for many small businesses, as it is the case with big businesses, book-keeping adeptness is achievable if practiced regularly, in order that a trend in the performance can be drawn over time. Correspondingly, the majority (84.1%, 74 and 4) of SME owners seemed to believe that their credit history significantly affected their readiness to access credit from financial institutions. This was supported by the informants’ submission that ‘many banks as a matter of principle consider the lack of adequate information about the business, financial or otherwise, is the most pronounced limitation to their involvement with the SME segment.’
4.4.1.4 Debt financing and its impact on SME growth and Profitability

Table 7: Summary of responses to assertions of Profitability

<table>
<thead>
<tr>
<th>Variable</th>
<th>In agreement</th>
<th>neutral</th>
<th>In disagreement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median</td>
<td>Freq</td>
<td>% age</td>
</tr>
<tr>
<td><strong>PROFITABILITY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit raises asset levels and productivity</td>
<td>5</td>
<td>75</td>
<td>85.2</td>
</tr>
<tr>
<td>Credit greatly increases sales revenue and profits</td>
<td>5</td>
<td>69</td>
<td>78.4</td>
</tr>
<tr>
<td>Credit improves market expansion rates</td>
<td>4</td>
<td>65</td>
<td>73.9</td>
</tr>
<tr>
<td>Credit improves diversification ability and facilitates product development</td>
<td>4</td>
<td>64</td>
<td>72.7</td>
</tr>
</tbody>
</table>

The findings stress that as per the majority of the respondents, credit from financial institutions enhances the profitability of their establishments. It is envisaged from the table that on average, over 70% of the traders seemed to believe that credit raises asset levels and sales revenue, ability to expand and facilitates diversification. In particular, an overwhelming majority (85.2%, 75 and 5) were in agreement with the suggestion that credit raises asset levels and productivity while it was 78.4% (69, 5) in support of increased sales revenue as a result of credit financing. Correspondingly, 73.9% (65, 4) and 72.7% (64, 4) were in agreement with the view advanced that credit improves both expansion and diversification ability respectively. These results suggest that accessing credit is considered to be an important factor in augmenting the growth and profitability of Small and Medium Enterprises by retail SME owners. It is thought that credit augments income levels, enhances the ability to expand and diversify production lines and thereby further supplement growth and profitability.
Table 10: ANOVA table

ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>9.733</td>
<td>3</td>
<td>3.244</td>
<td>26.795</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>10.171</td>
<td>84</td>
<td>.121</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>19.904</td>
<td>87</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), age, collateral, interest rates
b. Dependent Variable: debt finance access

Source: SPSS output

The above table is an associated ANOVA test. This test is used to verify if the regression analysis is a better way of verifying the linear relationship between the factors and debt financing access by SMEs. This test is done at 5% significance level. From the table, the test is significant, F=26.795, p < .05.
CHAPTER FIVE

SUMMARY, DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
The study examined the influencing factors of debt financing access by retail SMEs in Rubaga, Kampala. The study specifically set out to: examine how interest rates, collateral requirements and age (trading experience) affect debt finance access by SMEs. This chapter presents the summary, discussion, conclusions and recommendations arising out of the study findings according to the objectives.

5.2 Summary of Findings
5.2.1 Interest rates and access to debt finance by SMEs
The study established that several SME owners perceive prime lending rates in Uganda as high. This is recognizable from the 93.2 of interviewees who indicated agreement with the affirmation that interest rates in Uganda are very high. Similarly, many respondents (86.4, 76 and 4) supported the idea that prime lending rates should be uniform across banks. Loans officers/ key informants suggested that the very high interest rates were justifiable because of the prevailing macroeconomic instability yet retail business owners argued that it is because of the instability that they could not afford to borrow at high rates.

Likewise, an overwhelming majority, 90.9 (80 and 5) of the respondents were in agreement with the proclamation that Islamic Banking is a preferred form of banking to commercial banking. This was attributed to the fact that Islamic banking does not involve loan repayment at an interest. In fact, when asked whether Islamic banking will eventually become more popular; respondents were mostly in agreement (83, 73 and 4). In view of this, it is was hoped by many business owners that one would be able to access credit to multiply their profits rather than register losses as a result of high loan repayment levels because of high interest payments. Although there was a significant number of neutrals (20.5) for responses to the impact of the loan repayment period to credit access and interest payable, a noteworthy 76.1 (67 and 4) were in agreement with the declaration that the amount of time in which a loan has to be repaid affects one's access to credit and availability of capital in the business. The hypothesis that; “low interest rates significantly boost the access to debt financing by
SMEs in Kampala” was accepted owing to the significant positive relationship between the two variables supported by $r = 0.601$ and $p$ value < 0.01. Likewise, interest rates together with collateral and age of the business accounted for 69.9% of the variation in debt financing access by SMEs. The study also revealed that a unit reduction in interest rates would improve their access to debt financing by 0.177 units.

5.2.2 Collateral requirements and access to debt finance by SMEs

The findings indicated that most respondents seemed to believe that collateral needs impact credit accessibility and growth/profitability levels because the likeliest response for many a respondent (median = 4) was either ‘strongly agree’ or ‘agree’. In effect when asked whether collateral requirements are very strict for many credit institutions, an overwhelming majority (96.6%, 85 and 5) were in agreement, while 81.8% (median=4, frequency =72) seemed to believe that despite the complexity of collateral needs, it was a realistic requirement for credit access. However, when asked if they had ever been discouraged from accessing credit because of the complexity of collateral needs, a significant 78.4% (median = 4, frequency = 69) were in agreement. Informants attributed this to the incapacity by small businesses to invest in sizeable assets such as land or automobiles that would enhance their access to credit. This in effect pointed to why 72.7% of the respondents acknowledged that they had been denied credit by financial institutions on the basis of collateral complications. In contrast, a number of respondents (22.7%, 20) were in disagreement with the belief that maximum credit accessible should be dependent on one’s collateral. Close to 65.9% of the respondents were however in agreement.

The hypothesis that, “Inflexible collateral requirements significantly affect debt financing access by SMEs in Kampala” was accepted in consequence of the significant positive relationship between the two variables supported by $r = 0.600$ and $p$ value < 0.01. Likewise, collateral along with interest rates and age of the business accounted for 69.9% of the variation in credit availability for SME recapitalization and the resultant profitability levels. The study also discovered that a unit relaxation in collateral requirements would raise their access to debt financing by 0.191 units.
5.2.3 Age (trading experience) of the business and access to debt finance by SMEs
The results indicated that the age and trading/borrowing experience of the business are major
determining factors when applying for credit from financial institutions. This was evident
from the 72.7% of the respondents who intimated to the research that age of the business had
been a contentious issue fronted by the lending institutions during the loan application
process. Likewise, positive responses (71.6%, 63 and 4) with regard to the fact that poor/ no
credit history affects credit availability to the prospective borrowers were recorded.
Moreover, the majority of key informants supported the belief that a history of bookkeeping
competences over their life cycle aid charting of SMEs’ financial performance and
significantly determine whether a business can be given a loan or not. This explained why
62.5% of the respondents seemed to believe that their firms' financial management
experience could determine their ability to access credit. Correspondingly, the majority
(84.1%, 74 and 4) of SME owners seemed to believe that their credit history significantly
affected their readiness to access credit from financial institutions. This was supported by the
informants' submission that 'many banks consider the lack of adequate information about the
business, financial or otherwise, the most pronounced impediment to their involvement with
the SME segment.

The hypothesis that, “Age and trading/borrowing experience of the business significantly
affect access to debt finance by SMEs in Kampala" was accepted on account of the
significant positive relationship between the two variables buoyed by $r = 0.644$ and $p$ value $<
0.01$. Equally, age alongside interest rates and age of the business accounted for 69.9% of the
variation in credit availability for SME recapitalization. The researcher also learned that a
unit increase in age and trading/borrowing experience of the business would raise its ability
to access debt finance by 0.274 units.
5.3 Discussion of Findings

5.3.1 Interests rates and access to debt finance by SMEs

The study determined that there is a significant positive relationship between interest rates and access to debt finance by SMEs. The interest rates levied by financial institutions to SMEs are high and unfavorable as they significantly increase the cost of borrowing. The respondents were overwhelmingly concerned with access to credit from financial institutions and willingness to pay the interest on the borrowed funds because it was the only alternative source of finance. This view is supported by Rosenberg (2008) who puts forward that SMEs are more concerned about access to financial services from financial institutions than the cost of money because they want to have business growth in making more profits and accumulate assets in the short term. The author established that the global average interest rate was about 35 per cent in 2008, yet the average in Mexico was above 60 per cent and in Sri Lanka it was below 20 per cent.

5.3.2 Collateral requirements and access to debt finance by SMEs

The researcher established that collateral requirements significantly affect access to credit from financial institutions. A significant positive relationship between collateral and access to debt finance by SMEs was revealed by this study. These findings suggest that a lack of collateral significantly dents any hope of getting a loan from formal lenders. This is a major challenge for small business owners since they largely operate with inadequate asset levels, comprising largely current assets rather than superior fixed assets that would be acceptable to lenders as security for their funds. It is also believed that even when small business owners are able to access credit, personal assets are attached as security. The attachment of private assets is not sustainable because, for instance, the large part of Africa has been experiencing an economic recession.

5.3.3 Age/ trading experience of the business and access to debt finance by SMEs

It was established that age and trading/borrowing experience of the business have a positive significant relationship with access to debt finance, indicating that age and trading/borrowing experience of the business is important in determining access to debt finance and its use for improving profitability and growing the business. For this study, age was used to include the trading experience of the firm. The positive relationship was expected since small firms are likely to seek debt financing in order to sustain or finance their growth and profitability. The
study also reveals that availability of trading and credit financial information for the business over its life cycle is important in determining access to debt finance as a tool for improving profitability and growing the business. This reduces the problem of information asymmetry in making financial information available to providers of debt finance and, as such, small firms are able to prove the quality of their projects. At the same time providers of debt finance have access to information at lower costs. This reduces loan administration and operation costs and allows SMEs to gain from the use of debt financing.

5.4 Conclusions
5.4.1 Interest rates and access to debt finance by SMEs
The study established that several retail SME owners perceive prime lending rates in Uganda as high with informants suggesting that the very high interest rates/costs of debt finance were justifiable because of the recent economic downturn. However, retail business owners argued that it is because of the economic downturn that they could not afford to borrow at high rates. Additionally, retail SME owners also believed that the amount of time in which a loan has to be repaid affects one's access to credit and availability of capital in the business. Moreover, from the results, Islamic Banking was a preferred form of banking to commercial banking because it does not involve interest rates. It is therefore apparent from this study that accessing credit is considered to be an important factor in swelling the profitability and augmenting the growth of Small and Medium Enterprises, yet the ease with which this is achieved is significantly affected by the high interest/prime lending rates.

5.4.2 Collateral requirements for credit acquisition and access to debt finance by SMEs
This study presupposes that although credit augments income levels and profitability of small businesses, it is only businesses that can easily meet the required collateral that profit from the credit. Collateral requirements have been cited as a major cause of financing problems by several retail SME owners interviewed. A significant positive relationship between collateral needs for debt finance and SME profitability was observed by this study. These findings suggest that a lack of collateral significantly dents any hope of getting a loan from lenders.
5.4.3 Age/trading experience of the business and access to debt finance by SMEs

According to this study, increase in age, trading history and credit experience along with improved information availability ease the business' access to credit. This in effect improves the business' risk bearing abilities, risk-copying strategies and consumption smoothing over time. The realization that age of the firm has a positive significant relationship with access to debt finance indicates that firm age is a major determinant of making alternative credit capital available to small businesses. This is supported by the realization that age/trading experience of the SMEs influences debt finance access (recapitalization for improving profitability) highly because a unit increase in age/trading experience improves debt finance available for SMEs by 0.274 units which is averagely 0.1 units higher than the collateral and interest rates' effect. The positive relationship also stems from the recognition that small firms seek debt financing in order to sustain or finance their growth and profitability drives. On the basis of these findings, it is imperative for small businesses to document their financial performance as they grow since this information is a basis for accessing credit from financial institutions.

5.5 Recommendations

SMEs, retail or wholesale, are vital to all economies and are a key source of economic growth in advanced industrialized countries as well as in emerging and low-resource economies. They should therefore be able to operate reliably in order to achieve profitability and sustainability in the long run. This study provides the following recommendations to the challenges faced by SMEs in accessing finances from financial institutions:

5.5.1 Interest rates and access to debt finance by SMEs

A necessary condition for the sustainable growth of the SME lending market in Uganda is the presence of a stable macroeconomic environment. The Bank rate which is dependent on the state of the economy is a major determinant of the prime lending rates adopted by financiers at a particular point in time. Bank of Uganda should as a priority strive to counter recession effects regularly. For instance, the government of Uganda needs not create unnecessary militarized standoffs with the public, especially in the capital city as they destabilize the economy of the country. Likewise, there is a need for commercial banks to promote transparency by regularly publishing bank charges and interest rates in the print media, as is done elsewhere in order to improve credit information sharing in Uganda. The banks should not be more interested in maintaining their dominance of certain market niches rather than
sharing information. This is likely to increase competition and thus ultimately reduce interest rates. Lastly, it is ideal for low-income earning SME owners to avoid trade credit since it can lead to high cash outflow of financial resources to the suppliers. However, strong macroeconomic performance and a stable fiscal and monetary framework that is consistent have to be sustained throughout the year.

5.5.2 Collateral requirements for debt acquisition and access to debt finance by SMEs
A better understanding of the SME segment and the implementation of measures aimed at addressing some of their intrinsic weaknesses should be a further policy priority. Efficiency of the courts and issues surrounding the definition of collateral, have been listed as important constraints to the development of the SME lending market. Therefore, the Government of Uganda should put in place a comprehensive national land policy to guide land usage and also to streamline land ownership. The current constitutional provisions have not adequately solved the historical conflict between mailo landlords and tenants, which has made tenants unable to use their land as collateral in banks because they have no land titles, the titles are with the mailo landlords who are the owners of the land.

5.5.3 Age/trading experience of the business and access to debt finance by SMEs
The realization that financial needs and options for small businesses change as they grow, gain further experience, and become less opaque in access to information, the study recommends that SMEs should endeavour to prepare and keep proper books of accounts to avoid deficit accounting. Commercial banks and micro finance institutions need to organize regular and comprehensive financial literacy programmes that target the operations of SMEs. Financial literacy programmes about the benefits of asset financing, hire purchase, the importance of financial cards, regular book-keeping and financial statement - analysis, among other credit products appropriate for the SME market, would be beneficial in that regard. These programmes should in principle enhance their ability to access debt finance and apply it suitably.
5.6 Limitations of the study
The researcher had a challenge of interviewing the respondents uninterrupted because of the informal nature of their businesses. Additionally, the localization of the study in one Kampala sub county stains the general picture painted by these findings; therefore the results of this research might not be representative of the entire SME sector of Uganda. Lastly, the researcher felt that some interview questions were somewhat complex and beyond the scope of a few respondents and this gave rise to several neutral responses.

5.7 Contributions of the study
The study in effect adds to literature on debt financing for SMEs in general and specifically for SMEs operating on retail basis in Uganda. The study re-affirmed that collateral requirements and high interest rates are constraints to accessing credit as perceived by owners of SMEs. Likewise, a number of weaknesses such as the lack of documented books of accounts and formalized credit history observed in their operations were viewed as prohibitive to SME operations which in turn affect their efficiency. This study also uncovered the fact that it is age/trading experience of the SMEs that influences access to debt finance more rather than collateral requirements and the level of market lending rates.

5.8 Recommendations for Further Research
The study recommends that further research on the financial lifecycle of small enterprises in Uganda; a longitudinal study on managerial competences and investment performance of small and medium-size enterprises; the use of information technology as a profitability increasing tool; budgetary control and performance in businesses, localized in Uganda, should be carried out.
REFERENCES


De la Torre, A., Martinez, M., & Schmukler, S. (2009). Drivers and Obstacles to Banking SMEs:


Frasch, R. (2013). Debt financing for your start up. June 12, 2013. Forbes, USA


Appendix: QUESTIONNAIRE

My name is KADDU EMMANUEL, a student at Makerere University. I am doing a study on factors influencing access to debt finance by SMEs in Kampala. Please answer objectively the questions below about your experiences on the research problem. The information provided will be treated with the highest degree of confidence, and at no point should you respond to a question you do not feel comfortable answering. When the questionnaire is completed, it should be submitted to the researcher. Thank you very much.

Researcher’s Signature……………………………Date……………………………………

Section A: General information of the company

1. Name of organization/Enterprise:…………………………………………………………

2. Nature of Organization. (Please tick as appropriate)
   a. Private Limited Company
   b. Public Limited Company
   c. Partnership
   d. Sole Proprietor
   e. Family Owned Business
   f. Others (please specify)…………………………………………………………………

3. Type of business. (Please tick as appropriate)
   a. Food and cash crops
   b. General Hardware and Construction materials
   c. Catering services/ restaurants
   d. Clothing & Shoes
   e. General merchandise for retail (processed foods and drinks, cosmetics, airtime and mobile money etc.)
   f. Others (please specify)
4. Do you have a trading license? Yes/ No

5. For how long has your company been in operations (please tick as appropriate)
   a. Less than one (1) year
   b. Between 1 and 5 years
   c. Between 6 and 10 years
   d. Between 11 and 15 years
   e. Over 15 years

6. How many people are employed by your company ………………………………

7. Do you have professionals in managerial positions in your company? Yes / No

8. What is the qualification of your management team (please tick as appropriate)
   a. Primary
   b. Secondary
   c. Tertiary
   d. Other (Specify)………………………………………………

9. Does your organization have an existing business plan? Yes / No

10. Source of Start-up Capital (please tick as appropriate)
    a. Personal Savings
    b. Family/ Relatives
    c. Credit from financial institutions
    d. Friends
    e. Others

11. What is the average monthly turnover of your business? (please tick as appropriate)
    a. Less than UGX 1,000,000
    b. Between UGX 1,000,000 and UGX 5,000,000
    c. Between UGX 5,000,000 and UGX 10,000,000
    d. Others (specify) UGX……………………………
SECTION B:

The following questions relate to the financing issues of your company: the difficulty in accessing credit and how it affects the financial performance/profitability of your business.

Please state if you agree or disagree to the following statements by ticking the appropriate box below.

[Scale: Strongly agree (5), Agree (4), Not sure (3), Disagree (2), strongly disagree (1)]

<table>
<thead>
<tr>
<th>INTEREST RATES AND THE BANK RATE EFFECT</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you agree that costs of debt finance/interest rates in Uganda are so high?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is it possible that the repayment period impacts access to credit?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fluctuation in cost of debt finance/interest rates affects access to credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount of interest paid on loan sways credit access</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do you believe that banks set their cost of debt finance/interest rates on the basis of the Central Bank Rate?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do you believe that cost of debt finance/interest rates should be uniform across all financial institutions?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will credit users eventually resort to Islamic Banking to avoid paying cost of debt finance/interest rates levied in financial institutions?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Based on your answer above, do you think that Islamic Banking is much better than commercial banking?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>COLLATERAL REQUIREMENTS</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Would you say the nature of collateral requirements demanded by banks is highly stringent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Have you ever been refused or denied credit from a bank because of insufficient collateral</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Should collateral be fronted as one of the main requirements for access to credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do you believe that the maximum credit you can access from the bank depends on the size of your collateral</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I have ever decided against getting credit from the bank because of strict collateral requirements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
AGE/ TRADING EXPERIENCE OF THE BUSINESS

<table>
<thead>
<tr>
<th>Proclamations</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have you ever been refused or denied credit from a bank based on how old your business is?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks and financial services specific outlook of profitability and credit history of the SMEs firm is a challenge to them in acquiring credit for the business</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit history determines credit worthiness</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inexperience on financial management and book keeping limits access to credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

GROWTH AND PROFITABILITY

<table>
<thead>
<tr>
<th>Proclamations</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>From experience and on the basis of how you have answered above, does access to credit in Uganda by SMEs improve asset levels and productivity?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do you believe that loans from banks would greatly increase sales revenue and profits of SMEs?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does credit boost a business’ market expansion, number of branches it operates?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does credit access boost ability of the business to diversify and develop new products?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Section C: Interview Guide (To be attempted by a Loans Officer)

This section is intended to collect methodical data about the research problem. I kindly request you to provide elaborate responses to the queries below;

What would you cite as the most challenging stage of the loan application process and why do you say so?

Explain

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________
What measures have financial institutions put in place to invite more SME owners to borrow from banks?

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

Has the government created an enabling environment for SMEs to access credit more easily?
What additional measures can the government take to enable SMEs easily access credit? Yes
{ } No { }
Explain

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________