THE EFFECT OF BANK CREDIT ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES

CASE STUDY OF KAMPALA DISTRICT

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List of Abbreviations

NGOs	-	Non-governmental Organization
SME’s	-	Small and Medium-sized Enterprises
BOU	-	Bank of Uganda
GDP	-	Gross Domestic Profit
COMESA	-	Common Market for East and Southern Africa
SACCOS	-	Savings and Credit Organizations
FSA’s	-	Financial Service Associations
DFCU	-	Development Finance Company of Uganda
EADB	-	East African Development Bank
EIB	-	European Investment Bank
UIA	-	Uganda Investment Authority
USSIA	-	Uganda Small Scale Industries Association
UDB	-	Uganda Development Bank
OECD	-	Organization for Economic Cooperation and Development

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Abstract

This paper looks at the effect of bank credit on the performance of small and medium sized enterprises in Kampala. The research builds from the fact that the following objectives are looked at critical to arrive at relevant analysis; the effect of bank credit on the performance of Small and Medium size enterprises in Kampala, the sources of finance for SMEs in Kampala, the factors inhibiting SME's access to bank credit/loans in Kampala and suggest solutions.

In carrying out the research, the methodology of the research was made up of the research design which was descriptive, and quantitative data was collected using open and closed ended questionnaires. The target population was that of the small and medium sized entrepreneurs in Kampala with a sample size of 60. The data analysis made use of tables and bar charts, which helped show how effective bank credit is on the performance of small and medium sized enterprises in Kampala, mainly to the SMES in Nakawa, Katwe and Kajjansi. The findings or results indicated that, bank credit greatly improved on the profits of the business. Lack of sufficient capital also was noted as being the cause of poor performance of SMES. Lack of sufficient capital did stand out a factor leading to poor performance of the SMES in Kampala and many people feared to get loans due to the fact they lacked collateral security and also the payment became very difficult. Low savings due to low income earned caused the fear to show the financial statements since this was not enough to meet up to the high loans the business wanted and it was established that gender was a factor that determined access to credit because the numbers were skewed towards women. It is however important to point out that age was not a factor in considering one for credit.

Various studies and literature put forward the fact that vigorous provision of credit to various entrepreneurs could help to boost their businesses and consequently eradicate poverty and therefore bring about growth in the economy.

Definition of key concepts

- **Finance:** A branch of economics concerned with resource allocation as well as resource management, acquisition and investment. Simply, finance deals with matters related to money and the markets, to raise money through the issuance and sale of debt and/or equity.

- **Entrepreneurs:** This refers to a person/entity who uses scarce/available resources to bring into existence a product or service that was not in existence or makes better changes on what was existing.

- **Bank credit:** The borrowing capacity provided to an individual by the banking system, in the form of credit or a loan. The total bank credit the individual has is the sum of the borrowing capacity each lender bank provides to the individual.

- **Loans:** A loan is a financial transaction in which one party (the lender) agrees to give another party (the borrower) a certain amount of money with the expectation of total repayment. The specific terms of a loan are often spelled out in the form of a promissory note or other contract. The lender can ask for interest payments in addition to the original amount loaned (principal). The borrower must agree to the repayment terms, including the amount owed, interest rate and due dates. Some lenders can also assign financial penalties for missed or late payments.

- **SMEs:** According to the OECD Observer, (2000), SMEs are defined as non subsidiary, independent firms which employ less than a given number of employees. This number varies across national statistical systems. The most frequent upper limit is 250 employees. According to (Obed. B. T 2013) a small enterprise is an enterprise employing a maximum of 50 people; annual sales/revenue turnover of maximum, Ushs 360 million, while a medium enterprise is an enterprise employing more than 50 people, annual sales/revenue turnover of more than Ushs 360 million and total assets of more than Ushs 360 million.

•**Entrepreneurship:** According to Hisrich,D. Peters. S, (2009) entrepreneurship is the process of creating something new with value by devoting the necessary time and effort, assuming the accompanying financial, psychic, and social risks, and receiving the resulting rewards of monetary and personal satisfaction and independence.

•**Investment:** An asset or item that is purchased with the hope that it will generate income or appreciate in the future. In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or appreciate and be sold at a higher price.

•**Funding**: Funding refers to providing financial resources to finance a need, program, or project. In general, this term is used when a firm fills the need for cash from its own internal reserves, and the term 'financing' is used when the need is filled from external or borrowed money.

CHAPTER ONE

1.0. General introduction

1.1. Introduction

This research is about the effect of bank credit/loans on the performance of Small and medium-sized enterprises in Uganda. The research will be based on SME’s in Kampala as a case study. This research contains five chapters; chapter one gives the general introduction and its outline consist of; specific definition of key terms and concepts, background of the study, research problem, general objective of the study, specific objectives, research questions, significance of the study, scope of the study, justifications of the study and its conceptual frame work.

1.2. Background of the study

This part of the study shows the context of the research that was carried out by the researcher.

1.2.1. General background

Globally, during the past half century, entrepreneurship has been growing as a recognized phenomenon in society. This has grown to include the small and medium sized enterprises and the possible reasons for their growth include among others; new political-economic orientation in some leading countries and the need for new jobs to be created (Bjorn. B and Claes. M. H 2002). According to me many other factors contribute to the growth to include technology, market and sufficient finances for the daily activities.

Also Paul Cook and asserts that, “the role of finance has been viewed as a critical element for the development of small and medium-sized enterprises. Previous studies have highlighted the limited access to financial resources available to smaller enterprises compared to larger organizations and the consequences for their growth and development. Typically, smaller enterprises face higher transactions costs than larger enterprises in obtaining credit. Insufficient funding has been made available to finance working capital. Poor management and accounting practices have hampered the ability of smaller enterprises to raise finance. Information asymmetries associated with lending to small scale borrowers have restricted the flow of finance to smaller enterprises. In spite of these claims however, some studies show a large number of small enterprises fail because of non-financial reasons (Liedholm, MacPherson and Chuta, 1999)"

Regionally, East Africa has also faced so many difficulties due to lack of finance but this can also be broadened to lack of securities and credit worthiness. According to Samuel. S (2013) Over two fifths of East African entrepreneurs also cited the state of the economy as a serious hindrance. 86% regard lack of access to credit as the biggest deterrent to setting up a business today. Red tape comes second at 70%, lack of government support at 57% and market domination by large corporations came last at 57%. Therefore these enterprises can survive in most cases with the help of finances which have to be borrowed most cases from the financial institutions such as the banks.

1.3. Statement of the Problem

Enterprise development spearheaded by the small and medium-sized enterprises is a major objective of many countries facing economic growth hence many entrepreneurs are faced with loads of financial barriers like acquisition of loans and balancing of books of accounting. Entrepreneurs have a rough time battling inflation, competition, political instability; these are all rounded up into make risks and uncertainties. Some of these enterprises shut down due to lack of insurance, bankruptcy and can't be helped out because the owners lack securities. However banks have extended loans to entrepreneurs to try and uplift them but how efficient are they to meet their activities. Samuel. S (2013) agrees with the researcher stating that Commercial bank loan rates average at 24%, out of range for many businesses. Reductions to the benchmark Central Bank Rate are expected to bring borrowing rates down. World Bank ranks Uganda's business environment at 120th out of 183 countries, the majority of businesses are aged between one and five years, with less than 10% of the enterprises having operated for more than 20years, for every business created nearly another is closed, leading to a high SME mortality rate. Many SMEs are started as sole proprietorships and operate on lean staff without accountants and finance, which undermines their growth and profitability. Furthermore, the biggest barriers hindering the performance and efficiency of these SMEs has been the failure of these SMEs to access needed credit from the available financial institutions such as banks and also in financial institutions because they do lack of collateral and most of them are not good at proper recording and accounting. Bank services, mainly credit, are engineered to have positive impacts on enterprise revenue, market share, fixed assets acquisition, earnings, employment, and transaction relationships between customers, thus providing great opportunities for avoiding poverty.

1.4. Objectives of the study

To examine the effect of bank credit/loans on the performance of Small and Medium sized.

1.5. Specific Objective

- To find out the effect of bank credit on the performance of Small and Medium size enterprises in Kampala.

- To find out the sources of finance for SMEs in Kampala.

- To find out the factors inhibiting SME's access to bank credit/loans in Kampala and suggest solutions.

1.6. Research Questions

- What is the effect of bank credit/loans on the performance of SMEs in Kampala?
- What are the factors inhibiting SME's access to bank credit/loans in Kampala?
- How do these factors affect the performance of SMEs in Kampala?

1.7. Scope of the study

The scope of the study is an establishment of the limit of the area to be covered by the study. It can be a specific period of time, geographical territory.

The scope may also indicate where the major focus will be laid and where the minor focus will be in data collection.

The study looks at the effect of bank credit/loans on the performance of SMEs. The sources of finance for SMEs in Kampala, the factors that inhibit SME's access to bank credit/loans in Kampala, how these factors affect performance of SMEs in Kampala.

The research carried out his research on the effect of bank credit/loans on the performance of Small and Medium sized entrepreneurs in Uganda and it covers a period between 1-5 years through a case study design samples of urban and semi urban areas of Kampala for in-depth analysis. This study covered Katwe, Nakawa, Kajjansi.

1.8. Justification of the study

This sections show why the research is worth and why people who can get access to it have to take a risk or time to read it. The study is an academic credit to the curriculum vitae of the researcher because, without this study, the researcher cannot be awarded a degree in bachelor of business administration and management from Uganda Martyr's University Nkozi which is one of the requirements for the award of a degree at Uganda Martyr's university Nkozi.

The research is bound to enlighten various entrepreneurs and owners of various enterprises on how best to improve their financial management techniques in order to better growth and easily access bank loans.

In addition, the study attempts to closely investigate the effects of bank credit/loans on performance of SMEs in Uganda. Therefore the findings of the study will compel different entrepreneurs whether to embrace or not to embrace bank credit/loan borrowing practices and establish guidelines to determine the extent to which they would be involved. The study will benefit the entrepreneurs in urban and semi urban areas as they will yield greater benefits of bank credit/loan borrowing practices.

The study will also help various enterprises focus on areas of performance that urgently need funding in order to avoid their demise, therefore posing a solution to the problem.

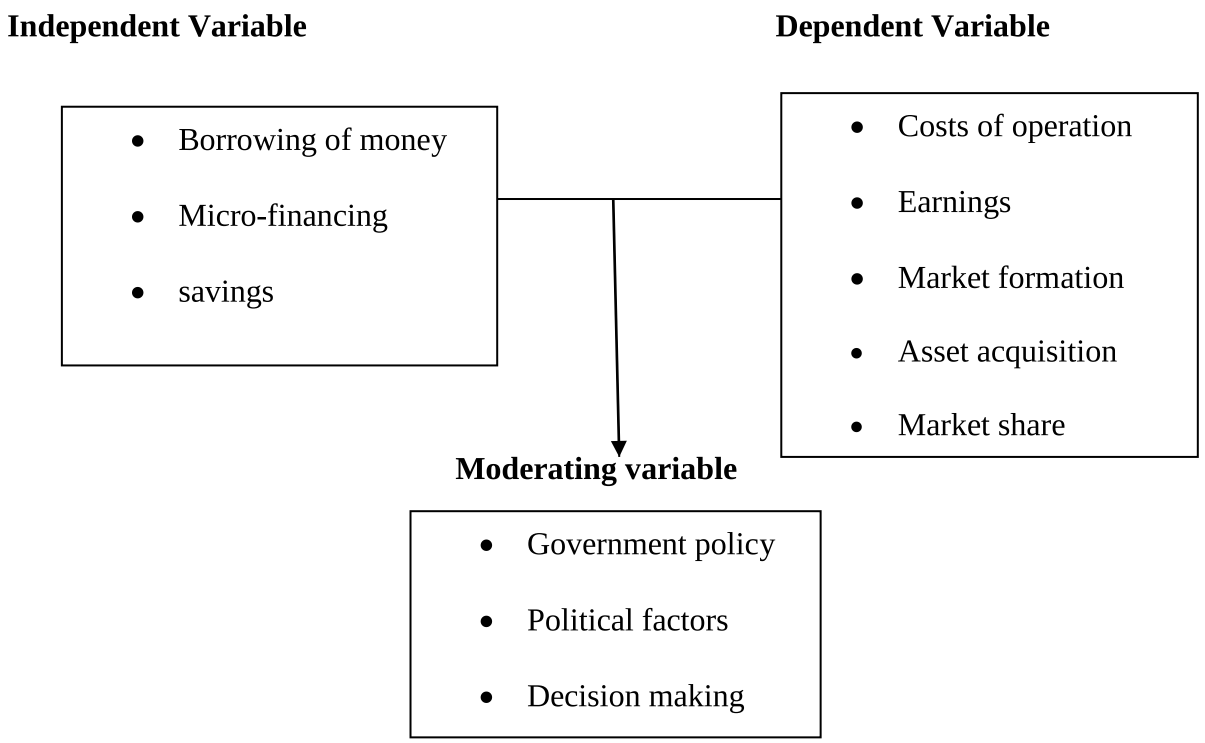
The government of Uganda and NGOs will also be able to adopt simpler ways in which to extend loans and finances to the SMEs since this study brings forward the various factors inhibiting credit acquisition by the entrepreneurs.

The research finally will bring forward the extent to which bank credit/loans practices are relevant to the performance of SMEs in Uganda and for which without this study being carried out will remain a myth.

1.9. Significance of the study.

The study further created a lot of importance ranging from narrow to broad contributions and these do include the following: The study helped the researcher socially interact with the world including meeting people of great skills and different classes such as sex, age, size and color. This even opened up employment links for the researcher. The study also stretched far to help SME in Kampala realize how useful bank credit/loans are to their performance and growth. The study will help the SMEs look at their SWOT analysis and try mainly fixing their financial management. The study will also simplify the research and education of other academicians who want to discover more about the effect of bank credit/loans to the performance of SME in Uganda or any other part of the world. They also will be able to discover the gaps left out by the researcher.

1.10: Conceptual Frame work



Source: Developed by Researcher after reviewing literature

The conceptual frame work depicts the effect of Bank credit/loans on the performance of SMEs. The researcher will see to it that he controls the moderating variables during the study. The independent variable consists of borrowing of money, Microfinancing, and savings whereas the dependent variable consists of costs of operation, earnings, market formation, asset acquisition and market share. The moderating variable on the other hand consists of government policy, political factors and decision making

1.11. Limitation of the study

The possible limitation of the research is attributed to the lack of time as well and lack of enough funds. The study would have been quite broad and representative if it had covered all Small and Medium sized enterprises in the whole country. However, the research is limited to only urban and semi-urban areas of Kampala to include Katwe, Nakawa, Kajjansi.

1.12. Conclusion

The information in this chapter greatly introduces the effect of bank credit on the performance of small and medium sized enterprises. A wider look intensifies the importance of the objectives and research questions in making the problem solvable.

CHAPTER TWO

2.0. LITERATURE REVIEW

2.1. Introduction:

Several theories and previous researches conducted on the subject matter will be explored with the aim of approaching and drawing conclusions that reaches a deeper understanding of the financing problems of these SME's in this chapter. This chapter covers important concepts like finance and bank credit financial accounting, and benefit to enterprise guided by opinions of different authors. The characteristics of enterprises and factor constraints, their access to financial resources, enterprise development, entrepreneurs and their roles are also looked at.

2.2. Theoretical review

Credit policy

These are guidelines that spell out how to decide which customers are lent money, the exact payment terms, the limits set on outstanding balances and how to deal with delinquent accounts. Bank supervisors place considerable importance on formal policies lay down by the board of directors and diligently implemented emphasizing most critical regard to the bank lending; a bank must adopt a sound system for managing credit risk. A lending policy should contain an outline of the scope and allocation of a bank’s credit facilities that is to say how to appraise, supervise and collect. For example limit on total outstanding loans, geographic limits, credit concentrations, type of loan, maturities (Hennie. V. G and Sonja. B. B 2003).

Pecking order theory

Also known as the pecking order model, the pecking order theory is an approach to defining the capital structure of a company, as well as how the business goes about the process of making financial decisions. The general idea is that companies will tend to take the course of least resistance, obtaining financing from sources that are readily available, and then steadily moving on to sources that may be more difficult to utilize. http://www.wisegeek.org/what-is-the-pecking-order-theory.html

According to Stokes. D and Wilson. N 2006, the choice to what type of finance is most appropriate for different kinds of small business has been shown to follow a pecking order theory of financial hierarchy. If internal funds are inadequate, then external finance becomes necessary. The small business will prefer debt to equity in the first instance, since the former is less "informationally sensitive" than the latter.

2.2.1. Bank credit and performance of smes

Bank credit is the borrowing capacity provided to an individual by the banking system, in the form of credit or a loan. The total bank credit the individual has is the sum of the borrowing capacity each lender bank provides to the individual, according to Megginson et al 1988, this is funding that the firm has borrowed and is contractually obligated to repay by a certain date. He adds that principal and interest payments, as legally enforceable claims against the business, therefore entail substantial risk for the firm. Therefore, this comprises the whole range of financial services to the rural, urban and peri-urban population at large. Financial services include savings facilities, credit, payment and transfer services, insurance and leasing. The act or process of providing funds for a business venture, and involves obtaining funds with which the firm can operate. This activity is necessary, of course to start the firm, but it is also a continuing activity as the firm grows and expands its operations. Funds are obtained from primary sources; owners and creditors (Hoskin. E. R 2001).

Megginson et al 1988, stresses that as a general rule, SMEs' long lived assets, such as building and other facilities, should be financed with long term and short lived assets, such as inventory or accounts receivable, should be financed with short term loans.

Bettner. S. M et al (2001), this refers to activities describing financial resources, obligations, and activities of an economic entity. This is used primarily by investors and creditors to help them assess an entity's financial position, its results of operations, and its ability to generate cash flow.

The primary task of the banks and other financial institutions is to meet the funding needs of their clients by relaying the funds of their investors and savers. In a country like Britain, though, the traditional emphasis has been on directing such funds to the larger, safer, longer-established enterprises. As Glancey and McQuaid(2000:177) observed "Simplifying and reducing the burden of taxes on new enterprises is claimed by many to reduce costs, encourage investment and increase incentives. A high level of taxation may act as a disincentive to entrepreneurs (or an incentive to move elsewhere)" David. A. K (2003)

Finance deals with the examination of cost and availability of various sources of short term funds and emphasis is given to trade credit, bank loans, corporate promissory notes and notes against receivables and inventory Geoffrey. A. H and Stanley. B. B(2002).

2.2.2. The rise of the need for financing to take place

SME's are faced with finance as one of the key constraints to their growth. This is worsened by the absence of financial markets in the developing countries. Small enterprise owners cannot easily access finance to expand business and they are usually faced with problems of collateral, feasibility studies and the unexplained bank charges. This means that they cannot access finance to enable them grow. According to Hisrich. R 2009, one of the most difficult problems in the new venture creation process is obtaining financing. For the entrepreneur, available financing needs to be considered from the perspective of debt versus equity and using internal versus external funds.

Microfinance institutions therefore do exist to help fill the gap of financing the capital needs of SMEs. The need for these institutions to be set up was the only missing link to the financing. This is because the SMEs in most cases do start up vigorously but all of a sudden do hit a rock which calls for immediate assistance. It is against this backdrop that a new system for provision of microcredit was to be introduced. SME development became a major issue of concern within the economic environment of fast growing economies.

Kuratko 2001 argues that many new ventures find that debt financing is necessary. Short term borrowing (one year or less) is often required for working capital and is repaid out of the proceeds from sales. Long term debt (term loans of one to five years or long term loans maturing in more than five years) is used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loans. He adds that the most common sources of debt financing are commercial banks.

Hisrich. R 2009, defines the two types of financing to include debt and equity financing, according to him, debt financing is a method involving an interest-bearing instrument, usually a loan, the payment of which is only indirectly related to the sales and profits of the venture and equity financing as a method which does not require collateral and offers the investor some form of ownership position in the venture.

According to Idowu 2000, accessing finance has been identified as a key element for small and medium enterprises to thrive in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries.

Megginson 1988, argues that many of the financial problems plaguing small businesses are avoidable, provided entrepreneurs analyze their own business's funding needs objectively and with sufficient lead time to act decisively. It is important that entrepreneurs use some personal funds for a portion of the initial capital before approaching a bank for financing. This is because financing institutions generally require a certain amount of own investment to show that you, as the entrepreneur, are committed to the business and motivated to achieve success. This could be possible but however entrepreneurs in developing countries are hit hard by poverty and lack of collateral.

This is also coupled by their weaknesses in operational and management information systems, poor internal controls, limited access to technical assistance, and dependence on donor funding, (Louis Kasekende and Henry Opondo 2003).

2.2.3 Characteristics of smes

Louis Kasekende and Henry Opondo, 2003 In Uganda, strong SMEs tend to be located in urban and peri- urban centres and are usually registered. However, they face a number of constraints, which include the difficulty in employing competent people with techniques in financial management because of the salaries such people would demand, financial problems arising from late payments by debtors, and inability to raise own finance and access financial services from formal sources. This category of SMEs usually looks to the banking sector and other financial intermediaries for instruments to finance working capital and to provide credit for short-term liquidity management. They continue to state that, the smaller the enterprise, the less likelihood its management will understand the need for financial management and the poorer the understanding of financial management. Likewise, the size and the distance from major cities/urban centres are negatively related to the level of awareness of financial instruments. That is, the smaller the size of the enterprise and the farther away from the city/urban centre the enterprise is, the less aware the firm is of the financial instruments available.

Table 1 Characteristics of SMES

Peculiar Characteristics	Rank	Remarks
Most do not or rarely keep records	1	Majority of entrepreneurs interviewed said they lacked time and some said they were illiterate and their clients do not have business records
Lack of traditional collateral. Limited access of financial services	2	Most enterprises in Uganda have few assets that can qualify for finance in banks hence causing the hindrance. SMES lack or have no initial financial resources and lack financial information.
Lack of capital stability Use of simple technology	3	Entrepreneurs within the SMES sector have limited capital and as a result they are unfortunately unstable They rarely use technology and when they do, the technology itself is simple and rudimentary
Mostly owned and managed by	4	Majority of SME'S are sole

an individual. Mostly lack entrepreneurial and management skills		proprietorships and family based enterprises. High illiteracy levels abound among SME'S especially small holder firms. They lack even basic skills in entrepreneurship business management.
They are based in rural or semi-urban areas	5	Most of the SMEs in less developed countries are situated in these areas due to the ease of tapping of the available resources. Less costs of production and operation also leads these SMEs to be situated in these areas.

Source: Primary source and researcher's information after reviewing literature

Given the above information, rating the present economy basing on available opportunities may be simplified in an approximate way. However there are numerous thoughts by scholars about what SMEs really are given multiple literatures written on the topic. Hence this brings about similarities and sometimes controversies in numerous research works which consequently limits uniform definition across the world. In practice, it is hard to define these characteristics, and even harder to draw precise line that separates small from large firms.

The need to distinguish between small businesses and entrepreneurial ventures may pose a solution. The rapidity of the rate of growth of a business is one useful way to distinguish between small business owners and entrepreneurs.

A difference in the two is further explained by Mary et al, 2009 " An entrepreneurial venture is one which the principal objectives of the entrepreneur are profitability and growth. Thus, the business is characterized by innovative strategic practices and/or products. The entrepreneurs and their financial backers are usually seeking rapid growth, immediate-and high-profits, and quick sell out with (possibly) large capital gains whereas A Small business, sometimes called a micro business, on the other hand, is any business that is independently owned and operated and is not dominant in its field. It may never grow large, and the owners may not want it to, as they prefer a more relaxed and less aggressive approach to running the business. They manage their own business in a normal way, expecting normal sales, profits, and growth. In other words, they seek a certain degree of freedom and ideally a certain degree of financial independence."

2.3. Actual review

This sets to widen the critical areas of the literature and involves looking at what other authors have to say about the each objective of the study.

2.3.1. The effect of bank credit on performance of smes

SME's are observed as capable instruments to solving the critical problems of development and poverty affecting most developing countries Mead and Liedholm, 1998. SME's are challenged by gaining access to bank credits and other financial markets have been also named as a key hindrance. Several factors contribute to the growth for SMEs, these includes, the development of horizontal relationships aimed at improving the market environment for small enterprises, the development of healthy cooperation with larger domestic enterprises, principally through subcontracting agreements; or the development of new inter firm networks that increase the small-scale sectors capacity for dialogue in relation to macro-level policy (for example, export rebates and tax concessions). All which are vital for the development of clusters which is a concentration of suppliers of raw materials and components; specialist organizations providing technical, financial and accounting services and national and international marketing agencies; and the availability of a large pool of skilled, specialized workers, specialist training centers and transport services (Cook, P. 2000). Despite the significant role these industrial factors play, a lack of sufficient capital and credit is often a major handicap to the development of SMEs, particularly in their early growth stages. Due to the need to eradicate poverty and consequences associated with it governments and non-governmental organizations have set up schemes are policies to meet this goal.

According to Peter Howells and Keith Bain (1998) bank credit helps SMES use this surplus to build up holdings of money. They receive their income in money form (usually by the transfer of bank deposits). They use some of that money to make consumption purchases. If consumption is less than income, they have positive savings. Their saving is simultaneously a financial surplus and if they make no positive decision about its allocation it will, by default, accumulates in the form of bank deposits.

At the same time that some people have income which is in excess of their current consumption needs, there will be those firms, households, public authorities whose incomes are insufficient for their current spending plans. This will usually be because they are planning to spend on large, expensive, “real” assets of a kind which lasts for many years. Their need to borrow this year, therefore, may be offset in future by years when saving is the norm. In certain circumstances, this furthers the purchase of financial assets. Notice that this is not likely to be a common situation since it is saying that borrowers can borrow funds at a lower cost than the return that they can get from the financial assets they purchase, which is extremely rare for the personal sector. It is usually much more expensive for individuals to borrow funds than it is for firms or public bodies Peter Howells and Keith Bain (1998).

According to Megginson et al 2006, sufficient capital is essential not only for small business but also for their continued operation. One main reason for the failure rate of small businesses is inadequate or improper financing. Too often, insufficient attention has been paid to planning for financial needs, leaving the new business open to sudden but predictable financial problems, for one difficulty most commonly experienced by rapidly growing firms is that they are unable to finance the investment needed to support sales growth.

2.3.2. Sources of funds for smes

Equity and smes

Ferrell 2011 puts forward that the most important source of funds for a new business is the owner. Many owners include among their personal resources ownership of a home, the accumulated value in a life-insurance policy, or savings account. A new business owner may sell or borrow against the value of such assets to obtain funds to operate a business. Additionally, the owner may bring useful personal assets such as a car or a truck. This is referred to as equity financing because the owner uses real personal assets rather than borrowing funds from outside sources to get started in a new business. The owner can provide working capital by reinvesting profits into the business or simply by not drawing a full salary.

According to Shari. W 2014 Equity financing, or equity funding, is trading a percentage of a business for a specific amount of money. This form of financing enables a business to receive the capital needed without taking on additional debt. Outside investors will want to see an owner also investing their own money to show they are willing to share the risks. While it is possible to attract investors, the main source of equity financing is still family and friends.

Borrowing creates financial leverage since payments of interests add to financing costs. Thus a percentage of increase in the earnings before interest and tax of a firm will result in a higher percentage increase in the net earnings of the firm. Consequently, the value of the owner's equity will appreciate. Similarly, a percentage reduction in net earnings before interest and tax will lead to a greater percentage reduction in net earnings, and consequently, the depreciation of owner's equity. Therefore the use of debt results in higher earnings volatility and increase the risk to owner's equity. Equity capital does not result in financial leverage (Brealey and Myers, 1996;Wert and Henderson, 1979).

Debt financing

The main source of external funding is conventional bank lending, with just over half of external finance coming from overdrafts and term loans. There has been a move away from a traditional emphasis on collateral and guarantees towards the use of business plans and cash flow projections, in securing loans. However, lack of collateral is still cited by some owners as a significant determinant of an individual's propensity to engage in enterprise. Complaints arise from interest rates and bank charges, lack of support in problem times, advice and information insufficiency. (David. S and Nicholas. W 2006).

Personal savings

The number one source of start up capital is an entrepreneurs own personal savings. This provides maintains or control of the business. Also most investors want to know that an entrepreneur has enough faith in an enterprise to risk his or her own money before investors risk theirs. (Earl. C. M and Kathleen. R 1994).

Obtaining money from friends and family

According to William. A. C (2006), friends and family are also good sources of money. This is the second fastest, easiest, and cheapest sources of cash that your need for your business, with fewer legal problems and with far less paperwork than outside sources. Many entrepreneurs warn never to borrow money from family and friends if you want to stay on good terms with those individuals.

Private investors and venture capitalists

Private investors are nonprofessional financing sources who tend to invest in the region in which they live. Sometimes they are called angels because of the help they give new businesses. They often become involved in start up financing and usually take on one or two new businesses a year. These are commonly found through networking in the society. Whereas venture capitalists are individuals or firms that invest capital professionally. In other words they make money through investments in their job, the way they make "profit". This is in contrast to private investors, who invest capital more as a sideline. Venture capitalists tend not to be good sources of start up capital for small businesses, mainly because they are relatively expensive. They usually want a significant interest in a company and a very high return on their investment. They also require financial projections for up to five years. This is because they usually take their cash and profits out of the business at that point (Earl. C. M and Kathleen. R 1994).

Bank financing

Commercial banks are the primary providers of debt capital to small companies. However, banks tend to limit their lending to providing for the working capital needs of established firms, especially for financing accounts receivable and inventory. Quite simply, they want firms with proven track records and preferably plenty of collateral in form of hard assets. Bankers are reluctant to loan money to finance losses, marketing campaigns and other "soft assets" (Moore. C. W et al 2008).

2.3.3. Constraints to borrowing of smes

Many small businesses have trouble getting the start-up or additional capital that they need. Without a long list of assets or a proven track record, there is no way to show banks exactly how promising your soon-to-be bustling business really is. According to William 2006, it is a fact of life in a modern economy that credit is necessary in most situations and for most businesses. This means that the basic problem is usually not whether to give credit, but how to manage the credit so that the following objectives are achieved: Your credit losses are minimized, you have increased and maximized profits, your customers or clients are encouraged to use your services or to buy your goods, your company's investment in accounts receivable is protected to the maximum extent possible. Businesses for reasons of failure to pay their debts are required to present securities and much more detailed information about them and their enterprises.

According to Mary. J. B et al 2009, the degree of uncertainty surrounding a small firm's long-term financial needs primarily depends on whether the business is already operating or it's just starting. If a business has an operating history, its future needs can be estimated with relative accuracy, even with substantial growth. Even for an existing business, however, an in depth analysis of its permanent financial requirements can be valuable. It may show the current method of financing the business to be unsound or unnecessarily risky. As a general rule, small businesses' long lived assets, such as buildings and other facilities, should be financed with long term loans, while short lived assets, such as inventory or accounts receivable, should be financed with short term loans.

Mary. J. B et al 2009, continue to stress that a new business, or a major expansion of an existing business, should be evaluated with great care, paying particular attention to its capital requirements. For example, the firm's fixed assets should be financed with equity funds, or with debt funds having a maturity approximately equal to the productive life of the asset. No business, however, can be financed entirely with debt funding, nor would such a capitalization be desirable-even if creditors were willing to lend all the funds required. Such capital structure would be extremely risky, both for the creditors and for the business. This is especially true for working capital, which includes the current assets, less current liabilities, that a firm uses to produce goods and services and to finance the extension of credit to customers. These assets include items such as cash, accounts receivable, and inventories. Management of working capital is always a central concern for managers of small firms because they are often undercapitalized and over dependent on uninterrupted cash receipts to pay for recurring expenses. Therefore, small business managers must accurately estimate their working capital needs in advance and obtain sufficient financial resources to cover these needs, plus a buffer for unexpected emergencies.

According to William. A. C 2006 the following are recommended:

- Description, provide a written description of your business, including the following information: Type of organization, Date of information, Location, Product, or service, Brief history, Proposed future operation, Competition, Customers, Suppliers.
- Management experience. Resumes of each owner and key management members.
- Personal financial statements: SBA requires financial statements for all principal owners (20 percent or more) and guarantors. Financial statements should not be older than 90 days. Make certain that you attach a copy of last year’s federal income tax return to the financial statement.
- Loan repayment: provide a brief written statement indicating how the loan will be repaid, including repayment sources and time requirements. Cash flow schedules, budgets, and other appropriate information should support this statement.
- Existing business: provide financial statements for at least the last three years, plus a current dated statement(no older than 90 days) including balance sheets, profit and loss statements, and a reconciliation of net worth. Aging accounts of accounts payable and accounts receivable should be included, as well as a schedule of term debt. Other

balance sheet items of significant value contained in the most recent statement should be explained.

- Proposed business: provide a pro forma balance sheet reflecting sources and uses of both equity and borrowed funds.
- Projections: provide a projection of future operations for at least one year or until cash flow can be shown. Include earnings. Expenses, and reasoning for these estimates. The projections should be profit and loss format.
- Collateral: list real property and other assets to be held as collateral. Few financial institutions provide non collateral-based loans. All loans should have at least two identifiable sources of repayment. The first source is usually cash flow generated from profitable operations of the business. The second source is usually collateral pledged to secure the loan

2.3.4. How the limitations to bank credit affect the performance of Smes

Access to bank credit by SMEs has been an issue repeatedly raised by numerous studies as a major constraint to industrial growth. A common explanation for the alleged lack of access to bank loan by SMEs is their inability to pledge acceptable collateral.

The primary task of the banks and other financial institutions is to meet the funding needs of their clients by relaying the funds of their investors and savers. In a country like Britain, though, the traditional emphasis has been on directing such funds to the larger, safer, longer established enterprises. According to David. A. K 2003 simplifying the burden of taxes on new enterprises is claimed by many to reduce costs, encourage investment and increase incentives. A high level of taxation may act as a disincentive to entrepreneurs.

Obed. B. T 2013 argues that whereas the number of banks has increased, their penetration is still not encouraging. Lending to SMES is still not appreciated due to perceived risks by banks, according to their lending policies. Whereas microfinance institutions have tried to bridge the gap, the interest rates they charge are too high yet SMES need cheap finance to enable them grow. Generally the bank interest rates are still too high for most businesses to be able to make profits. Whereas banks offer credit facilities, this is also done by private investors. The challenge is that, private investors prefer manufacturing, energy and natural resources, and some service businesses as investment. They tend to avoid retail businesses because such enterprises have a higher failure rate, and private investors tend to be conservative. On average, these investors would like to get ten times their investment at the end of five years from a start-up venture. Like bankers and venture capitalists, private investors look for a strong management team Earl. C. M and Kathleen. R. A 1994.

Despite SMEs strong interest in credit, commercial banks profits orientation may deter them from supplying credit to SMEs because of the higher transaction cost and risk involved. First, SMEs loan requirement are small so the cost of processing the loan tend to be high relative to the loan amounts. Second, it is difficult for financial institutions to obtain the information necessary to assess the risk of new unproven ventures especially because of the success of small firms often depends heavily on the ability of the entrepreneur.

Similar to the issue at hand, Ferrell 2011 says among the relatively few sources of money available are banks, friends, family, the small business administration, or own funds. The owner’s personal financial condition determines his or her credit standings. Additionally, they may pay higher interest rates on borrowed funds from banks than do large corporations because they are considered greater risks. Often, the only way they can borrow money for business purposes is to pledge a car, a house, other real estate, or other personal assets as well as the business. Publicly owned corporations, in contrast, can not only obtain funds from commercial banks but can sell stock and bonds to the public to raise money.

He continues to argue that despite the importance of SMES to our economy, there is no guarantee of success. Half of all the new employer firms fail within the first five years.

Restaurants are a case in point. This is due to a poor business concept such as insecticides for garbage cans will produce disaster nearly every time. Expanding a hobby into a business may work if a genuine market niche exists, but all too often people start such a business without identifying a real need for the goods or services. The other challenge includes the burdens imposed by government regulation, insufficient funds to withstand slow sales, and vulnerability to completion from larger companies. Many small rural operations cannot obtain financing within their own communities because small rural banks often lack the necessary financing expertise or assets sizable enough to encounter the risks involved with small-business loans. Without sufficient funds, the best small-business idea in the world will fail.

Ferrell (2011) suggests that poor management is the cause of many business failures. Just because an entrepreneur has a brilliant vision for a small business does not mean he or she has the knowledge or experience to manage a growing business effectively. A person who is good at creating great product ideas and marketing them may lack the skills and experience to make good management decisions in hiring, negotiating, finance, and control. Moreover, entrepreneurs may neglect those areas of management they know little about or find tedious, at the expense of the business success. Growth often requires the owner to give up a certain amount of direct authority, and is frequently hard for someone who has called all the shots to give up control. It has often been said that the greatest impediment tool the success of a business is the entrepreneur. Similarly, growth requires specialized management skills in areas such as credit analysis and promotion-skills that the founder may lack or not have time to apply. The founders of many small businesses, including those of Gateway and Dell Computers, found that they needed to bring in more experienced managers to help manage their companies through growing pains.

Therefore, poorly managed growth probably affects the business' reputation and products that do not arrive on time or goods that are poorly made quickly reverse a success. The principle immediate threat to small amid mid-sized businesses include rising inflation, collapse of the dollar's value, energy and other supply shortages, excessive household and/or corporate debt, and the growing federal deficit.

2.4. Conclusion

The researcher managed to meet the available critiques of other authors in relation to the effect of bank credit on the performance of SMES. The literature brought forward shows a positive relation between the objectives and their ability to bring in place relevant solutions to the problem.

CHAPTER THREE

3.0. METHODOLOGY

3.1. Introduction

This section of the study primarily seeks to cater for the specific methods and techniques employed in undertaking this research. The entire chapter clearly spells out the means through which these techniques are used and how effectively they contribute to the realization of the set objectives. Notable within the section are in-depth information with regards to the population, sample and sampling techniques which are employed in carrying out this research. Further information is provided concerning the research design, data collection and mode of analysis.

3.2. Research design

This is a blue print for the collection, measurement, and analysis of data, based on the research questions of the study Uma. S and Roger. B(2013).

The researcher used cross sectional design in the study. The variations were in respect of age, religion, marital status, level of education. The variations were established because more than one case was examined. A lot more than two cases was selected because they the researcher was more likely to encounter variation in all the variables in which he was interested.

3.3. Population of the study

This refers to the entire group of people, events, or things that the researcher wishes to investigate. It is the group of people, events or things of interest for which the researcher wants to make inferences (based on sample statistics) Uma Sekaran and Roger. B (2013).

60 subjects were selected from the given variety such as the small entrepreneurs, businesses men, and medium sized entrepreneurs. The target population was therefore 60 owners of micro businesses in Katwe, Kajjansi, Nakawa.

3.4. Sample size and Selection

This is the segment of the population that is selected for investigation. It is a subset of the population Alan. B and Emma. B 2007.

The sampling size was 50 owners of small and medium size enterprises who ply their trade in Katwe, Kajjansi, Nakawa suburbs of Kampala.

3.5. Sampling Technique

The researcher used a non probability method, specifically, convenience sampling was employed in the study, which the researcher convinced maintains the experience that is important to the topic at hand.

3.6. Methods of Data Collection

These included interviews, observation and questionnaires.

Interviews

According to Mark et al (2003), an interview is a purposeful discussion between two or more people. The use of interviews can help you to gather valid and reliable data that are relevant to your research questions and objectives. Where you have not yet formulated such a research question and objectives, an interview may help to achieve this.

The researcher met with some business owners and traders face to face and conducted interviews hence getting information about how they manage to acquire loans. This information couldn't be got using some other methods.

Questionnaires

According to Uma. S and Roger. B 2013, a questionnaire is a pre-formulated written set of questions, to which respondents record their answers, usually within rather closely defined alternatives.

Structured questionnaire containing both open and Closed ended questionnaires were used obtain information from respondents and administered by the interviewer. The first part of the questionnaire had background information about respondents such as gender, age, educational background, marital status. Some of questions were very specific with a fixed range of answers. The structured questionnaire had multiple-choice questions in which the researcher provided a choice of answers and respondents were asked to select one or more of the alternatives and questions that have only two response alternatives, yes or no.

Observation

Uma. S and Roger. B 2013, also put forward that observation concern the planned watching, recording, analysis, and interpretation of behaviour, actions, or events. These may be distinguished by four key dimensions that characterize the way observation is conducted: Control care the observations conducted in an artificial or in a natural setting. Structure (to what extent the observation is focused, predetermined, systematic, and quantitative in nature) Concealment of observation (are the members of the social group under study told that they are being studied or not?

The researcher observed those factors that led enterprise failure. Accuracy was also a major merit of this method.

Library research

Data was collected from books, here primary data and secondary was gathered. This allowed the researcher to systematically collect data.

3.7. Data management and Analysis

The questionnaires were checked to find out if all were answered. This involved checking for errors and quality data was used for analysis. This also involved interpreting and analyzing the available data in order to produce meaningful information.

Therefore the data processing will involve using statistical Package for Social Scientists (SPSS) and computer packages like MS word, excel computer program, to reduce on errors and check for relevancy and adequacy. This data when properly edited and analyzed will give information that is relevant to the study.

Data analysis

Statistical Package for Social Scientists (SPSS) will also be used here and will help to summarize data into frequencies and tables. This will determine the computation of Linear Correlations Analysis of Variance and Multiple Linear Regressions to determine the relationships between different study variables as spelt out in the study objectives and conceptual framework

Data summarizing: Information was attached to its required group or section so as to represent its required meaning.

Data editing: This involved going through the work and analyzing it in order to avoid mistakes or unwanted data

3.8. Reliability and Validity:

According to Uma. S 2003, the reliability of a measure indicates the extent to which it is without bias(error free) and hence ensures consistent measurement across time and across the various items in the instrument, the reliability of a measure is an indication of thr stability and consistency with which the instrument measures the concept and helps to assess the "goodness" of a measure. The reliability and validity was checked to ensure that results were consistent through personal analysis and conclusion by the researcher and validity acts to ensure uniformity of the answers given and their reliability was considered.

3.9. Ethical consideration

The respondents were briefed about the importance of the study, assured that their anonymity would be a top priority, and not forgetting the permission to do the study concerning the effect of bank credit on the performance of SMES.

3.10. Limitations of the study

There was a problem of limited and scanty literature: some sources required literature was scanty whereas other literature was not up to date economic levels.

The researcher spent a lot of money in printing of relevant data and searching for it on the internet.

3.12. Conclusion

This section of the study positively contributed towards the easy acquisition of data as regards to the effect of bank credit on small and medium sized enterprises by the use of relevant and applicable data collection techniques.

CHAPTER FOUR

4.0 DATA ANALYSIS AND PRESENTATION

4.1. Introduction

This chapter focuses on the data collected and the various formats used in presenting the data collected. It however presents data by the use of tables, bar chart and graph with its associated analysis. The results of the study are presented according to the objectives and research questions. The research objectives were treated separately. The corresponding interpretations also follow each objective. The findings were analyzed and interpreted using SPSS. All the responses are presented in terms of frequencies, percentages, means, standard deviation and correlation coefficient which are displayed in tables, and graphs. The quantitative data was analyzed based on 1- Strongly disagree to 5-Strongly agree scale rate and statistical measures like the mean standard deviation and the correlation. The statistical data from the quantitative part of the questionnaire was then supported by the qualitative data of the study from the interviews and the literature review. A total of 60 questionnaires were but only 45 questionnaires were returned. The response rate for the distributed questionnaires for this study was for that reason 75% which was representative enough of the research respondents

4.2 Descriptive Analysis

Age of the Respondents

The researcher set out to establish the age of the research respondents who participated in the research study. The following was the research data that was captured from the research field.

Table 2 Age of the respondents

Age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	20-29 years	24	53.3	53.3	53.3
	30-39 years	21	46.7	46.7	100.0
	Total	45	100.0	100.0	

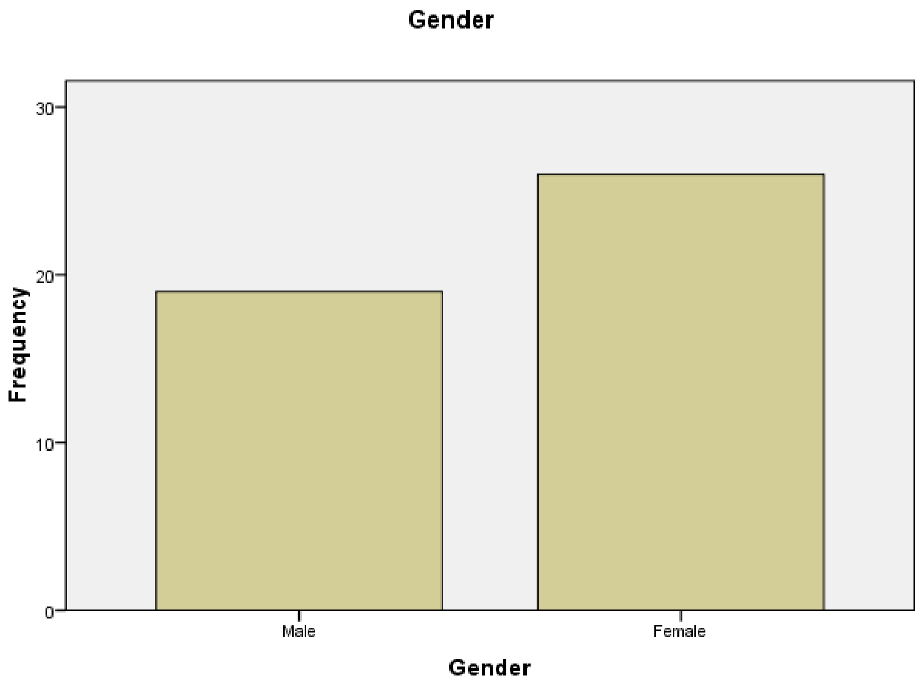
Source: Primary Research Data (2014)

Table 2 above presents the research findings on the age of the research respondents. It shows that the highest number of respondents was aged 20-29 years, those between 30-39 also represented 46% while 50 and above had none. During the interview, respondents commented on their age categories where some revealed that, the majority of the respondents in the highest age category were those who had just completed their training. From the findings above, it should be noted that all the respondents were mature adults who clearly understood the effect of bank credit on the performance of small and medium sized enterprises. This gave an opportunity to get reliable views.

Gender of the Research Respondents

This research study also set out to find out the gender of the research respondents who participated in the research study. The following was the research data that was captured from the research field.

Figure 1 Gender



Source: Primary Research Data (2014)

The bar chart above presents the research findings on the gender of the research participants. From the research findings above it should be noted that the highest number of the research respondents was females who comprised 26 of the respondents and males comprised 19 of the research respondents. This is because, women have been targeted or have been identified as a major source through which poverty can be eradicated. They have been identified as very responsible people who pay their loans on time and committed in ensuring that the business run to generate income to feed the family and to see to it that basic needs such payment of school fees, household bills, medicals women and often rely on some type of group-lending Technology. The implication of the research results means that the distribution of the research study in terms of the gender was fairly balanced and as such, though the low number of men in SMEs means they should acquire financing. The results from the study can be relied on for drawing empirical conclusions and recommendations for the study.

The effect of bank credit on the performance of SMES

During the research study, the researcher sort to find out the effect of bank credit on the performance of SMES. The researcher was guided by a couple of research questions and the relationship was determined using descriptive statistics. The research results in the table below represent the descriptive statistics. Therefore the questions are sub- presented as below.

Bank credit has greatly improved on the profits of the business

The following were the research findings that were captured from the research field work.

Table 3 Bank credit has improved on business profits

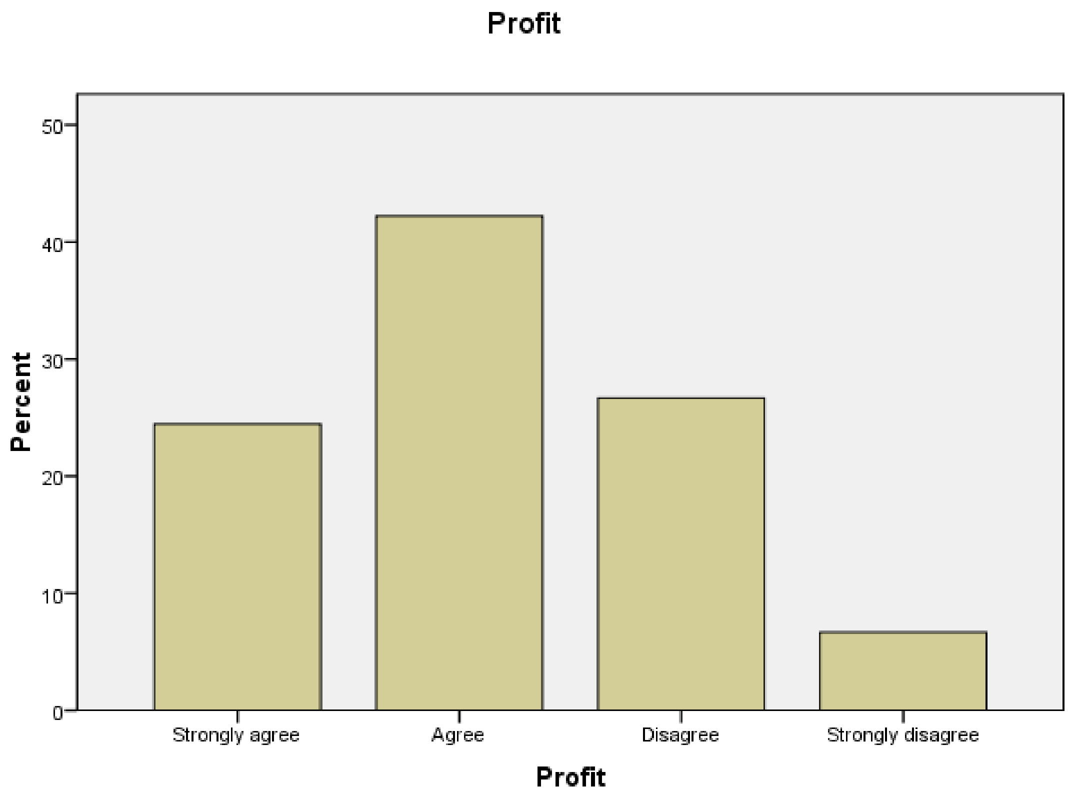
Profit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	11	24.4	24.4	24.4
	Agree	19	42.2	42.2	66.7
	Disagree	12	26.7	26.7	93.3
	Strongly disagree	3	6.7	6.7	100.0
	Total	45	100.0	100.0	

Source: Primary Resource Data (2014)

The table 3 above presents the research findings on the effect of bank credit on the profits of a business. The research results in the table above reveal that based on the scale of 1-strongly disagree to 5 strongly agree, based on the research, the highest frequency was 19. The respondents under this agree that their profits increased due to bank credit. According to Peter Howells and Keith Bain (1998) bank credit helps SMES use this surplus to build up holdings of money.

Figure 2 Profit



Source: Primary Research Data (2014)

Using the bar chart, the effect of bank credit on the profits of the business of the respondents basing on the scale of 1-strongly disagree to 5 strongly agree, showed that 42.2% agreed, 26.6% disagreed, 24.4% strongly agreed and 6.7% strongly disagreed.

Lack of sufficient capital has caused poor performance in the business

Respondents were asked if the lack of sufficient capital had caused poor performance in their business and the responses were as shown in the table below.

Table 4 Lack of sufficient capital

Sufficient

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	7	15.6	15.6	15.6
	Agree	23	51.1	51.1	66.7
	Disagree	6	13.3	13.3	80.0
	Strongly disagree	9	20.0	20.0	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

As the figures above show, 26 of the respondents agreed that lack of sufficient capital has caused poor performance in their business. These also constituted a big percentage of 51.1%. This is supported by (Cook, P. 2000) despite the significant role these industrial factors play, a lack of sufficient capital and credit is often a major handicap to the development of SMEs, particularly in their early growth stages.

The business has been able to acquire assets as a result of bank credit

Table 5 Assets acquisition has been due to Bank credit

Assets

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	6	13.3	13.3	13.3
	Agree	20	44.4	44.4	57.8
	Disagree	12	26.7	26.7	84.4
	Strongly disagree	7	15.6	15.6	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

The table 5 above shows that the bank credit has simplified acquisition of assets. This therefore portrays a positive performance. The result that came up showed that 44.4% respondents agreed that assets were easily acquired due to bank credit. According to Peter Howells and Keith Bain (1998), some people have income which is in excess of their current consumption needs, there will be those firms, households, public authorities whose incomes are insufficient for their current spending plans. This will usually be because they are planning to spend on large, expensive, "real" assets of a kind which lasts for many years.

Bank credit has been useful in your business

The respondents were asked whether bank credit was useful to their businesses and they gave the following responses.

Table 6 Usefulness of bank credit to the business

Useful

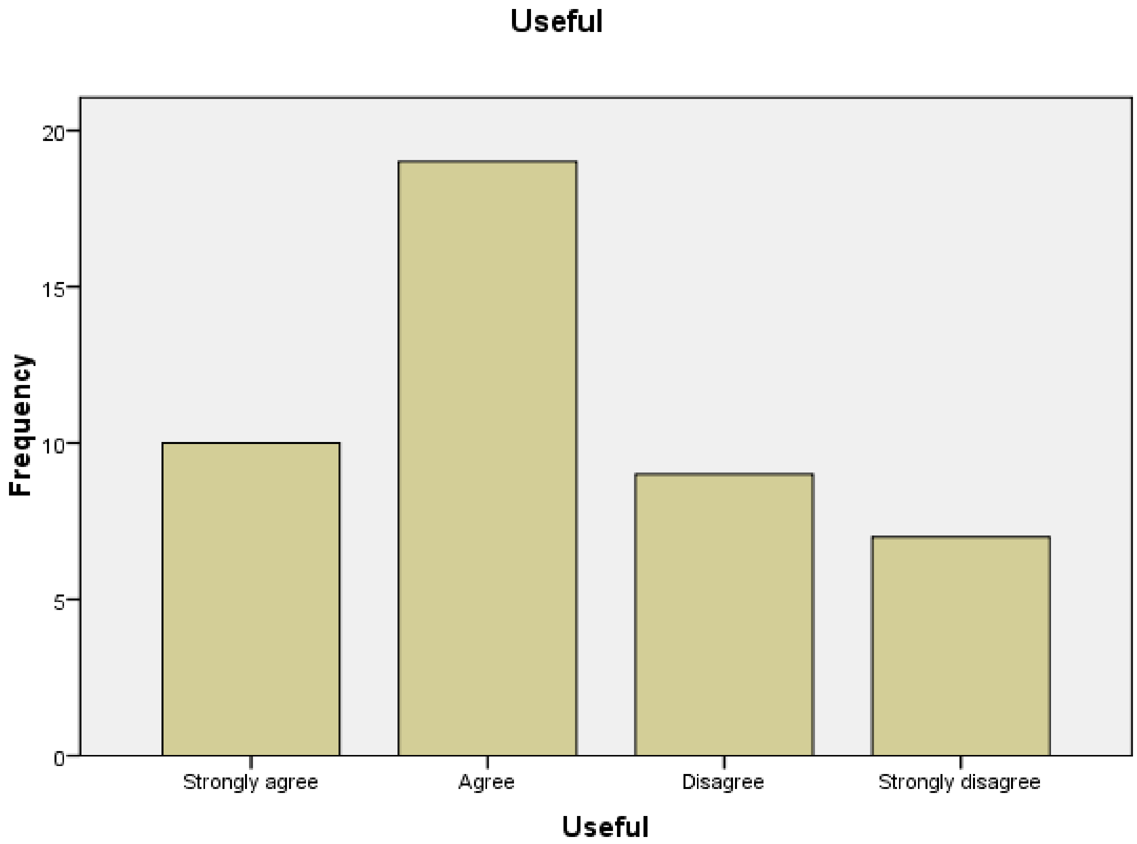
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	10	22.2	22.2	22.2
	Agree	19	42.2	42.2	64.4
	Disagree	9	20.0	20.0	84.4
	Strongly disagree	7	15.6	15.6	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

19 respondents agreed that bank credit has been useful in their businesses, this was also represented by a percentage of 42.2%.

The bar chart below show a diagrammatic representation of the responses towards the usefulness of bank credit in business.

Figure 3 Usefulness



Source: Primary Research Data (2014)

According to Idowu 2000, accessing finance has been identified as a key element for small and medium enterprises to thrive in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries. It can be seen from the chart that bank credit is useful. The frequencies of those who agree are sufficient to back this up.

The bank credit was used for expansion of the business

Table 7 Expansion of the business

Expansion

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	6	13.3	13.3	13.3
	Agree	11	24.4	24.4	37.8
	Disagree	18	40.0	40.0	77.8
	Stongly disagree	10	22.2	22.2	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

18 of the respondents disagreed that the bank credit was used for expansion of the business. Therefore 13.3% strongly agreed, 24.4% agreed, 40% disagreed and 10% strongly disagreed. Megginson 1988, argues that many of the financial problems plaguing small businesses are avoidable, provided entrepreneurs analyze their own business's funding needs objectively and with sufficient lead time to act decisively.

Factors limiting bank credit

During the research study, the researcher sort to find out the factors limiting bank credit in SMEs. The researcher was guided by a couple of research questions and the relationship was determined using descriptive statistics. The research results in the table below represent the descriptive statistics. Therefore the questions are sub- presented as below.

Prior to credit acquisition, the bank asked for collateral

Table 8 collateral

Collateral

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	22	48.9	48.9	48.9
	Agree	16	35.6	35.6	84.4
	Strongly disagree	7	15.6	15.6	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

Of the respondents, 22 strongly agreed that the banks did ask for collateral security during the process of loan acquisition. They had a percentage of 48.9% and those who agreed were composed of 35.6%.

Most of the financial institutions do ask for collateral securities this is because a person borrowing money may fail to buy within the required period and therefore the bank has to recover its money by selling the asset.

Many small businesses have trouble getting the start-up or additional capital that they need. Without a long list of assets or a proven track record, there is no way to show banks exactly how promising your soon-to-be bustling business really is. According to William 2006, it is a fact of life in a modern economy that credit is necessary in most situations and for most businesses. This means that the basic problem is usually not whether to give credit, but how to manage the credit so that the following many objectives are met.

Before acquiring the loan, the bank asked for cash flow statements

Table 9 cash flow statement

Cash Flow Statement

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	10	22.2	22.2	22.2
	Agree	16	35.6	35.6	57.8
	Disagree	13	28.9	28.9	86.7
	Strongly disagree	6	13.3	13.3	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

Banks usually ask for cash flow for businesses that have been operating. This is based on the fact that the bank is able to know the worth of the business, how long it can take to pay back the loan through reflecting on the previous and current performances of the business. According to the information on shown on the tables, a percentage of 35.6 of the respondents agreed that the banks did ask for the financial statements of their businesses.

According to Mary. J. B et al 2009, the degree of uncertainty surrounding a small firm's long-term financial needs primarily depends on whether the business is already operating or it's just starting. If a business has an operating history, its future needs can be estimated with relative accuracy, even with substantial growth. Even for an existing business, however, an in depth analysis of its permanent financial requirements can be valuable.

Before acquiring the loan, the bank asked for total assets

Table 10 total assets

Total assets

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	14	31.1	31.1	31.1
	Agree	15	33.3	33.3	64.4
	Disagree	13	28.9	28.9	93.3
	Strongly disagree	3	6.7	6.7	100.0
	Total	45	100.0	100.0	

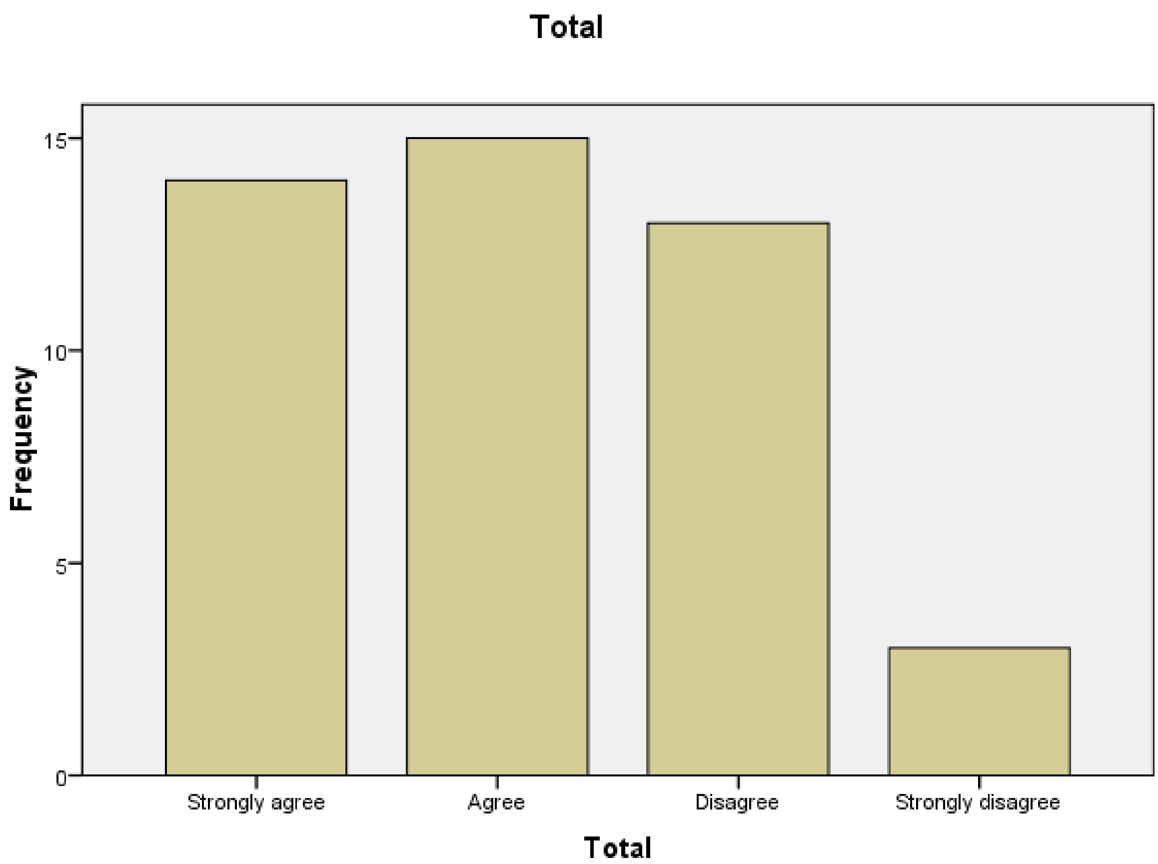
Source: Primary Research Data (2014)

15 respondents agreed, 14 strongly agreed, 13 disagreed and 3 strongly disagreed that the banks did ask for total assets during the process of loan acquisition.

The assets of the business do help it stand out in its duties to accomplish long term obligations, therefore this portrays a positive picture of the performance of the business and their need is paramount.

As a general rule, small businesses' long lived assets, such as buildings and other facilities, should be financed with long term loans, while short lived assets, such as inventory or Accounts receivable, should be financed with short term loans, a new business, or a major expansion of an existing business, should be evaluated with great care, paying particular attention to its capital requirements. For example, the firm's fixed assets should be financed with equity funds, or with debt funds having a maturity approximately equal to the productive life of the asset. Mary. J. B et al 2009.

Figure 4 Total assets



The bank did ask for financial statements

Table 11 Financial statements

Financial

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	16	35.6	35.6	35.6
	Agree	10	22.2	22.2	57.8
	Disagree	8	17.8	17.8	75.6
	Strongly disagree	11	24.4	24.4	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

According to the table above, 35.6% of the respondents agreed that the bank did ask for financial statements before giving out the credit.

- According to William. A. C 2006, Personal financial statements: SBA requires financial statements for all principal owners (20 percent or more) and guarantors. Financial statements should not be older than 90 days. Make certain that you attach a copy of last year's federal income tax return to the financial statement and for existing businesses, provide financial statements for at least the last three years, plus a current dated statement(no older than 90 days) including balance sheets, profit and loss statements, and a reconciliation of net worth. Aging accounts of accounts payable and accounts receivable should be included, as well as a schedule of term debt. Other balance sheet items of significant value contained in the most recent statement should be explained.

The bank did ask for a business plan

Table 12 Business plan

Business Plan

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	4	8.9	8.9	8.9
	Agree	13	28.9	28.9	37.8
	Disagree	10	22.2	22.2	60.0
	Strongly disagree	18	40.0	40.0	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

From the research, the researcher found out that majority businesses in Kampala did not present business plans to banks when getting credit. As the figures show in the table, 18 respondents strongly disagreed that the bank asked for a business plan when applying for loans.

The following relate to the sources of finance

How start up of the business was financed

Table 13 Start up

Start up

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Personal savings	27	60.0	60.0	60.0
	Bank credit	10	22.2	22.2	82.2
	Friends and relatives	8	17.8	17.8	100.0
	Total	45	100.0	100.0	

Source: Primary Research Data (2014)

60% of the responses showed that the business owns financed the start up of their businesses from personal savings.

The number one source of start up capital is an entrepreneurs own personal savings. This provides maintains or control of the business. Also most investors want to know that an entrepreneur has enough faith in an enterprise to risk his or her own money before investors risk theirs. (Earl. C. M and Kathleen. R 1994).

Challenges faced when acquiring finance

The respondents were able to put forward various challenges they faced and these included the following.

Low savings due to low income earned caused the fear to show the financial statements since this was not enough to meet up to the high loans the business wanted.

Lack of collateral security did limit the acquisition of loans. According to William. A. C 2006, list real property and other assets to be held as collateral. Few financial institutions provide non collateral-based loans. All loans should have at least two identifiable sources of repayment. The first source is usually cash flow generated from profitable operations of the business. The second source is usually collateral pledged to secure the loan

Some respondents argued that the banks do ask for a lot of personal information that they think they shouldn't really disclose. They put forward that this kind of process is a waste of too much time since they really need the financial help.

The too much information asked brought about bureaucracy and this possesed a big challenge for the SMES. For example According to William. A. C 2006 banks do ask for, written description of your business, including the following information: Type of organization, Date of information, Location, Product, or service, Brief history, Proposed future operation, Competition, Customers, Suppliers.

The high interest rates did limit the acquisition of credit. Most of the respondents faced this challenge. This really de motivates loan acquisition since the payments are sometimes high yet the period with which to pay is not favourable to the business owners. This high interest rate demanded from the SME sector by the banks is due to the high risk nature of this sector, resulting from the high default rates associated with SMEs financing. The high default was also linked by the respondent SMEs to the delay in receiving payments for their goods and services rendered.

4.3. Conclusion

Considering the views expressed on the research objectives arising from both quantitative and qualitative results, it can be deduced that there is a positive relationship between bank credit and the performance of small and medium sized enterprises. According to the data that was gathered from the research at Kampala district, it was found out that bank credit greatly affects the performance of SMES.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter discusses the main findings of the study. Also conclusions and recommendations are made. The goal of this research is to study the effect of bank credit on SMES in Kampala. Specifically, the study sought to identify the sources of finance, the factors limiting the access to finance for the SMES and the solutions to these challenges.

5.2 Summary

The study reviewed literature on some of the effects of bank credit on the performance of SMES in Kampala. The study also looked at the following theories, the credit policy, pecking order theory and M. Friedman theory of Money. The literature also reviewed the sources of finance such as personal savings, obtaining money from friends and family, private investors and venture capitalists, bank financing. In addition the review also looked at the constraints to borrowing faced by SMES. The methodology of the research was made up of the research design which was descriptive and quantitative data was collected using open and closed ended questionnaires. The target population was that of the small and medium sized entrepreneurs in Kampala with a sample size of 60. The data analysis made use of tables and bar charts. The researcher also looked at the characteristics of entrepreneurs in terms of their ages and gender as well as their marital status, experience in the business. During the research study, the researcher sort to find out the effect of bank credit on the performance of SMES, it was found out that bank credit greatly improved on the profits of the business. Lack of sufficient capital also was noted as being the cause of poor performance of SMES.

5.2 Conclusions

With the numerous results acquired from the review and the data that was analysed, bank credit does have an impact on the performance of SMES in Kampala.

This can be further explained basing on the following information;

The business owners who did get credit from banks realised an increase in profits.

Lack of sufficient capital did stand out a factor leading to poor performance of the SMES in Kampala and many people feared to get loans due to the fact they lacked collateral security and also the payment became very difficult.

Low savings due to low income earned caused the fear to show the financial statements since this was not enough to meet up to the high loans the business wanted and It was established that gender was a factor that determined access to credit because the numbers were skewed towards women. It is however important to point out that age was not a factor in considering one for credit.

5.3 Recommendations

Various studies and literature put forward the fact that vigorous provision of credit to various entrepreneurs could help to boost their businesses and consequently eradicate poverty and therefore bring about growth in the economy.

According to the characteristics of SMES, most of them do exist in the peri-urban and the rural areas and these areas are not occupied by the rich therefore bank credit is a way to target poverty reduction in these areas.

Accessing small amounts of credit at reasonable interest rates give people an opportunity to set up their own small business. They could acquire loans to help them maintain their enterprises and perform better but they lack securities, have poor credit worthiness, banks lack information pertaining their financial activities and also some financial institutions are not very reliable. However many banks and governments have put up credit facilities and schemes. In Uganda banks such as BOU, CRDB, DFCU, EADB, EIB have opened up opportunities for entrepreneurs to easily access loans. The government also provides finances to promising entrepreneurs, while some NGO's have looked towards also running projects that offer credit to these enterprises. Whereas these finances are extended to SME's one thing for sure is how these entrepreneurs use these finances. Poor households use bank credit to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education. If the following suggestion are given the needed attention if will improve the performance of micro credit and its beneficiaries;

Acquisition of credit is not a guarantee that a firm will perform well because this is backed up by good managerial skills and proper decision making.

The SMES should be encouraged to make savings their habit so that they can reduce their dependent on the bank credit, since most entrepreneurs started up their businesses from personal savings.

Furthermore SMEs should device method of increasing on their sales in order to enable them save adequately.

Although most of the banks are giving out credit, it seems the credit is not large enough to see to the growth of businesses. I therefore recommended that these banks try to increase their loan size. An increase in loan size will have a greater multiplier effect on households' income through profits from income generating activities;

The banks should look at diversification of the loan products offered, in order to sort a variety of business ideas and prospects. The credit services should be diversified by providing working capital loan, fixed asset loan, seasonal agricultural loan, car loan, consumer loan, emergency loan and parallel loan. To increase the impact, the loan products have to fit the financial needs of a wider range of household economic activities. This will however help reduce diversion and a significant reduction in the defaulting rate of customers;

SMES should be sensitized about the importance of loans, and how to manage their debts this will therefore assist them reduce on the diversion of funds into other businesses other than the reason for the financial request. This can be avoided by the financial institution ensuring that the items that the customer intends to purchase for example equipment, payment is made directly to the supplier;

Banks and other financial intermediaries should train and equip their employees with adequate and necessary skills for the sole purpose of monitoring effectively loans given out as well as educate their customers on financial management.

5.4 Suggestions for future research

The findings and the implications discussed above provide some directions for future Research.

Research should be carried out on the relationship between saving and the performance of the SMES. This is because this could help track down the financial challenges the SMES are facing.

In addition, future research should examine the impact of bank credit on borrowers over

Time, since some studies suggest that it takes time for microfinance to have an effect on livelihoods of the poor. For instance according to Aguilar (2006) and Ausburg (2008) argues that, there is the need for a plus component (training in financial management, marketing and managerial skills and market development) for microfinance to succeed.

The research was also carried out in parts of Kampala such as Nakawa, Katwe and Kajjansi and is not a full representation of all SMES in Uganda hence a recommendation that further studies should be carried out in the whole Also, I recommend a research on diversion of credit into other expenses other than the business.

Further research should be carried out on the effect of having a credit act. Because banks do face many risks associated with credit and therefore this should be looked at effectively in order to strengthen their knowledge about their customers. Banks tend to limit their lending to providing for the working capital needs of established firms, especially for financing accounts receivable and inventory. Quite simply, they want firms with proven track records and preferably plenty of collateral in form of hard assets. Bankers are reluctant to loan money to finance losses, marketing campaigns and other “soft assets” (Moore. C. W et al 2008).

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Appendices

APPENDIX 1: QUESTIONNAIRE

Dear respondent, I am an undergraduate student in Uganda Martyrs University Nkozi pursuing a bachelor's degree in Business Administration and Management.

I am carrying out a research on the effect of bank credit on the performance of small and medium sized enterprises. Please spare some time for this questionnaire so that you can tick and fill where appropriate.

I assure you that the responses you give will be treated with strict confidentiality. All information provided in this interview schedule will be added to those of other respondents for a general analysis so there will be no way of identifying sources of specific responses after analysis. Your co-operation will therefore be of much importance in the success of this study. Thank you.

SECTION A: DEMOGRAPHIC CHARACTERISTICS

1: AGE: 20-29 ☐ 30-39 ☐ 50-59 ☐ Above 60 ☐

2: GENDER: Male ☐ Female ☐

3: MARITAL STATUS

Married ☐ Single ☐ Divorced ☐ Separated ☐ Widowed ☐

4: LEVEL OF EDUCATION

Primary ☐ Secondary ☐ Institution ☐ University ☐

5: RELIGIOUS AFFLILIATION

Christian ☐ Islam ☐ Traditional ☐ Others ☐

6: EXPERIENCE

1-5 ☐ 6-10 ☐ 11-15 ☐ 16-20 ☐

SECTION B. the following questions relate to the effect of bank credit on the performance of your business. **Just tick 1: Strongly agree 2: Agree 3: Disagree 4: Strongly disagree**

	1	**2**	**3**	**4**
1. Bank credit has greatly improved on the profits of the business				
2. The lack of sufficient capital has caused poor performance in the business				
3. the market expansion of the business was due to bank credit				
4. the relationship between the business and customers has improved after financing the business				
5. the business has been able to easily acquire assets as a result of bank credit				
6. bank credit has been useful in your business				
7. the loan acted as your start up capital				
8. the loan was meant to be working capital				
9. the loan was used for expansion of the business				

The following questions relate to factors limiting bank credit

When acquiring the loan,	**1**	**2**	**3**	**4**
10. the bank asked for collateral				
11. the bank asked for cashflow statements				

12. the bank asked for total assets				
13. the bank asked for financial statements				
14. the bank asked for a business plan				
15. the rates high				
16. taxes limited your business growth				

The following relates to the source of finance

17. How did you finance the start up of the business?

i. Personal Savings ☐

ii. Bank credit ☐

iii. Friends & Relations ☐

iv. Others (Specify)………………………………………………

18. What are the challenges faced when acquiring finance?

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19. What solutions do you suggest to address the challenges identified?

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