THE EFFECT OF CREDIT FINANCING BY MICRO FINANCIAL INSTITUTIONS ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMES) IN UGANDA

CASE STUDY: SOROTI MUNICIPAL COUNCIL IN SOROTI DISTRICT

by

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DEDICATION

I dedicate this research report to my beloved husband John Diing Yuot, my parents Mr and Mrs David Alfred Esamij for their support and to my children; Christiana, and Timothy. Without forgetting my dear sister Rosette who showed me the way back to school. And my only Aunt Grace Ariko who encouraged and guided me throughout my study. May the Lord protect, guide and bless you all.

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I owe a vote of thanks to Uganda Martyrs University for shaping me intellectually confident and for providing the necessary requirements to enable me follow my academic career.

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LIST OF ABBREVIATIONS AND ACRONYMS.

BDC	**:**	Business Development Service
AMFIU	**:**	Association for Microfinance Institutions of Uganda
BOU	:	Bank of Uganda
CDO	**:**	Community Development Officer
MFI's	**:**	Microfinance Institutions
NGO	**:**	Non-Governmental Organization
UBOS	**:**	Uganda Bureau of Statistics
LDC	**:**	Low Developed Country
SMC	:	Soroti Municipal Council
SME	:	Small and Micro Enterprises
STECOS	:	Soroti Teacher Cooperative Society
MSME	:	Medium Small and Micro Enterprises
MFPED	**:**	Ministry of Finance Planning and Economic Development
UMU	**:**	Uganda Martyrs University

ABSTRACT

This study aimed at establishing the effect of Credit Financing on the performance of small and medium Enterprises (SMEs) in Soroti Municipality. The study was guided by two variables that is credit financing with dimensions of credit assessment, risk management and credit monitoring as the independent variable and performance of SMEs as the dependent variable was dimensions of profitability, sales volume and market share.

A stratified sampling method was used, the researcher used 127 respondents from different SMEs in Soroti Municipality.

The study used a case study design and used both qualitative and quantitative approaches, questionnaires were used to gather respondents' views.

The findings showed that credit financing positively affect the performance of SMEs in Soroti Municipality. And the researcher recommended that different small businesses should ensure that they carryout credit assessment, monitoring and risk assessment as they do the borrowing so as overcome challenges related to borrowing by SMEs.

CHAPTER ONE

GENERAL INTRODUCTION

1.0 Introduction

Credit financing for SMEs in developing countries is mainly limited to bank loans and trade credit (Organization for Economic Cooperation and Development, 2006). According to Rungani (2009) commercial banks are a principal source of debt finance for new SMEs. Commercial banks offer new SMEs a wide range of services in their own right or through wholly or partially owned subsidiaries. Commercial banks are in a better position to gather information on SMEs through established relationships which their staffs have with SMEs and their owners (Schayek, 2011). Thus, without financial intermediaries like banks it would simply be too costly for most investors to learn the information needed to provide the credit, and too costly for the small firm to get the credit services.

This research assessed the effect of Credit financing with more emphasis on credit assessment, risk management and credit monitoring and performance in terms of profitability, market share and sales volume. This chapter includes the background of the study, statement of the problem, general objective, specific objectives, research questions, Scope of the study, significance, justification of the study and definition of key terms and the conceptual framework of the study.

1.1 Background to the study

Microfinance services have become significantly important globally and more preferably at national levels in developing countries. A Microfinance institution (MFI) is an organization that provides financial services in terms of loans, funds at a given interest rates. For example the modern microfinance movement started in the 1970s when pilot programs in Bangladesh, Bolivia, and other countries began to provide small loans to groups of vulnerable women to invest in economic activities.

Globally Small and Medium-sized Enterprises (SMEs) are the backbone especially for European Union economy: they represent 99.8% of European Union companies, almost 60% of GDP (total value added) and near 70% of the total workforce (Deakins et al., 2010). To address this market failure, national and supranational governments and organizations in the European Union and USA have long adopted a variety of financial measures aimed at supporting SME finance including notably grants, direct lending, guarantee and counter-guarantee schemes, equity financing and support to securitization of SME loans (Berman and Héricourt, 2010). The use of Credit Schemes is particularly widespread, across both OECD and non-OECD economies, as a direct policy tool to alleviate SMEs' financial distress.

The number of small and medium enterprises is growing rapidly in East Africa (World Bank report, 2014). The SMEs sector accounts for 75% of the total employment in East Africa while contributing 18.4 percent of the Gross Domestic Product (Aghion, 2007). According to Watson (2011), the performance of the SMEs has continued to decline in Uganda. Virtually most small enterprises had collapsed leading to the closure of some of the SMEs that were producing 40% of the employment in East Africa. Other SMEs were auctioned while some were merged or acquired signifying questionable financial performance due to lack of proper management of debt acquired (Thrikawala, 2011). Generally, financial constraints remain a major challenge facing SMEs in East Africa this is because the SMEs have little access to finance, further access to finance is an important ingredient to developmental and eventual growth and performance of SMEs (Wanjohi and Mugure, 2008).

The performance of SMEs in Uganda is still below the expectation and this possesses a threat to the Ugandan economy since SMEs are great contributors to the GDP (Ernst and Young, 2011). Some suggestions are advanced for the SMEs under-performance such as poor access to finances and generally lack of strategic resources consistent (Degryse et al. 2010). SMEs managed by owners with little knowledge in business management could suffer from this predicament. Orobia et al. (2013) argued that firms could underperform due to inadequate resources and this could therefore be extended to SMEs financial performance. Moreover, Degryse et al, (2011) explains that performance trends in SMEs depends on efficient working capital as a major predictor of profitability and overall performance. Erasmus, (2010) stressed that credit financing determines the level of performance of SMEs. Akisimire (2010) stressed that access to credit finances and business development services are essential for growth, improved performance and development of SME.

1.2 The problem statement

Accessing finance has been identified as a key element for SMEs to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation. However, access to adequate credit for working capital and long-term investment purpose has been cited as one of the major constraints that SMEs face in their operations in Uganda and other developing countries (Reddy, 2011). Abafita, (2014) explained that 26 % of small scale businesses in Uganda reported lack of working capital as the most serious problem they face in their operations since accessing credit from lending is complex basing on the collateral needed as security for the loan. Agyeman, (2011) states that small scale firms in Soroti District experience great difficulty in attracting investment funds, which inhibits their ability to adopt modern methods of production. Without finance, SMEs cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms (Feakins, 2012). Therefore the constraint of credit access to SMEs was also identified as one of the challenges that SMEs have faced overtime not only in Soroti but the whole Uganda. The continuous complains that growth and competitiveness of SMEs are constrained by lack of access to enough financial resources exist in many parts of the world. This means that practices of SMEs have to change if they are to turn out better in terms of profits, attract financial assistance and create bigger supply and demand networks. The owners of SMEs will need to carry out financial record keeping, keeping of receipts and invoices in order to prove that SMEs have to capability to refund the credit offered to them. Therefore basing on the assessment, the studywas carried out in order to ascertain the role played by credit finances in areas of credit assessment, risk management and credit monitoring that can be used to ensure performance and growth of SMEs in Uganda.

1.3 Broad objective of the study

The study investigated the effect of credit financing by MFIs on performance of SMEs

1.3.1 Specific objectives of the study

1. To examine the effect of Credit Assessment on Performance of SMEs in Soroti Municipality

2. To examine the effect of Risk Management on Performance of SMEs in Soroti Municipality
3. To assess the effect of Credit Monitoring on Performance of SMEs in Soroti Municipality

1.4 Research questions

1) What is the effect of credit assessment on profitability of SMEs in Soroti Municipality?
2) What is the relationship between risk management and market share of SMEs in Soroti Municipality?
3) What is the impact of credit monitoring on sales volume of SMEs in Soroti Municipality?

1.5 Scope of the study

1.5.1 Geographical scope

The study was carried out on SMEs in Soroti Municipality in Soroti District. This area was selected because businesses are flourishing yet most of the businesses depend on borrowed funds from a number of MFIs like pride, STECOS.

1.5.2 Content scope

This study was guided by credit financing as the independent variable and Performance of SMEs as dependent variable. In the study more emphasis was put on credit financing with dimensions of Risk management, credit assessment and credit monitoring in respect to performance of SMEs in line with profitability, market share and sales volume.

1.5.3 Time scope

The study focused on information relating to the period from 2012-2017 since most businesses use credit to finance their ventures and above that economy is not performing well since most people are unemployed. This period is sufficient since economic factors keep changing and interest rates are high and thus SMEs have to come up with challenges of credit finance.

1.6 Significance of the study

The study benefited the owners and management of the chosen SMEs on a side of credit financing with emphasis on Risk management, credit assessment and credit monitoring areas to ensure that these enterprises can actually be profitable and be able to perform better.

The research also benefited new business people or entrepreneurs with the essential knowledge of financial management especially in areas of Risk management, credit assessment and credit monitoring

The researcher herself was in position to generate more knowledge in the field of credit financing using this study as an opportunity.

1.7 Justification of the study

Despite the increasing importance attached to small scale economic activities across the globe, little has been reported on performance improvement in the credit financing of SMEs especially in Soroti Municipality. The research seek to know whether Risk management, credit assessment and credit monitoring address help businesses to get financial needs and whether those borrowed funds are put to best use

The study set out to find out how assessment is done to prevent credit risk and how management of SMEs ensures that the credit granted is put to right use in order to repay the credit interest in time.

1.8 Definition of key terms

SMEs: these are non-subsidiary, independent firms which employ few employees between 30 to 50 and with capital of less than one hundred millions.

Credit financing: This is use of borrowed funds to run and manage business operations.

Credit assessment: This means the evaluation of the possible credit risks knowing the significance and effects

Risk management: forecasting and evaluation of financial risks together with the identification of procedures to avoid or minimize their impact

Credit Monitoring: The way credit risk is monitored and reviewed for effective management

Profitability: a business' ability to generate earnings as compared to its expenses and other relevant costs incurred during a specific period of time.

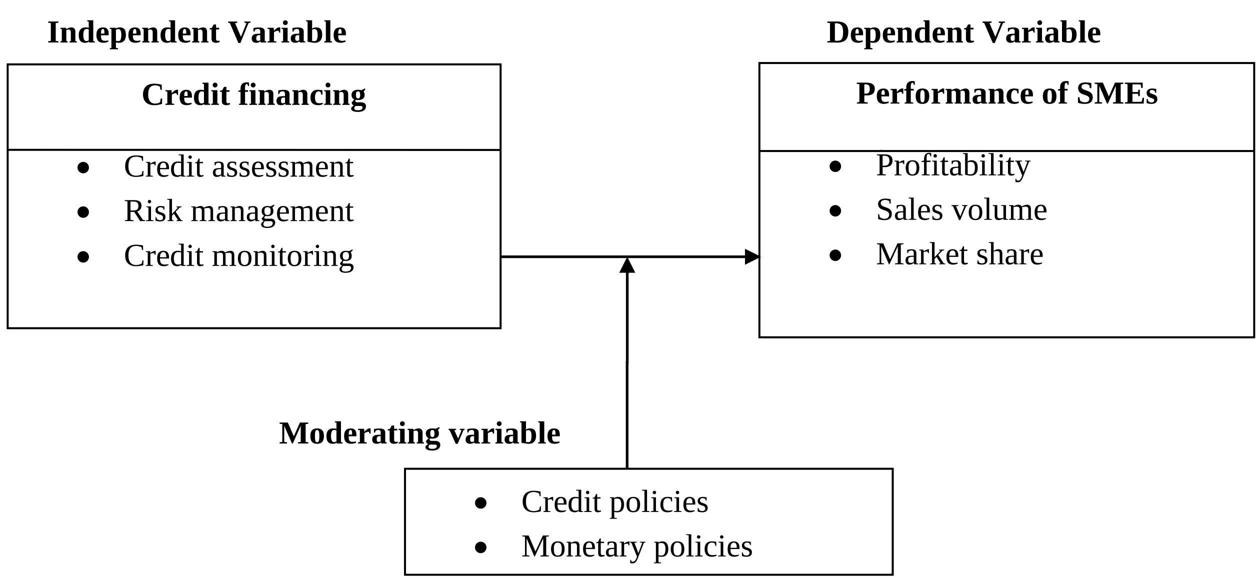
Sales volume: The amount of money that a business gets from its sales during a particular period.

Microfinance: A type of banking service that is provided to unemployed or low income individuals or groups who would otherwise have no other means of gaining financial services. Ultimately, the goal of microfinance is to give low income people an opportunity to become self-sufficient by providing a means of saving money, borrowing money and insurance.

1.9 Conceptual framework

Credit financing is an essential part of the economic and non-economic activities which help an organization to decide about the efficient procurement and utilization of finance in a cost effective manner (Subramanian and Paramasuvan, 2009). Turyahebwa et al, (2013), credit financing among SMEs is defined in terms of observed variables which include; Risk management, credit assessment and credit monitoring. Performance of SMEs focuses on the ability of business to meet the required standards, increased market, share sales turnover, improved facilities, ensuring profitability, and total cost reduction; once this is achieved, a business is believed to be performing effectively and efficiently (Fitzgerald et al 2006). However this relationship is affected by credit policies and interest rates

Figure 1.0 Conceptual frame work



Source: (*Onaolapo 2012***;** *Bidani et al, 2004) and modified by researcher (2017)*

Fig 1.0 above describes the linkage between credit financing with its dimensions which are; credit assessment, risk management and credit monitoring and their ripple effects on the business performance of SMEs in terms of profitability, turnover and market share. The relationship is affected by credit policies about credit offerings and interest rates.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter covers the empirical literature on credit finance and their relevance to performance of SMEs. The chapter reviews literature from other scholars on the aspect of credit risk, credit assessment and credit monitoring. The chapter covers the theoretical review about the liquidity theory of credit and reviews the objectives under the conceptual framework.

2.1 Theoretical review

2.1.1 Liquidity Theory of Credit

This theory was suggested by Emery (1984), it proposes that credit rationed firms use more trade credit than those with normal access to financial institutions. The central point of this idea is that when a firm is financially constrained the offer of trade credit can make up for the reduction of the credit offer from financial institutions. In accordance with this view, those firms presenting good liquidity or better access to capital markets can finance those that are credit rationed. Several approaches have tried to obtain empirical evidence in order to support this assumption. For example, Nielsen (2002), explained that when there is a monetary contraction, small firms react by increasing the amount of trade credit accepted. As financially unconstrained firms are less likely to demand trade credit and more prone to offer it, a negative relation between a buyer's access to other sources of financing and trade credit use is expected.

Shrbini (2009) critiqued the theory by stating that the theory works well in the short run since Keynes assumed that levels remain constant yet in the long run, income levels change.

It’s impossible to have a stable equilibrium interest rate without reaching the equilibrium level of income, savings and investment. Shrbini (2009) further stressed that liquidity theory considers the supply and demand for money whereas businesses, consumers and government demand for credit cleanly have an impact upon the cost of credit to the borrowers. JaTeline (2010) adds that there is no liquidity without saving which contradict the Keynes theory where it states that interest is rewarded to existence of liquidity. This means that the liquidity theory is important to consider when businesses are using credits. However, business owners should consider other option to finance their business operations without over relying on credit.

2.2 Actual Review

2.2.1 Credit assessment and performance of SMEs

The assessment of credit risk must be correct in order for the SMEs to produce results which would help in reducing capital requirement (Ayodele, 2014). The purpose of an assessment is to solicit enough information about the applicant in order to determine willingness and capability to serve the loan if granted in accordance with the term of the loan agreement (Basel, 2010). This enables leading institutions to determine the degree of risk they are willing to assume and the amount of credit that can prudently be expected, given the risk involved and the term and condition for granting the loan (Abafita, 2014). Basel (2010) stressed that the aspects to be focused on during the assessment include: purpose of the client, need genuineness, repayment capacity of the borrower, quantum of loan and security. This implies that for lending institutions to avoid financial loss, management has to assess SMEs owners who apply for loan to determine their credit worthiness.

Credit assessment plays an important role to keep the loan losses to minimum level, hence if loan officers appointed for loan appraisal are competent then there would be high chances of lending money to non-deserving customers (Boldizzoni, 2008).The aim of financial institution loan process assessment is to minimize the credit risk since these risks emerge in all cases as a result of the bank's loan approval or issuance of the credit instrument, such as a guarantee or a letter of credit, on the client's behalf (Petrovic and Davidovic, 2011). A credit assessment criterion help management get the relevant information to make its experienced judgments about the credit quality of the loan portfolio and provides the foundation upon which loan losses or provisioning methodology is built (Walsh, 2011). Ayodele, (2014) assert that establishing an effective assessment would help owners of SMEs to monitor the credit portfolio since the loan repayment period given is enough to pay back the loan.

There are no risk-free loans and therefore the risk simply means the possibility that the SME owners, who take the loan or requires the bank to issue a letter of credit/guarantee on their behalf, will not be capable to fulfill the commitments to the bank within the due dates on the basis of the principal repayment and payment of installments/fees (Christen and .Pearse, 2013). Through assessment, business owners get enough information about the loan before borrowing which helps them reassess whether they can meet the policy accordingly before encountering any major setback (Onaolapo, 2012). The credit policy should explicitly provide procedural guideline and making sure that the Interest charged on the loan is affordable and can easily be paid by business owners without affecting their businesses (Onaolapo, 2012). Credit analysis is geared toward generating profitable loan that do not expose the lender to excessive amount of risk (Ivanović, 2008). The reason for the acceptance or reject decision of a credit should be clearly documented and the decision should be in accordance with a lending institution stated loan policy.

Credit assessments comprise those decision-making structures associated with the reduction of exposures to credit asset classification and loan loss provisioning. According to Nancy (2001), assessment of risk relates to the minimization of the potential that a borrower will fail to meet its obligations in accordance with agreed terms. This implies that before SME owners access loans, they are assessed to prevent loss due to defaults. According to Jones (2002), prudential credit assessment is about managing risk by designing an investment portfolio that is highly diversified and exposed to risks associated with higher expected returns. In other words, prudent investors only take on an amount of risk they feel is appropriate for them, and try to limit their exposure to those risk factors for which there is not a reasonable expectation of higher returns. Prudential credit assessment is about structuring an investment strategy that is right for the investor, not one that reflects what an advisor is trying to sell, or what will earn the advisor the most fees and commissions.

Credit assessment should be designed to match each client's appetite for risk, while helping SME owners reach their financial goals with broad diversification and excellent personal service (Richard, 2014). It is believed that investors and their advisors should follow the six (6) elements of prudent financial advice namely, recognize that markets work, manage investment risk, focus on education, elevate fiduciary responsibility, retain transparency and integrity and, maintain investment principles (Ahmed, 2002).The creditworthiness assessment of borrowers should involve the gathering, processing and analyzing of information on the loan applicant (Feder and Just, 2011). The most reliable way of gathering information is by way of credit references and credit rating but Uganda is yet to have credit rating agencies, which will provide opinion on the credit standing of individuals and businesses in the system. Loan officers should have adequate knowledge about the borrowers business in order to determine the credit worthiness of the borrower.

2.2.2 Risk management and performance of SMEs

Risk management techniques is a practice undertaken by a lending institution in identification, assessment, and prioritization of risks as the effect of uncertainty on objectives, whether positive or negative followed by coordinated and economical application of resources to minimize, monitor, and control the probability or impact of unfortunate events or to maximize the realization of opportunities (Lewis, 2012). Methods for treating risks Traditional risk management techniques for handling event risks include risk retention, contractual or noninsurance risk transfer, risk control, risk avoidance, and insurance transfer. Other techniques used for other types of risk for example credit, operational; interest rate risks include financial tools such as hedges, swaps, and derivatives (Fatemi and Glaum, 2000). Risk management framework is important for SMEs if they are to avoid loan loss due to investment in less risk investments.

Risk management is an intuitive management skill that is expected of all business managers and financial institutions at large. The SME owners have an overview of operations, manages the loans and has to ensure that the business is profitable (Jha and Hui., 2012). Bennet,(2009)noted that risk management processes; require SME owners to be satisfied that the financial institutions has in place a comprehensive risk management process. SME owners need to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile (Agyeman, 2011). The risks are managed through observing variances in various operating metrics and there after combine it with experience and judgment the measures with losses and near misses. Lewis, (2012) explained that to reduce risks, SME owners have to develop risk management strategies which are effective if defaults are to be reduced.

As such, risk-management approaches by a firm are relevant in the sense that they are able to add value (Saunders and Cornett, 2010). Risk management activities increase the market price of business market shares. Approaching financial risks, such as market, credit, and operational uncertainties, in a professional manner is becoming increasingly important (Rose, 2010). Market swings, interest-rate volatility, loan defaults, falsified data in company reports, and fraud have not only led to financial losses but also tarnished reputations of SMEs (Reta, 2011). It has emerged that businesses strive to improve and sustain financial performance hence needs for risk management techniques to mitigate financial losses and improve financial performance (Pausenberger and Nassauer, 2000). This implies SMEs can perform better if risk management is taken into consideration since it helps to reduce financial loss.

Akakpo (2010) noted that being involved in the intermediation process, risk management is as important to the financial institutions since SME owners can strive to invest in business in order to get returns. Lending is a risky business and several risk factors such as credit, liquidity, operational and market risks have been identified as critical to ensure that the credit union position remain intact amidst the intense competition in the financial industry(Jansson, 2008). The survival and success of a financial organization depends critically on the efficiency of managing these risks (Carey, 2001). More importantly, efficient risk management is highly relevant in providing better returns to the shareholders (Lewis, 2012). In addition, prudent risk management by SME owners is the hallmark to avoid financial distress that could lead to a full blown financial crisis.

According to Richardson (2012), the importance of risk management is increasing with time because of some reasons like economic crises and stagnation, company bankruptcies, infraction of rules in company accounting and audits, growth of off-balance sheet derivatives, declining and volatile values of collateral, borrowing more easily for the small firms, financial globalization and business risk-based capital requirements. These findings are consistent with Mwirigi (2006) who found that the most important risk that credit institutions face was credit, financial and liquidity risk followed by interest rate risk and technological risk and that these risks were managed using swaps, futures, forwards and options. Therefore if risk management is effectively taken into consideration, SMEs will prevent running bankrupt due to financial distress.

2.2.3 Credit monitoring and performance of SMEs

Credit monitoring refers to measures to; ensure that the bank understands the current financial condition of the borrower or counterparty; ensure that all credit are in compliance with the existing covenant; follow the use customer make of approved credit lines; ensure that projected cash flows on major credits meet debt servicing requirements; ensure that where applicable, collateral provides adequate coverage relative (Seppala, 2000). Many of the agonies and frustrations of slow and distresses credits can be avoided by good loan supervision. The credit monitoring process criteria's like on site visit, regular contact with SME owner as well as checking for compliance with covenants in the loan agreements (Baesens, 2009). Montana (2012) stressed that debt recovery is assuming an alarming trend as its growth is looking almost unstoppable. Financial institutions are individually devising new techniques and strategies to improve their debt monitoring to ensure that loan are used for the right purpose by SME owners.

Irrespective of how monitoring accountabilities are assigned, if they are not underpinned by a consistent and replicable cross-enterprise risk exposure measurement frame work that provides for the consolidation and aggression of risk exposures, the business environment are futile (Brancato et al, 2006).Baesens (2009) assert that financial institutions should establish an adequate system for monitoring and reporting risk exposures of SMEs and the impact of risk profile to reduce non-performing loans. Gestel and Baesen (2009) noted that the credit risk management has to be organized such that the risk profile and capital needs of SME owners are regularly monitored and reported to the senior management and board of directors to evaluate the level and sensitivity of the credit risk and be able to determine the sufficient capital held against the risk and there after assess the future capital requirements so as to make adjustments to the bank's strategic plan where necessary. This means that monitoring of credit determines the level of credit risks SME owners will have to expect if business activities are well monitored.

Richardson (2012) suggested that supervisors should require that SME owners have an effective system in place to identify, measure, monitor and control credit risk to ensure funds are used in accordance to the purpose. Sinkey, (2011) further advised business owners should be aware about the credit monitoring policy the bank uses in granting of the credit and the ongoing management of the portfolio. Additionally, supervisors should consider setting prudential limits to curb institution exposures to single borrowers or groups of connected counter-parties. Gestel and Baesen (2009) explained that the owners of SMEs should endorse credit monitoring policies to help in monitoring credits if they are to reduce credit loss. Businesses have to follow the sound credit management criteria of the bank if they are to get credit facilities (Rahman et al, 2006). This reduces moral hazard in the granting process and ensures that credit facilities are used for intended purpose.

Using ongoing monitoring as the basis for assessing the performance of controls is consistent with a management-centric approach. The issue is not whether or not to rely on ongoing monitoring, because owners of SMEs should be able to do so; it is how to make ongoing monitoring sufficiently rigorous that it can become the basis of assessing internal control performance of commercial banks (Schwatz, 2007).Reuvid (2010) further encouraged regular credit checks for owners of SMEs and make this a regular review. Chijoriga, (2007) adds that supervisors may decide to monitor a few SME owners that way lending institutions have an effective time frame to know if customer is in trouble and help control potential bad debt and fraud. This implies that monitoring helps in reducing uncertainty and loss if business owners invest in right projects which have absolute returns.

Reuvid (2010) emphasizes record keeping, keeping a log of the calls made: who you spoke to, what was stated and when for proper monitoring of business flow. SMEs can also log the customer's payment dates on their systems and always get the details of the person in charge of the accounts team, so that if they have concerns about payment issues they can contact them directly. Owners of SMEs should also instruct their credit controllers to write a monthly cash-flow forecast, stating when in the month payments will be received, and, if not received, get them to chase immediately. Owners of SMEs should be direct in asking why the payments have not arrived; after all it is their money. Richardson (2012) noted that this mitigates the risk of the credit facility not achieving the intended purpose and generating sufficient cash flows to service the facility as well as liquidate the principal amount.

2.3 Performance of SMEs

Parrenas (2005), defines performance measurement as a way of ensuring that resources available are used in the most efficient and effective way. The essence is to provide for the organization the maximum return on the capital employed in the business. Financial performance for SMEs is very important because managers need to know how well the SMEs are performing. There are two major reasons for SMEs to have financial performance measurement and the first one is to produce financial statements at the right time and the second one is that, financial statements should be analyzed to produce information about the performance of the scheme, which must be used to improve performance (Johnson and Rogely, 2007). This implies that owners of SMEs have to prepare timely reports and that is only possible if financial statements are prepared.

SMEs performance may be measured using objective, subjective, or operational measures (Schayek, 2011). Richard et al (2008) suggest the goal approach as a composite measure of SME performance. The goal approach measures performance using financial objective and non-financial measures subjective measures. Financial measures of performance can be referred to as the results of a firm's operations in monetary terms (Business Directory 2011). Financial measures of performance are derived from the accounts of a firm or can be found in SMEs profit and loss statement or the balance sheet. Cooke and Uchida (2204) suggest that the return on assets provides information about how much profits are generated, on average, by each unit of the assets of the firm (Petersen and Schoeman, 2008).

Delmar et al (2003) suggest that if there is one measure of SME performance that could be used then it has to be sales growth. Schayek (2011) argues that most SME owners/managers are very sensitive about disclosing information relating to their firm's performance. In addition Watson (2007) suggests that because most SMEs are not required to report and publish their financial records, it is difficult to obtain, directly, the financial figures on sales and profitability of most SMEs. A similar technique is used by Sawyerr*et al.* (2003) Thrikawala (2011) and Watson (2011). This approach is implemented as it avoids the direct approach of asking for sales or profitability figures but infers the performance, indirectly, through the responses on the level of satisfaction with sales and profitability growth of the firm. However, it is important to note that sales and profitability growth should not be viewed in isolation as profits and sales may increase as a result of some underlying factor such as price increases or sales promotions, respectively, and not due to the improved performance of the firm or its products.

2.3.1 Profitability

Profitability is the ability of a business to use its resources to generate revenue in excess of its expenses (Business Directory 2011). Financial measures of performance are derived from the accounts of a firm or can be found in the firm's profit and loss statement or the balance sheet. Financial measures are also referred to as objective measures because they can be individually measured and verified (Kellen, 2003). Cooke and Uchida (2004) suggest that the return on assets (ROA) is used as a vital measure of profitability. The ROA provides information about how much profits are generated, on average, by each unit of the assets of the firm (Petersen and Schoeman, 2008). In addition, Petersen and Schoeman (2008) note that ROA can be measured suing the equation. ROE relates the earnings left over for equity investors after debt service costs have been factored into the equity invested in the firm (Damoradan, 2007). The equation used to measure ROE can be represented as: Profitability Growth: This is the growth in the profits of a firm. Profitability growth can also refer to the continuous increase in the financial profit after all expenses have been paid over a given period on time (Business Dictionary, 2011). Damoradan, (2007) stressed that an increase in the profitability of a firm achieves the measure of performance as it shows that the firm is continuously improving.

There are two important concepts that figure in Bank decision that is economic profits and accounting profits (Dwivedi, 2008). In accounting sense profitability in the bank means the surplus of revenue over and above all point out costs including both manufacturing and overhead expenses (Pandey 2010). On the other hand, profitability accounting to economists takes into account the implicit or imputed cost; the implicit cost is the opportunity cost. Opportunity cost is defined as the payment that would be necessary to draw forth the factors of production from their most remunerative alternative employment. That is opportunity cost is income foregone which a businessman could expect from the second best alternative use of his resources. Profitability represents the ability to provide a reasonable and adequate return on capital employed which shows that business profits are increasing (Pandey 2010).

Wali (2010) found that inconclusive relationship between E-banking and the profitability of banks. However, Isizoh*et al*. (2012) further found a positive relationship between E-banking and profitability. Milne, (2006) supported this view when he stated that modernization of E-banking has set the stage for extraordinary improvement in banking procedure throughout the world. Frank and Oluwafemi (2012) revealed that credit brings down the operational costs of the banks and that Internet technology facilitates and speed up banks procedures to accomplish standardized and low value added transactions. Ugwuanyi (2013) suggests that SME expenditure has a negative relationship with banks profitability due to the fact that investment in SME increases expenditure as well as increases assets thereby reducing operating profits as well as return on assets (ROA).

2.3.2 Sales volume

Sales in business terms are the actual sales in money values, a company receives after necessary collections are made from different sales channels of the original total production put on the market (Young, 2005). It is sales that stimulate production in a company and consequently profits which are affected by various factors some of which are controllable like quality and others are uncontrollable like competition and general price changes. Sales volume also refers to the total amount of firm’s output sold to the market especially on monthly or annual basis. This is affected by many factors including customer relationship, marketing management of the firm and sales force skills and motivation and even the pricing of the goods and services (Amanda, 2002).

Having a sales strategy enables organizations to plan and model sales strategies and ensure timely execution of sales initiatives while ensuring both front line sales people and decisions-makers have visibility made decision about the amount of sales and this represents the next generation of best practices for sales (Michael, 2006). Sales revenue is the total amount of money that the firm gets from the sale of all its goods and services in a given period of time. This is usually six months or a year if a firm produced only one product or service, the sales revenue will be the price of the product multiplied by the number of products sold. In the case of more than one product or service the revenue from each needs to be added together to determine that the amount of output sold has increased ((Kotler, 2005). The figure for sales revenue in profit and loss account does not necessarily mean that the firm has received all the money because although they may have sold that quantity of the product, they may still be owed some of the money as debtors (Baker 2001).

Companies have to be flexible and change with the changing environment and different consumer needs so as to be able to offer consumers what they need, when they need it (Meshach (2007). An effective sales process produces sales results with unerring precision as a manufacturing unit produces finished products, it should therefore be evaluated to gauge performance of both the staff and organization in order to determine whether the market for products has widened (Kingsley, 2012). Thus considers constant monitoring and supervision of organizational activities. A sales process can be viewed as an integrated method where man power refers to the sales force, the product or service is the raw material, strategy refers to sales plans and methods, and technology refers to the latest communication and sales technologies (Kotler, 2009).

2.3.3 Market share

Market share is said to be a key indicator of bank's competitiveness against competitors. This metric, supplemented by changes in sales revenue, helps managers evaluate both primary and selective demand in their market. That is, it enables them to judge not only total market growth or decline but also trends in customers' selections among competitors (David and Reibstin, 2010). Generally, sales growth resulting from primary demand is less costly and more profitable than that achieved by capturing share from competitors. Conversely, losses in market share can signal serious long-term problems that require strategic adjustments. Firms with market shares below a certain level may not be viable. Similarly, within a bank's product line, market share trends for individual products are considered early indicators of future opportunities or problems (David and Reibstin, 2010).

The market size for business products increases upon as product sales more products to ensure that business attain the profit objective (Kesten, 2010). The mentioned usage of market share as a basis for gauging the performance of competing firms has fostered a system in which firms make decisions with regard to their operation with careful consideration of the impact of each decision on the market share of their competitors. It is generally necessary to commission market researchto determine. Sometimes, though, one can use primary research to estimate the total market size and a company's market share include some of the construction (David and Reibstin, 2010). Market share can be decomposed into three components, namely: penetration share, share of customer, and usage index. These three underlying metrics can then be used to help the brand identify market share growth opportunities. With the preliminaries the managers are now in a position to explore further the relationship of a firm's market shares with its marketing activities.

For the time being managers shall assume that a relevant industry is defined and industry sales are measured.

2.4 Challenges faced by Small and Medium Enterprises

During the opening of the 5th Session of the 7th Uganda Parliament on June 7, 2005 the President of Uganda informed the Nation that the industrial growth rate in Uganda has averaged at 10.2 percent p.a. since 1986 and the industrial sector employed 3.3 million people by 2004. That small and medium enterprises (SMEs) have registered a 10 percent growth in the last five years and created 150,000 jobs per annum while large-scale industries add 20,000 jobs p.a. That the cooperative societies have been revived and to date employ up to 80,000 people. However, that 300,000 people join the job market every year. Therefore this was introducing “Bonna Bagaggawale” (all get rich or prosperity for all) Programme to enable each household earn at least UShs 20 million per annum through training in modern agro practices, establishment of agro production export villages, among others. The focus here should be on startups and small scale enterprise development The institutional framework within which firms, in this case SMEs, interact with MFIs, government, NGOs and other service providers, and each other, can have a profound influence on a SMEs economic and noneconomic performance. Mnenwa and Maliti (2009) report that education, motivation, sources of initial capital and technology are some of the socio-economic factors that have a positive influence on profit margins and employment creation. The potential and ability of small businesses to contribute to poverty reduction objectives are largely vested in the capacity of the SME institutions to provide the needed education, incentives, employment and capital.

Babajide (2007) argued that MFIs can offer their clients who are mostly the men and women who could be below or slightly above the poverty line a variety of products and services. The most prominent of their services is financial. This they often render to their clients without tangible assets as collateral security. These clients mostly live in the rural areas and a majority of whom are illiterate. Formal financial institutions do not often provide these services to small informal businesses run by the poor as profitable investments. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral (farms) due to distance. It is by this that the cost to lend a dollar will be very high and also there is no tangible security for the loan. The high lending cost is explained by the transaction cost theory. The transaction cost can be conceptualized as a non-financial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan. The cost incurred by the lender include; cost of searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinizing loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts.

On the other hand, the borrowers may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings (Christabell, 2009). The parties involved have the sole responsibility to reduce the risk they may come across. Microfinance comprise of financial sustainability, outreach to the poor, and institutional impact in a triangular manner.

There are costs to be incurred when reaching out to the poor and most especially with small loans. The financial institutions always try to keep this cost as minimum as possible and when the poor are in a dispersed and vast geographical area, the cost of outreach increases. The provision of financial services to the poor is expensive and as argued by Adam and Pischke (1992) making financial institutions sustainable requires patience and attention to avoid excessive cost and risks.

The deliveries of MFIs products and services have transaction cost consequences in order to have greater outreach. Some microfinance institutions visit their clients instead of them to come to the institution thereby reducing the cost that clients may suffer from For MFIs to be sustainable, it is important for them to have break-even interest rates. This interest rates need to be much higher so that the financial institution’s revenue can cover the total expenditure (Hulme and Mosley, 1996). Moreover, the break-even rate which is higher than the market rate is defined as the difference between the cost of supply and the cost of demand of the products and services. The loan interest rates are often subsidized (Robinson, 2003). He further notes that loans demanded by smaller enterprises are smaller than those requested by larger ones but the interest rates remain the same. This indicates that, per unit cost is high for MFIs targeting customers with very small loans and possessing small savings accounts. Even though the interest rate is high for applicants requesting very small loans, they are able to repay and even seek repeatedly for new loans. The social benefits that are gained by clients of MFIs supersede the high interest charged (Rosenberg, 1996). The high interest rate is also as a means to tackle the problem of adverse selection where a choice is made between risky and non-risky projects. This implies that the good clients suffer at the expense of the bad ones as noted by Babajide (2007).

Low-income men and women have a serious hindrance in gaining access to finance from formal financial institutions. Ordinary financial intermediation is not more often than not enough to help them participate, and therefore MFIs have to adopt tools to bridge the gaps created by poverty, gender, illiteracy and remoteness. The clients also need to be trained so as to have the skills for specific production and business management as well as better access to markets so as to make profitable use of the financial resource they receive (Bennett, 1994). In providing effective financial services to the poor requires social intermediation. The author argues that it is "the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals". Some microfinance institutions provide services such as skills training, marketing, bookkeeping, and production to develop enterprises. Social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly. This implies that the services provided to microfinance clients can be categorized into four major different categories: Financial intermediation, Social intermediation, Enterprise development services and Social services.

Accessing credit is considered to be an important factor in increasing the growth of Small and Medium Enterprises. It is thought that credit augment income levels, increases employment and thereby alleviate poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995). The main objective of microcredit according to Navajas et al, (2000) is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter presented the methodology that was used to collect, manage and analyze data which is presented. The chapter discusses the methodology of the study such as; the design, study area, the population of the study, sample size and selection, the source of data, data tools as well as data management and analysis. To accomplish the task off the study, the methodology helped the researcher to gather adequate data on credit financing in relation to performance of SMEs

3.1 Research Design

This study employed a case study research design and for the case of this study SMEs in Soroti Municipality were used as the case study. This study used quantitative and qualitative research approach for data collection through self-administered questionnaire for evaluation because the quantitative approach helps a researcher to analyze descriptive information and qualitative approach helps with analysis of narrative information. The quantitative data was presented in tables and pie charts while the qualitative data was presented in explanatory form.

3.2 Area of Study

The study was conducted in Soroti Municipality in Soroti District which is one of the fastest developing districts with an increasing number of businesses.This area was selected because businesses are flourishing yet most of the businesses are funded by borrowed funds.

3.3 Population of the Study

The population of the study included the SMEs owners and business attendants. The population of the study included the Manager, accountants, loan officers, and other employees. The population of this study comprised of 200 respondents from which information was obtained.

3.4 Sampling size and selection

3.4.1 Sample size

The sample size, according Saunders et al, (2012), is the actual number of respondents that would be representative of the population under study, they proceed to state that the size must be large enough and should bear some proportional relationship to the size of population from which it is drawn. The researcher used Krejice and Morgan (1970) table to determine the sample size. The sample size of the study according to the table was 127. The table was attached as an appendix.

3.4.2 Sampling techniques

Sampling technique, according to Blumberg et al, (2008) is a scientific or rather statistical method of selecting the sampling units that would offer the requisite estimates with their related margins of uncertainty; this would emerge from the probe of only part (sample) and not the whole population. The study used a simple random sampling technique.

3.5 Data sources

3.5.1 Primary Data

Greener (2008), explained that primary sources are those which come into existence in the period under research for example questionnaires completed for the study. Primary data was collected through a questionnaire

3.5.2 Secondary Data

Secondary Data involved analysis from text books, reports, published journals and previous studies as related to topic researched.

3.6 Data collection instruments

In this study, the researcher used a questionnaire as primary source of gathering data. The questionnaire was the best in determining the affective domain of the respondents. The questionnaires were both open and close-ended, designed in a Likert scales to solicit the opinions of the respondents. The researcher used a questionnaire because of being reliable and dependable instrument for collecting information from respondents who are scattered in a vast area.

3.7 Measure of variables

The independent variable was credit financing and the dependent variable was performance of SMEs. A structured standard questionnaire was used. The tool helped to solicit responses on a five point likert scale with the following verbal anchors: would be: 1) Strongly disagree, 2) Disagree, 3) Not sure, 4) Agree, 5) strongly agree which will be used to measure the variables.

3.8 Quality Control

3.8.1 Validity

Data collection instrument was presented to the supervisor who reviewed to a certain to whether the instrument was valid. In addition to ensure that data collection instrument was valid, the content validity index (CVI) was computed using the following formula;

$$\text{Content valid index} = \frac{\text{No of relevant items on the questionnaire} * 100}{\text{Total No of items}}$$

$$\mathbf{= 13/16}$$

$$\mathbf{=0.81}$$

This result is higher than the coefficient of 0.7 which means that the instrument was valid since it was 0.81.

3.8.2 Reliability

Amin (2005), defined reliability as the degree to which the instrument consistently measures whatever it is measuring. That an instrument is reliable if it produces same results whenever it is repeatedly used to measure traits or concepts from the same respondents even by other researchers. The reliability of the questionnaire was assessed using SPSS Cronbach Alpha at 0.05 level of significance. Cronbach Alpha was computed to measure the consistency of the research variables and administered in a single test as it was presented below.

Table 3.1: Reliability Statistics

Items	Cronbach's Alpha	No of Items
Credit assessment	.901	5
Risk assessment	.722	4
Credit monitoring	.614	6

Source: *primary data (2017)*

The finding revealed that the information was reliable since it was above the coefficient determinant of 0.05. This means that the information obtained from field can be relied on as proved by the reliability statistics

3.9 Processing and Data analysis

The collected data was organized and edited at the end of each step to ensure accuracy, completeness and consistency of the information given by the respondents. The results were coded and the coded data then analyzed using Statistical Package for Social Scientist (SPSS) for Windows version 16.0 software to establish the correlational relationship among the variables.

3.10 Ethical considerations

The researcher was guided by the following main considerations**.** Certain information was kept confidential on special request by respondents.

It is also prudent to document information from archives only with the consent of respondents. The researcher acknowledged all published sources of literature to be used in the study.

3.11 Limitations of the study

The issue of finances limited the research in that the researcher does not have enough funds to facilitate various activities like printing, transportation for various trips to the study area and this was minimized by the use of soft copies via E-mail if a supervisor permits.

The results had human errors, omissions and possible misstatements. However, the researchers ensured that the research meets all the relevant requirements for a research through editing and thereby reducing errors to the barest minimum.

The study was also limited by scope due to the fact that it was carried out in one Municipality, which did not permit a comparison of information with other Municipality. However the researcher used reliability test using SPSS to compare the information and this was in addition to the case study design the researcher used.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS, AND DISCUSSION OF FINDINGS

4.0 Introduction

This chapter presents the research findings that were captured from the field of the study. The chapter presents, interprets and discusses the findings of the study. Therefore 127 questionnaires were designed for the study and 92 questionnaires were returned therefore the response rate of the study was 72.4%.

4. 1 Bio data of the Respondents

In this section, efforts are made to document the background information of the respondents such as gender, education qualification and duration in the organization.

4.1.1 Gender of the Respondents

The research study sought to establish the gender of the respondents who participated in the study. The table below presents the findings of the study.

Table 4.1: showing gender of respondents

		Frequency	Percentage
Valid	Male	65	70.7
	Female	27	29.3
	Total	92	100.0

Source: primary data (2017)

Table 4.1above indicates that there were more male respondents than the female respondents. This is shown by the male having a percentage of (70.6%), while the female shown by a percentage of (29.4%). This therefore implies that during the research most of the respondents were males since men are more in running small scale businesses in Soroti District.

4.1.2 Respondents' level of Education

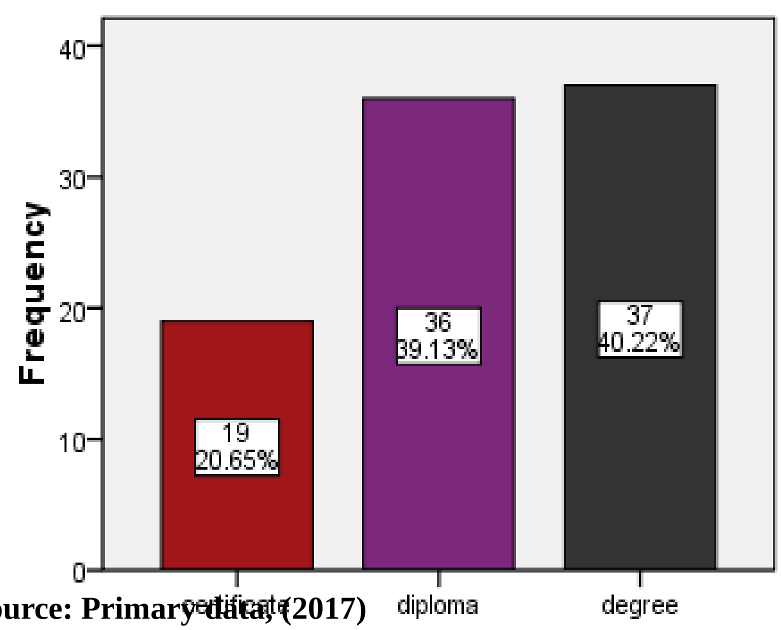
The researcher had interest in knowing the academic qualification of respondents so that he could establish whether employees are technically skilled and also whether they have acquired formal education

Table 4.2: showing the Level of Education

		Frequency	Percentage
Valid	Certificate	19	20.7
	Diploma	36	39.1
	Degree	37	40.2
	Total	92	100.0

Source: Primary data, (2017)

Figure 4.1: showing the Level of Education



Source: Primary data, (2017)

Results from figure 4.1 above indicated that majority of the respondents (40.2%) had attained degrees, (39.1%) had attained diploma and (20.7%) had certificates. What this implied is that the selected respondents understood the questions and answered as expected because their level of education allows them to have the basic knowledge in reading and writing apart from those who never attained any education level whose understanding was difficult.

4.1.3 Duration spent in the organization

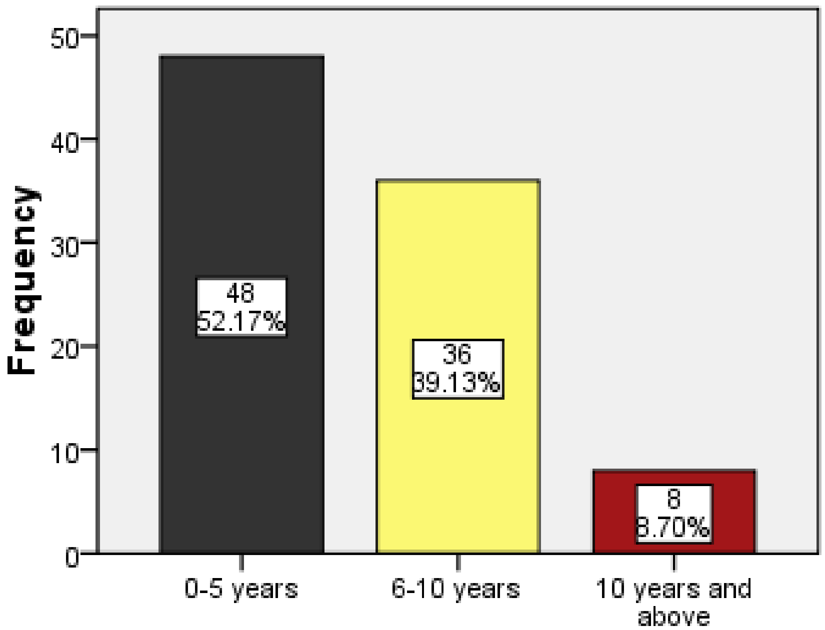
In this study, Duration spent in business was analyzed and details are presented below.

Table 4.3: Showing Duration spent in business

		Frequency	Percentage
Valid	0-5 years	48	52.2
	6-10 years	36	39.1
	10 years and above	8	8.7
	Total	92	100.0

Source: Primary data, (2017

Figure 4.2: Showing Duration spend in business



Source: Primary data, (2017)

Results shown in table 4.3 revealed that (52.2%) respondents have been in business for over a period of 0-5 years, (39.1%) in business for over 5-10 years and finally (8.7%) for a period of over 10 years. This probably meant business has been fair to respondents business they have been in business for quite a good time and therefore know the values of using credits in business.

4.2 Descriptive Statistics basing on study objectives

In the study, analysis was also based on study objectives and results were presented on the following statements; credit assessment, risk management and credit monitoring. Therefore the mean level of agreement was computed as (5+4+3+2+1)/5= 3.0. This therefore implied that all responses averaging 3.0 and above amounted for Agree whereas all responses averaging below 3.0 accounted for Disagree.

4.2.1 Credit assessment and performance of SMEs

Table 4.4: Descriptive statistics on Credit assessment and performance of SMEs

Details	**N**	**Min**	**Max**	**Mean**	**Standard Deviation**
The business has a credit assessment criteria in practice	92	1	5	4.00	.744
I get enough information about the loan before borrowing.	92	1	5	3.98	.785
Credit assessment helps to keep the loan losses to a minimum level in business.	92	1	5	4.04	.683
Interest charged on the loan is affordable.	92	1	5	4.02	.785
Repayment period given is enough to pay back the loan.	92	1	5	3.98	.785

Source: Primary Data, (2017)

On the statement "The organization has credit assessment criteria in practice"

Findings revealed that respondents with a mean value of 4.00 agreed that the organization has a credit assessment criterion in practice. This means that credit assessment criteria's are important on assessing loans. This is in line with Walsh, (2011) who noted a credit assessment criterion helps management get the relevant information to make its experienced judgments about the credit quality of the loan portfolio and provides the foundation upon which loan losses or provisioning methodology is built. However a standard deviation of value 0.744 of respondents was in a disagreement with the statement. This can imply that organization can use other elements to assess creditors without using assessment criteria.

"I get enough information about the loan before borrowing**"**

The findings determined that respondents with a mean value of 3.98agreed that they get enough information about the loan before borrowing. This can mean that through assessment, business owners get enough information about the loan requests especially the terms and standards. This is supported by Onaolapo, (2012) who explained that through assessment, business owners get enough information about the loan before borrowing which helps them reassess whether they can meet the policy accordingly before encountering any major setback. However a standard deviation value of 0.785 of respondents was in a disagreement with the statement which can mean that business owners may not get all the information they need about the credit facility.

"Credit assessment helps to keep the loan losses to a minimum level in business**".**

The field data collected indicated that respondents with a mean value of 4.04 agreed that credit assessment helps to keep the loan losses to minimum level. This means that clients have to be screened to know their credit worthiness in order to reduce loan loss. This is in line with Boldizzoni, (2008) who noted that credit assessment plays important role to keep the loan losses to minimum level, hence if loan officers appointed for loan appraisal are competent then there would be high chances of lending money to non-deserving customers. However the standard deviation of value 0.683 of respondents were in a disagreement with it though assessment takes place, not all information is got and this leads to increase in loan loss

"Interest charged on the loan is affordable**."**

The findings estimated that respondents with a mean value of 4.02 agreed that interest charged on the loan is affordable. This means that business owners can borrow if they feel the interest charged on loan is favorable and affordable for them to pay the charges. This is in line with Onaolapo, (2012) who stressed that the credit policy should explicitly provide procedural guideline and making sure that the Interest charged on the loan is affordable and can easily be paid by business owners without affecting their businesses. However a standard deviation of value 0.785 of respondents was in a disagreement with the statement. This can mean that at times borrowers have no choice provided they get the money they need to finance their business activities; they do not care much about the loan interest.

"Repayment period given is enough to pay back the loan**."**

The study revealed that respondents with a mean value of 3.98 agreed that repayment period given is enough to pay back the loan. This can mean that financial institutions give borrowers enough grace period to repay the loans due and this helps a business owner to plan and use finances effectively. This is in line with Ayodele, (2014) assert that establishing an effective assessment would help owners of SMEs to monitor the credit portfolio since the loan repayment period given is enough to pay back the loan. However a standard deviation of value 0.785 of respondents was in a disagreement with the statement. This can mean that at times because a business needs finances, and therefore even if the period is not enough, the business owner would have to borrow without much focusing on the time frame.

4.2.2 Risk management and performance of SMEs

Table 4.5: Descriptive statistics on risk management and performance of SMEs

Details	N	Min	Max	Mean	Standard Deviation
Risk management helps the business to identify credit risks	92	1	5	4.04	.798
Risk management helps business owners manage the loans and ensure that a business is profitable	92	1	5	3.98	.785
Management of risks ensures risks are evaluated and controlled	92	1	5	4.00	.744
Risk management reduces financial risks	92	1	5	4.02	.743
Reducing risks involved in credit financing has helped to lead to sustainable financial performance.	92	1	5	4.04	.743

Source: Primary Data, (2017)

“Risk management helps the business to identify credit risks**”**

Findings still indicated that respondents with a mean value of 4.04 agreed that risk management helps the business to identify credit risks. This means that business owners can identify risks and prevent them through use of risk management procedures. This is in line with Agyeman, 2011) who stated that SME owners need to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. However a standard deviation of value 0.798 of respondents was in a disagreement with the statement. This can imply that at times it’s not easy to identify all the risks and this leads to financial loss because there are many risks which businesses face.

“Risk management helps business owners manage the loans and ensure that a business is profitable**”**

The field data collected indicated that respondents with a mean value of 3.98 agreed that Risk management helps business owners manage the loans and ensure that a business is profitable. This means that areas where a business would face challenges of finances are revealed and easily managed. This is line with Jha and Hui., (2012) who noted that the SME owners have an overview of operations, manages the loans and has to ensure that the business is profitable. However a standard deviation of value 0.785 of respondents were in a disagreement with the statement which can mean that profitability may not be achieved if loans are diverted and investment is made in assets with no returns.

“Management of risks ensures risks are evaluated and controlled**”.**

The findings estimated that respondents with a mean value of 4.00 agreed that Management of risks ensures risks are evaluated and controlled. This means that business owner can control and evaluate their risk exposures and be in position to manage them. This is in line with Agyeman, (2011) who explained that SME owners need to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. However a standard deviation of value 0.744 of respondents was in a disagreement with the statement. This can imply that at times controlling risks is hard even if evaluation is done well and this leads to financial loss.

"Risk management reduces financial risks"

Findings still indicated that respondents with a mean value of 4.02 agreed that risk management reduces financial risks. This means that using risk management process; business owners can reduce risks which could affect their finances. This is in line with Lewis, (2012) explained that to reduce risks, SME owners have to develop risk management strategies which are effective if defaults are to be reduced. However a standard deviation of value 0.743 of respondents was in a disagreement with the statement. This can imply that financial risks will be minimized if there is risk management but if the risk procedures are not well coordinated, financial loss will still occur

"Reducing risks involved in credit financing has helped to lead to sustainable financial performance."

The findings estimated that respondents with a mean value of 4.04 agreed reducing risks involved in credit financing has helped to lead to sustainable financial performance. This means that if a business is to perform better, they should endeavor control risks in financial area. This is in line with Pausenberger and Nassauer, (2000) who noted it has emerged that businesses strive to improve and sustain financial performance hence needs for risk management techniques to mitigate financial losses and improve financial performance. However a standard deviation of value 0.743 of respondents was in a disagreement with the statement. This can mean that risks can be controlled but still business will not perform better in terms of profitability and therefore other means have to be developed to improve business performance.

4.2.3 Credit monitoring and performance of SMEs

Table 4.6: Descriptive statistics credit monitoring and performance of SMEs

Details	N	Min	Max	Mean	Standard Deviation
The business has a monitoring criteria it uses in managing credit	92	1	5	4.04	.743
The business owner is aware about the credit monitoring policy the MFIs uses	92	1	5	4.02	.729
The business follows the loan monitoring criteria the MFIs uses	92	1	5	4.02	.699
Loan monitoring ensures that funds are put to best use	92	1	5	4.06	.697
Loan monitoring reduces loss due to non performing credits	92	1	5	4.06	.798

Source: Primary Data, (2017)

"The business has monitoring criteria it uses in managing credit"

The findings indicated that respondents with a mean value of 4.04 agreed that the business has monitoring criteria it uses in managing credit. This means that for a business to improve performance, they should build strong credit monitoring procedures to prevent loss of finances. This is supported by Gestel and Baesen (2009) explained that the owners of SMEs should endorse credit monitoring policies to help in monitoring credits if they are to reduce credit loss.

However a standard deviation of value 0.743 of respondents was in a disagreement with the statement. This can possibly mean that some credit monitoring criteria's may not manage loans well and this may result into loan loss.

"The business owner is aware about the credit monitoring policy the MFIs use"

The findings determined that respondents with a mean value of 4.02 agreed that the business owner is aware about the monitoring policy the bank uses. This means that business owners make known to employees the policies the bank uses over credit in order to reduce tendencies of not meeting the standards for the loan. This is supported by Sinkey, (2011) who advised business owners should be aware about the credit monitoring policy the bank uses in granting of the credit and the ongoing management of the portfolio. However a standard deviation value of 0.729of respondents were in a disagreement with the statement which can mean that risks can still occur even if business owners know the credit policies used by the MFIs they can still default due business circumstances.

"The business follows the loan monitoring criteria the MFIs uses"

The findings estimated that respondents with a mean value of 4.02 agreed that the business follows the loan monitoring criteria the MFIs uses. This means that businesses have to follow the criteria banks use in monitoring of credit being given to them. This is in line with Rahman et al, (2006) who noted that businesses have to follow the sound credit management criteria of the bank if they are to get credit facilities. However a standard deviation of value 0.699 of respondents was in a disagreement with the statement. This can mean that even if there are criteria, monitoring can still not be effective leading to funds being used in different venture

"Loan monitoring ensures that funds are put to best use"

The field data collected indicated that respondents with a mean value of 4.06 agreed that Loan monitoring ensures that funds are put to best use. This means that through monitoring, business owners ensure that funds are not diverted and used for purpose which they were not intended to This is in line with Richardson (2012) who suggested that supervisors should require that SME owners have an effective system in place to identify, measure, monitor and control credit risk to ensure funds are used in accordance to the purpose. However a standard deviation of value 0.697 of respondents were in a disagreement with the statement which can means that even though loans are monitored, business owners can still use them wrongly and that affect their portfolio repayment schedule.

“Loan monitoring reduces loss due to non performing credits”

Findings further revealed that respondents with a mean value of 4.04 agreed that Loan monitoring reduces loss due to non performing credits. This means that good monitoring process can help businesses to reduce the probability of having non-performing loans. This is in line with Baesens (2009) who asserted that financial institutions should establish an adequate system for monitoring and reporting risk exposures of SMEs and the impact of risk profile to reduce non-performing loans. However a standard deviation of value 0.798 of respondents was in a disagreement with the statement. This can mean that non-performing loans can still exist if there are monitoring procedures and this is due to risks involved in businesses.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.0 Introduction

This chapter provides a summary of findings of the research on the effect of credit financing on the performance of SMEs based on the study objectives. They are presented in sections of the summary of findings, conclusion and recommendations derived from the study findings and lastly the suggestions for further research concerning credit financing and performance of SMEs

5.1 Summary of findings

The study was guided by the following specific objectives; to examine the effect of credit assessment on performance of SMEs, to examine the effect of risk management on performance of SMEs and to assess the effect of credit monitoring on performance of SMEs.

5.1.1 Credit assessment and performance of SMEs

The research showed that majority of the respondents acknowledged that businesses have an assessment criteria it follows in managing credit risk exposures and the criteria is communicated to staff and also followed through using the Internal Risk Rating approach and credit scores to assess the quality of loans and estimate the probability of portfolio losses.

5.1.2 Risk management and performance of SMEs

The research findings revealed that majority of the respondents believed that a risk management procedure exists in the organization, staff are aware about it and the system is effective to facilitate management work.

5.1.3 Credit monitoring and performance of SMEs

The findings showed that majority of the respondents agreed that the organization has an effective monitoring criteria which is communicated and followed within the business and the business owners monitor credit risk majorly through use of credit checks which enable him/her to ascertain the actual exposures against limits on a daily basis so that they reduce on the level of making losses thus reducing on the risk exposure.

5.2 Study conclusion

Objective one of the study which was to establish how credit assessment affects the performance of SMEs indicated that credit assessment approaches such as Internal Risk Rating approach and credit scores of statistical analysis play a great role in ensuring proper assessment of credit risk management in businesses.

Basing on the findings from the second objective which was to risk management and performance of SMEs, the researcher found out that there is a positive relationship between risk management and performance of SMEs This therefore implies that business owners should consistently strive to have an effective management system which it employs to ensure that the credit risk management policies within the businesses are followed to promote efficiency, increased returns.

The last objective was to establish whether credit monitoring affects the performance of SMEs. It was found out that a monitoring procedure positively affects the performance of SMEs. This implies that businesses should always have a monitoring criteria it follows such as carrying out credit checks and going out in the field to acquire more information about their clients and capability to fulfill their obligations to prevent loans from going bad thus increasing their net interest margin and growth.

Generally, the research results indicated that Credit financing positively affects the performance of SMEs and their profitability is inversely influenced by the levels of loans, advances and non-performing loans hence there was a significant relationship between credit financing and performance of SMEs

5.3 Recommendation

Several recommendations were made in regard to the study findings.

From the findings on the first objective which was to find out how credit assessment affects the performance of SMEs, business owners should ensure they have the necessary qualifications while being evaluated so that the loan is got.

Basing on the findings from the second objective which was to examine the effect of risk management on performance of SMEs, the researcher recommends that business owner should ensure that they have sound risk management policies in place to avoid making losses due to loan repayment.

From the findings of the last objective, monitoring and performance of SMEs, the researcher recommends business owners to closely continue monitoring their funds so that the money is used for the right purpose.

5.4 Areas of further research

The research was however focused on SMEs which greatly experience many cases of non-performing loans and high levels of risk exposure. This therefore calls for further research on the large scale businesses.

Given the limited time for carrying out this research, the researcher suggests that further research should be carried by different institutions on this topic so as to address key issues on credit risk management and performance of SMEs.

Another study should cover the effect of credit facilities and the financial performance of small and micro enterprises (SMEs).

A study can also be carried out on the effect of credit policies and performance of small businesses

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Appendix I: Respondent Questionnaire

Dear respondent, I am ***Aguti Judith*** a fourth year student pursuing a Bachelor of arts in micro finance and community Economic development at Uganda Martyrs University. I am carrying out a study on the topic ***"The effect of credit financing on Performance of SMEs".*** I request you to spare some time to fill this questionnaire, the information provided is very important and shall be accorded the necessary confidentiality and the results of the study will be used for academic research purposes only.

A. BACKGROUND INFORMATION

1) Gender of respondents

i) Male ☐ ii) Female ☐

2) What is your level of education?

i) Certificate ☐ ii) Diploma ☐

iii) Degree ☐

3) For how long have you been in this business?

i) 0-5 ☐ ii) 6-10 ☐

iii) 10 and above ☐

Please indicate by ticking your opinion by using the following scale.

Strongly Disagree (SD) 1	Disagree (DA) 2	Not sure (NS) 3	Agree (A) 4	Strongly Agree (SA) 5

B. Credit assessment and performance of SMEs

Statement	SD	D	NS	A	SA
The business has a credit assessment criteria in practice					
I get enough information about the loan before borrowing.					
Credit assessment helps to keep the loan losses to a minimum level in business.					
Interest charged on the loan is affordable.					
Repayment period given is enough to pay back the loan.					

C. Risk management and performance of SMEs

Statement	**SD**	**D**	**NS**	**A**	**SA**
Risk management helps the business to identify credit risks					
Risk management helps business owners manage the loans and ensure that a business is profitable					
Management of risks ensures risks are evaluated and controlled					
Risk management reduces financial risks					
Reducing risks involved in credit financing has helped to lead to sustainable financial performance.					
	92		5	4.04	.743

D Credit Monitoring and performance of SMEs

Statement	SD	D	NS	A	SA
The business has a monitoring criteria it uses in managing credit					
The business owner is aware about the credit monitoring policy the MFIs uses					
The business follows the loan monitoring criteria the MFIs uses					
Loan monitoring ensures that funds are put to best use					
Loan monitoring reduces loss due to non performing credits					

THANK YOU FOR YOUR TIME

APPENDIX II: KREJCIE & MORGAN TABLE FOR DETERMINING SAMPLE SIZE

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	246
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	351
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	181	1200	291	6000	361
45	40	180	118	400	196	1300	297	7000	364
50	44	190	123	420	201	1400	302	8000	367
55	48	200	127	440	205	1500	306	9000	368
60	52	210	132	460	210	1600	310	10000	373
65	56	220	136	480	214	1700	313	15000	375
70	59	230	140	500	217	1800	317	20000	377
75	63	240	144	550	225	1900	320	30000	379
80	66	250	148	600	234	2000	322	40000	380
85	70	260	152	650	242	2200	327	50000	381
90	73	270	155	700	248	2400	331	75000	382
95	76	270	159	750	256	2600	335	100000	384

Note: "N" is population size

"S" is sample size.

From :Krejcie, Robert V., Morgan, Daryle W., "Determining Sample Size for Research Activities", Educational and Psychological Measurement, 1970.