# THE INFLUENCE OF MICROFINANCE ON THE GROWTH OF SMALL AND MEDIUM SIZED BUSINESSES.

**A CASE STUDY OF FINCA UGANDA**

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**FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT**

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**AN UNDERGRADUATE DISSERTATION SUBMITTED TO THE FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A DEGREE IN BUSINESS ADMINISTRATION AND MANAGEMENT AT UGANDA MARTYRS UNIVERSITY**

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## DEDICATION

I dedicate this book to my dear parents, Mr and Mrs Tibuhwa Gabriel who sewed the first seed of civilization into me, along with formal education, and who, by God's grace, have seen it grow to this level of Education. I also dedicate it to my dear brothers and sisters, Allan, Allen, Michael and Brian who always came in to help financially and gave me all the support I needed to the end.

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Thank you all once again

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## ABSTRACT

The following study was conducted to investigate the contribution of FINCA to the growth and development of small and medium sized businesses. The study was guided by the following research objectives: (i) to examine the extent to which interest rates by MFI influence the growth of SMEs in Uganda.

(ii) To examine how credit facilities rendered by MFI influence the growth of SMEs in Uganda.

**(iii)** To establish how collateral security effects the growth of SMEs in Uganda.

The case study design was used as an approach in the study for collecting data aimed at exploring an in depth analysis and the population under investigation included the SME owner's using the FINCA for financial services plus the FINCA staff involved in the process.

Primary and secondary data were used in the research. The primary data was got from FINCA clients (staff and present clients). The information was obtained through self-administered questionnaires and interviews where a total of 45 male and female individuals participated. Secondary data was obtained from published materials, which included journals, textbooks magazines, internal reports and newspapers. The study elicited several conclusions; notable among them is that FINCA offers several services to its clients that are of economic and growth benefit. The study yielded the following recommendations; collateral requirement should be given due attention because it could have significant negative effects on the financial institutions' lending, the management of lending institutions should ensure that they carry out a research on consumer needs to establish the ideal interest rates to be charged and also the owners of the SME's should always monitor their loan usage to avoid misappropriation.

## ACRONYMS

**SMEs**: Small and Medium Sized Businesses.

**MFIs**; Microfinance institutions.

**FINCA:** Foundation for international community assistance.

**AMFIU**; Association of microfinance institutions in Uganda.

# CHAPTER ONE

# INTRODUCTION

## 1.1 Introduction

The major challenge facing many developing countries, especially in Africa, is planning and devising appropriate development strategies that will capture the financial services instruments to support SMEs, which constitute about 70 per cent of the business sector and are responsible for employing 56-70 per cent of the population in Uganda. Delivery of microcredit to operators of SMEs in developing Countries is increasingly being viewed as a strategic means of assisting the so-called “working poor”.

Microfinance is a relatively new term in the field of development, it first came to prominence in the 1970s (Robinson, 2001). Prior then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidized rural credit programmes. These often resulted in high loan defaults, high loss and an inability to reach poor rural households (Robinson, 2001).

Robinson asserts that 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and BRI2 began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients.

The 1990s saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale (Robinson, 2001). Dichter (1999) refers to the 1990s as “the microfinance decade”. By then Microfinance had turned into an industry according to

Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these services (MIX, 2005).

Small and medium-sized enterprises (SMEs) form the back bone of the private sector, making up approximately 90 per cent of Uganda's private sector and contribute two-thirds of national income (Badagawa, 2002; Kisaame, 2002). SMEs generate employment, add value, bring in foreign exchange and investment, improve labour skills, and have linkages with large organizations (Sarapaivanich, 2003). Therefore sustainable development and employment cannot be achieved without SMEs.

Although SMEs contribute greatly to economic development, access to finance tops the list of constraints faced by them everywhere. Because of the high transaction costs and inability of SMEs to provide collateral banks require, SMEs find themselves starved for funds at all stages of their development ranging from start-up to expansion and growth (Beyene,2002).

Therefore this research investigates the role of Micro Finance Institutions towards the growth and development of small and medium sized businesses. The research work is comprised of five chapters: General introduction, Literature review, Research Methodology, Presentation of analysis and discussion of findings; finally the Summary, Conclusions and Recommendations. In the current chapter, the researcher will give a number of issues such as the general introduction, background of the study, statement of the problem, purpose of the study, objectives of the study, research questions, Scope of the study, justification of the study, and finally the conceptual frame work.

## 1.2 General Background

Marguerite S. Robinson, in the Microfinance Revolution states that among the economically active poor individuals of the developing world, there is strong demand for small-scale commercial financial services for both Credit and Savings. Where available, these financial services help low income people improve household and enterprise management, increase productivity, smooth income flows and consumption costs, enlarge and diversify their microbusinesses, and increase their incomes. But the demand for this is rarely met by the formal financial sector .One reason is that demand is generally not perceived and the other is that many participants in the formal sector believe, wrongly, that microfinance cannot be profitable for banking institutions.

Uganda is one of the many countries around the continent that greatly depend on the micro-economic sector from which family the small-scale enterprises are categorised. This sector is also a major source of income for both government and a good percentage of Ugandans living both below and above the poverty line which explains the governments' emphasis towards improving the performance and productivity of the sector.

Small scale businesses play a key role in the economic development achievement process of the economy. They are believed to be a major source of entrepreneurial skills innovation and employment.

The definition of small scale businesses varies; in the United States the small business administration establishes small businesses size standards on an industry by industry basis according to Wikipedia, the free Encyclopaedia small business, but generally specifies a small business as having fewer than 250 employees and less than 7 million in annual receipts. In

Australia a small business is defined by the fair work act 2009 as one with fewer than 15 employees. Turnover value of assets is also another method used to classify small business enterprises.

For a developing country like Uganda, a small scale enterprise would overtly mean one with less than 50 workers and a minimum of 5 workers, the value of assets excluding land, building and working capital of less than Ugshs 50 million and the annual turnover of between 10-50 million. These small businesses are at the heart of growth through creating employment opportunities in the country, income generation through self-employment and generally supporting local production hence working toward the poverty alleviation base. They also keep the economy continuously nourished with ideas, skills, innovative minds all that are necessary in promoting competition and the efficient allocation of scarce resources. All in all they are among the leading growth engines of the Ugandan economy.

According to Charles, Garry, D.B.,et al. in Entrepreneurship-A small Business Approach ,the world bank estimates that one of the strongest factors in the growth in any nations GNP is the presence of small and medium sized enterprises(SMEs) which explains the wide spread efforts to encourage their development. They go on to explain that one of the majorly highlighted efforts to encourage the growth and expansion of these SMEs are the Microloan programs which are now widely spread to further encourage self-development. The success of such loans has been substantial. To reinforce their argument, they further argue that the absence of financial services means that the firm does not have the flexibility to respond to issues such as the need to hire replacements or even fund the different day to day activities.

The small enterprise base in Uganda is estimated to be 800,000, due to this perception towards them by potential clients as lacking in the ability to provide quality services and also being weak in regard to satisfying big/crucial projects simultaneously, there are quite a number of hindrances that limit their growth and finally their ability to attain economies of scale. However, contrary to most people's belief, these challenges do not only spring from financial issues but also areas like the human resource sector, market access, knowledge about modern technology and information and most importantly the poor management capacity. This inadequate management capacity is a vital issue since it is from its existence that all the challenges spring. Due to poor management areas like the process of securing funds for business activities such as procuring raw materials and products, investing in plant and equipment

From the external perspective are all bound to collapse. Hence the Government, to overcome some of these constraints liberalized the economy to encourage the growth of micro-financing businesses that are believed to be the major remedy.

The savings promotion and enhancement of enterprise development (2006) states that, providing small loans and savings facilities to people who are excluded from commercial financial services has become a strategy for reducing poverty in many communities. Access to this credit boosts opportunities to partake an active role in their perspective economies through entrepreneurs and building income, bargaining power and social growth. Fin Scope in 2007 conducted a study in Uganda where they discovered that lack of access to financial services was one of the biggest obstacles to the growth and expansion of SMEs in the country. A significant obstacle they found was the fact that the financial sector tends to concentrate on the densely populated urban areas. They found out that only around 38% of Ugandans had access to these services at the time they later concluded that around 65% of the people living in rural and peril urban areas could not get access to these services; around 52% of those in urban areas hence the idea that sometimes all people need is a little hand up and not a hand out.

Marguerite S Robinson defines Microfinance as small-scale financial services-primary credit and services provided to people who operate small enterprises. Micro Credit overall helps low-income people reduce risk, improve management, raise productivity, obtain higher returns on investments, increase their incomes and improve the quality of their lives and those of their dependants.

According to the Association of microfinance institutions of Uganda (AMFIU) reports, Uganda has a total of 2115 microfinance institution providers, with 4,830,583 total accounts, 3,429,269 Deposit accounts, 952,331 kinds of loans, with a gross loan portfolio of 450,434,982 total deposits of 398,998,047, serving a population of 32,709,864 people.

A microfinance institution is an organization that offers financial services to low income populations. The effective long term provision of these services occurs through microfinance institutions that adhere to the key principles endorsed by the consultative group to assist the poorest (CGAP) and its 28 member donors. MFIs are considered crucial in serving rural markets which formal financial institutions may not find commercially viable to serve which is mainly due to their simple and cost effective original structure and ability to respond to clients' needs. Since 2005 the government of Uganda focused its support fully on the MFI sector in a bid to increase the outreach to rural areas.

Marguerite S. Robinson goes on to note that what matters to microfinance clients is the access and cost of financial services. Many people are served by informal money lenders, who generally provide easy access to credit but at a high cost. Microfinance institutions can also offer much-in-demand savings services that provide savers with security, liquidity and returns, a combination not generally available in the informal sector.

### 1.2.1 FINCA Uganda

The Foundation for International Community Assistance (FINCA) was founded in 1992 with a vision to be a global network, collectively serving more financially unable entrepreneurs than any other MFI while operating on commercial principles of performance and sustainability. It currently has 1.7 million lowest income clients in 22 countries with a $948 loan portfolio worldwide providing services aimed at creating employment, raising family incomes and reducing poverty. The FINCA branch in Uganda has about 143, 842 clients, a $26million loan portfolio, 27 service outlets, and a $585 average loan amount. To support micro enterprises, FINCA subsidiaries offer products and services like individual loans, village banking loans, agriculture loans, micro energy loans, savings, insurance and remittances as well as money transfers.

FINCA pioneered ‘Village banking’ which brought together groups of people ranging from 10-30 in a community, mostly women who guaranteed small loans for each other. The small loans enable them to create income-generating opportunities. Before customers at FINCA are lent, they are trained about credit, managing cash flows and the importance of retaining a portion of their profits and savings. Customers are also helped to determine whether they have the capacity to expand their businesses. This training helps to ensure their success as borrowers and as business owners.

Foundation for international community assistance is firmly committed to fair practises and maintains strict policies on loan collection practices and evaluations. The loan officers are trained in FINCAs mission and dedicated to helping clients build successful businesses.

### 1.3 Problem Statement

According to Fin scope Uganda, lack of financial services is the biggest obstacle to development. Association of microfinance institutions of Uganda (AMFIU) reports show that though several attempts have been put in place to increase the accessibility of the microfinance institution services to empower the local population, significant challenges are still being registered like low turn up due to the numerous obstacles both within and outside the microfinance industry which could include issues like high interest rates charged. Standard banking practices consider that the under privileged are not reliable to gain some credit so the microfinance institutions come in to bridge this gap since they trust in the SME owner's capabilities to pay back.

The study seeks to investigate and gauge how much involvement of the MFIs has helped to improve the development strategies of SMEs looking at all the support programmes involved especially the credit facilities bit. According to its main website FINCAs loan products fall under three categories that is the Business, Small group and Village group loans. The Business loans are for those individuals that own small businesses and vary from a minimum of Uganda shs 500,000 to a maximum of Uganda shs 60,000,000. There are small group loans for groups of 5 t0 20 people with each individual having access to a loan amount of Uganda shs 300,000 to Uganda shs 6,000,000, lastly the Village group loans are for groups of 5 to 10 people each individual liable to a loan amount of Uganda shs 50,000 to Uganda shs 6,000,000. If FINCA's influence been a success or failure together with what is being done to keep improving/upgrading the whole system is what I am looking at.

In every economy, the understanding of the performance of SMEs is crucial to the stability and health of the economy. Most SME businesses are not thriving because the owners but mostly lack of enough capital to do something that can generate the money. With this opportunity availed, they could find their own way to expand and later repay the money they owe.

## 1.4 Broad Objective

The purpose of the study is to find out the influence of microfinance institutions on the growth of small and medium sized businesses in Uganda.

## 1.5 Specific Objectives

(i) To examine the extent to which interest rates by MFI influence the growth of SMEs in Uganda.

(ii) To examine how credit facilities rendered by MFI influence the growth of SMEs in Uganda.

**(iii)** To establish how collateral security effects the growth of SMEs in Uganda.

## 1.6 Research Questions

1. How do interest rates provided by MFI influence the growth of SMEs in Uganda?
2. How do credit facilities rendered by MFI influence the growth of SMEs in Uganda?
3. Do collateral securities asked by MFI effect the growth of SMEs in Uganda?

## 1.6 Research hypothesis

The hypothesis of the study will be:

There is a relationship between MFI and the growth of SMEs in Uganda.

**1.7 Significance of the study**

Micro credit is the major tool being used to stimulate development.

The study will add value onto the literature already in existence for reference by scholars, researchers and others interested in the microcredit scheme in relation to SME performance.

The information will also assist the credit officers of certain MFI's to advise the potential borrowers of how and where to invest in order to benefit from the loans availed.

**1.8 Justification of the study**

In the last 25 years, the delivery of financial services to SMEs has been considered an important tool for poverty reduction through provision of job opportunities. This is part of the Millennium Development Goal (MDGs) to alleviate poverty where MFIs can contribute tremendously, as argued by Hiderink et al (2009). Moreover, the main challenge facing the poor is to gain financial power to enable them to boost their income generating activities since accessing finance is pivotal in the struggle to reduce poverty (Yunus, 2003; Kasekende and Opondo 2003).

Many MFI's have been established in Uganda but SME's growth and prosperity is still low, therefore because of this urgency, the researcher was persuaded to go ahead to find out the influence of microfinance institutions on the growth of SMEs at FINCA Uganda so as vital recommendations are given to the MFI on how to influence the growth of SMEs in the area.

## 1.8 Scope of the work

Subject scope; the study will confine the effect of the MFI loan policies on the growth of SMEs.

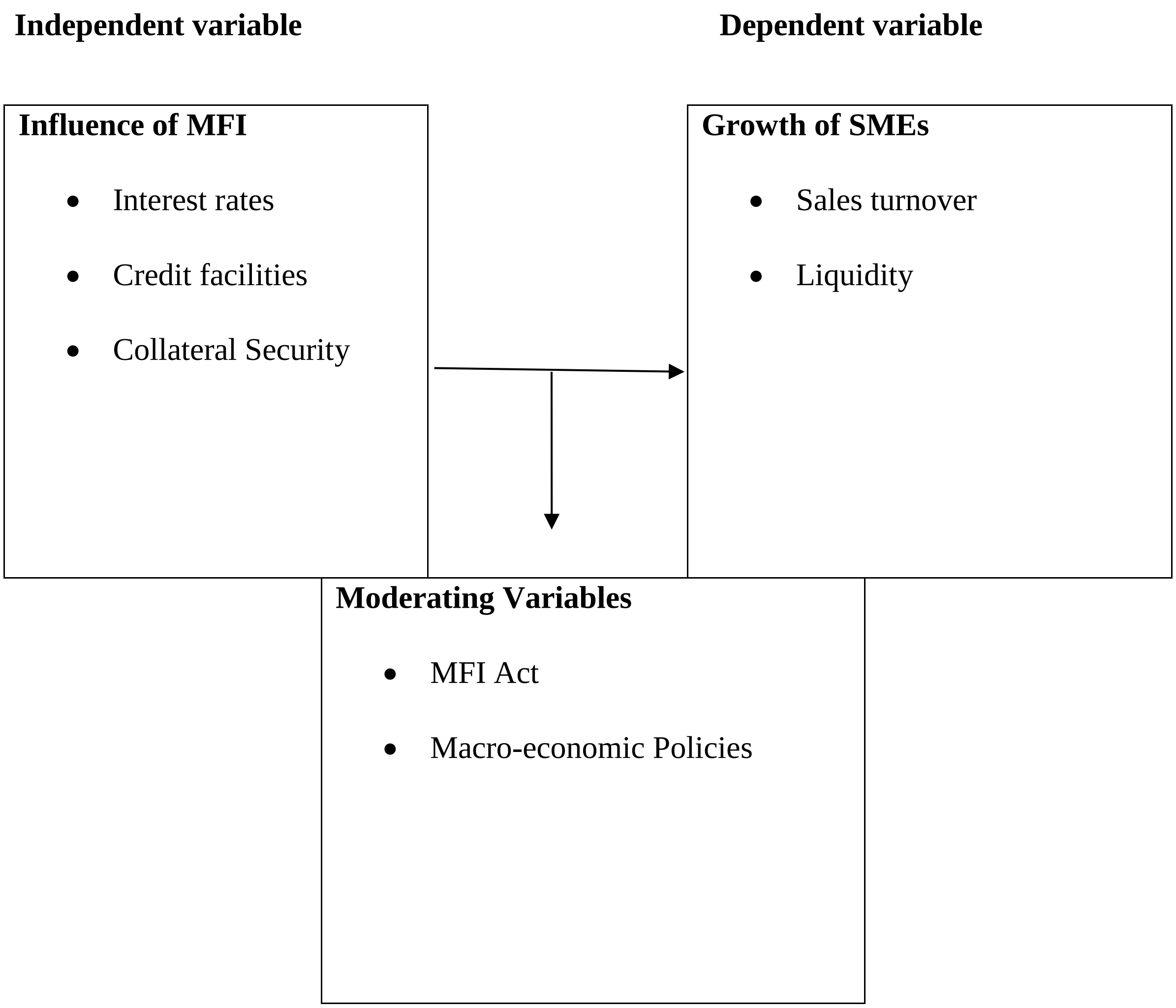
Time scope; the study will cover any literature on the recent past history on the MFI influence on SMEs.

Content scope; the study will focus contextually on establishing a relationship between MFIs and the economic growth of SME’s.

## 1.10 Conceptual frame work

A conceptual frame work provides a model for linking categories of possible variables or concepts in the study as perceived by the researcher (Odiya, 2009

**Figure 1 conceptual framework**




***Source:*** Developed for this research after reviewing literature with parts from (Sayma *et al*. (2009), Choudhury *et al*. (2005), (Mohammad, 2008; Mohammad, 2008) and UBOS Annual Reports (2008-2012).

### 1.10.1 Explanation of the conceptual frame work

Figure 1 above illustrates a conceptual frame work developed by the researcher from her objectives, it comprises of three variables that is, the independent variables, dependent variables and the moderating variables. From the frame work, the independent variables such as interest rates, credit facilities and collateral security do influence the dependent variable which is growth of SMEs which is conceptualised into sales turn over and Liquidity. Although the dependent variables are influenced by the independent variables, moderate factors such as MFI Act and Macro-economic policies cannot be underestimated because they also influence the success of the dependent variable.

## 1.11 Conclusion

This has been the introductory chapter of this research work and it has clearly highlighted its intentions drawing guidelines from the introduction, problem statement has been stated and the gap stands for further investigations. Basing on the conceptual framework on which the study is formed, the independent variable been narrowed down to dimensions and then indicators listed followed by an explanation showing how they affect performance. The dependent variable and the indicators have been clearly stated. In the next chapter, literature review is discussed.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.0 Introduction

This chapter analyses the existing literature on the effect of credit terms/ Microfinance on the performance of SMEs. Information from text books, secondary data and internet sources are utilised as a basis for this section.

## 2.1 Theoretical review

In the study of credit terms and performance of SMEs there are several theories that attempt to explain how credit terms affect performance and how they can be used to forecast future changes. These theories include classical, liquidity reference, loanable funds and rational expectations theories. Each of these theories makes assumptions with regard to the behaviour of aspects of the economy and focuses on the behaviours of other aspects as determinants of the prevailing interest rates (Gorder, 2009).

### 2.1.1 Classical Theory of Interest Rates

The classical theory of interest rates applies the classical theory of economics in determining interest rates. It defines the interest rate as the element that equates savings to investment. The theory compares the supply of savings with the demand for borrowing. Using supply and demand curves the equilibrium rate is calculated by determining the curves intersection point.

Thus if savings are greater than investments the interest rate drops until they reach equilibrium and vice versa, if savings are less than investment the interest rate increases until the reward for savings encourages increased savings rates causing the market to again reach equilibrium( Gorder, 2009). Other proponents of the classical theory of interest rates look at it differently. Marshal argues that interest rate is the price paid for the use of capital and that it is determined by the intersection of aggregate demand and supply of capital. According to Keynes, interest rate definitely influences the marginal propensity to save. He concludes that the rate of interest should be at a point where the demand curve for capital at different rates intersects the savings curve at a fixed income level.  However the classical theory of interest rates fails to account for factors besides supply and demand that may affect interest rates such as the creation of funds, the importance of income and wealth and changes in the primary borrowers in an economy.

### 2.1.2 Liquidity Preference Theory

Liquidity preference theory asserts that economic units have a preference for liquidity over investing. Applying this theory explains the premium offered in forward rates in comparison to expected future spot rates. This premium is used as payment for the use of scarce liquid resources. The preference for liquidity can be accounted for by the fact that economic units need to hold certain levels of liquid assets for purchase of goods and services and the fact that these near term future expenditures can be difficult to predict. Liquidity theory is limited by its short-term nature, the assumptions that income remains stable, and, like classical theory, only supply and demand for money are considered (Gorder 2009).

## 2.2 Overview of MFI's

Historical context has helped explain how specialized MFIs have developed over the last few decades. Between the 1950s and 70s, governments and donors focused on providing subsidized agricultural credit to small and marginal farmers; in hope of raising productivity and incomes. During the 1980s micro-enterprise credit concentrated on providing loans to poor women to invest in tiny businesses enabling them to accumulate assets and raise household income and welfare. These experiments resulted into the emergence of NGOs that provided financial services to the poor. In the 1990s, many of these institutions transformed themselves into formal financial institutions thus enhancing their outreach.

Microfinance today can be defined as a range of small scale financial services that are provided to those people that need to improve their capacity to take their development in their own hands. However, not all people can be helped with micro-credit rather since it is deposit worthy and there is need for payments, the capable are aimed at. Microfinance services are characterized by the fact that they are tailor made for this target group and that financial services take into account the needs and restrictions of these people.

In the emerging and developing economies, there is a tendency seclude for the disadvantaged persons in the formal financial sector. Financial institutions impose conditions on the provision of their services that are unlikely to be met by the "poor" households hence financial exclusion arises. The consequence is that most people with low incomes obtain these financial services through informal agreements in the market which are generally expensive, not so safe and unsustainable in the long run. This financial gap is brought about by various financial institutions that provide microfinance services. This idea is both out of consideration for development and a business opportunity on the other hand. Each microfinance institution may differ in objectives, focus on financial services, loan implementation strategies, business orientation, target group within the microfinance segment, ownership-structure, capacity to mobilize/regulate savings etcetera but all share the same commitment to providing services to an otherwise 'unbanked' population.

### 2.2.1 Microfinance and its context

**A**ccording to the 2001 bank of Uganda study paper: 'Microfinance in Uganda', Interest in microfinance has soared in the recent decades and it is now seen as one of the most promising tools to abate poverty in the developing world. The fascination with microfinance derives from the fact that the provision of financial services can contribute to poverty eradication plus pass the test of sustainability as well. However, microfinance sometimes disappoints some of its participants. Only a few micro enterprises experience sustained growth while a majority grow only a little or maintain their operations at a constant level.

The Bank of Uganda 2001 study paper further stipulates that Uganda is generally seen as the country with the most vibrant and successful microfinance industry in Africa. Evidently deduced from some MFI's experiencing a strong growth and now reaching a considerable number of clients and close to financial sustainability or even surpassing it.

The paper further argues that one of the most pressing challenges for a large number of MFI's in Uganda is the considerably high dropout rates indicating that clients make use of increased competition and shop around. This also suggests that clients are not satisfied with the types of products offered in fact a closer look at the methodologies shows how much the products offered by a majority are very similar to each other's and not adjusted to the specific needs of different client groups.

### 2.2.2 Indicators of growth

Indicators of growth in economic activities which require commitment, co-operation and cohesion at all levels of development include the following.

Growth and profitability: It should be reflected in profitable enterprises, growing enterprises and conversion into medium or large enterprises also in terms of profits. Profit making organisations look at the rate of return on the resources of the firm (Pandey, 1996).

Increase in market share as another way of measuring growth: according to Kotler (2000), the company's growth is be determined by the increase in the rate of growth of its market share. The increase in market share will be reflected in the increase in the volume of sales and establishment of distributional channels for the goods and services to a targeted market segment.

Also improved savings and economic assurance is an indicator. MFI's help people become more economically secure. Savings serve as measures for important household expenditures and as assurance against sudden crises that can otherwise result into destitution (Cheston et al 1999)

Through MFI's traditional savings ethics is enhanced plus it is important to keep in mind that for any financial service to have a lasting impact, it must be flexible and innovative to adapt to the needs of its clients (Leger wood 1999)

### 2.2.3 Lending services

Access to finance in particular credit is one of the most often quoted constraints to business development by the self-employed and micro-entrepreneurs. The definition of micro-credit has evolved over the years and its interpretation varies across a range of countries and institutions. In Some countries where the microfinance industry has grown into a competitive business, the central Banks have established a definition of what can be considered in terms of turnover, assets, employees' etcetera and characteristics of the debt (size of loan, number of loans) etcetera.

Some definitions are rather narrow and strict. Only consider a micro-credit when it is a loan invested in an entrepreneurial activity. In other circumstances and more often it is accepted that the money lent is fungible and that it can be invested to respond to any need the household might have. In this case, the level of income of the borrower or average loan size is more determining for whether a loan is a micro loan or rather typical retail loans considering the different interpretations of micro credit that exist.

### 2.2.4 SMEs as determinants to economic growth

Interest in the link between small and medium sized enterprises and economic growth has attracted and increasing attention in the recent years. It is surprising that the SME sector is the target for international and national aid agencies indeed in 2003; the World Bank approved US$ 1.3 billion in SME support programs (Beck et al., 2005).

Studies that have examined the impact of SMEs on economic growth income like that by Beck et al. (2005) where the amended standard growth regression is estimated including the relative size of the SME sector for a cross section of countries' similar approach is also employed in Audretsch and Keilback (2004) and Muller (2007) to evaluate the impact of entrepreneurship on the economic growth in developed countries. Whilst studies that focus on a cross section of countries suggest a negative or neutral impact of SMEs and entrepreneurship on the economic growth, those studies examining developed countries suggest a positive impact summarizing the results of empirical studies. Van stel et al. (2005) and Wennekers et al (2005) provide evidence that suggests a positive impact of entrepreneurship on growth of developing countries. Acs et al (2008) has attributed these differences in empirical results to different entrepreneurship responses to institutional arrangements. Moreover, Heterogeneity in institutional arrangements and human capital lends across countries and regions are likely to provide different incentives to rent-seeking activities.

Audretsch (2007) argues that entrepreneurship and small firms are an important determinant of economic growth. Solow (2007) discusses that entrepreneurship is an important activity that drives a wedge between knowledge and total factor productivity by bridging the gap between specific prices of technological knowledge and innovations through the creation of new firms therefore explaining how SMEs impact on growth can add to the explanatory power of the traditional growth theory.

Baumol (1990) argues that while the total supply of entrepreneurs differs across economies, the productive contribution of the society's entrepreneurial activities varies more due to their allocation between productive and unproductive activities; therefore, policy makers should be concerned about the allocation of entrepreneurship by providing an institutional arrangement that promotes productive entrepreneurship at the expense of rent seeking. Similarly Baumol (2008) argues that institutions are important to entice entrepreneurs away from their previous unproductive activities and lead them into innovative undertakings

Institutions also play a role of stimulating human capital formation for productive entrepreneurs. Dias and McDermott (2006) develop a model where structural changes towards a modern economy depend on the role of entrepreneur's human capital and institutions in setting, entrepreneurs come from a pool of individuals that belong to the managerial class. More importantly, entrepreneurs lead to more human capital formation. Workers seek education in order to ]#productive job that is (that requires a higher level of human capital) covered by entrepreneurs therefore a policy response is to increase the motivation by removing the barriers that prevent productive entrepreneurship to develop and better institutions. The institution quality is important for entrepreneurial activity according to Nystrom(2008) therefore if institutions fail, it is likely performance of SMEs will fail too.

### 2.3 Interest rates

Kimutai (2003) defines interest rate as the price one pays for using borrowed money (loans).In money – monetary economies money creates claims because it is an asset, store of value as well as a medium of exchange. Therefore, those who lend money expect to be compensated for handing over their claims for the period of the loans to those who borrow money. This interest rate also covers the expose to credit risk by lenders. Therefore interest rate can be defined as the price lenders expect (and borrowers pay) for exchanging current claims for greater future claims to goods and services. Interest rates represent the cost of money.

Almost all firms are exposed to interest rate risk, but it can manifest it's self in different ways. A proper response to this risk can only come following a full understanding of the context of the firm and its strategy. Firms should generate a well thought out key performance indicator (KPI) (Will Spinney, 2010). Interest rate risk is the exposure of the firm to changing interest rates, which has four dimensions; what is meant by interest rate risk? Always define the concepts.

Ingram (2011) states that interest rates are important because they control the flow of money in the economy. High interest rates curb inflation but also slow down the economy. Low interest rates stimulate the economy, but could lead to inflation. When interest rates are high, people do not want to take loans out from the bank because it is more difficult to pay the loans back, and the number of purchase of real assets goes down. The contrary is true. The effects of a lower interest rate on the economy are very beneficial for the consumer. When interest rates are low, people are more likely to take loans out of the bank in order to pay for things like houses and cars. When the market for those things gets strong, price decreases and more people can purchases these things. This also bodes well for investors, who perceive less risk in taking out a loan and investing it in something because they would have to pay less back to the bank. Once people do not have to spend as much money on bank payments, they have more disposable income to put toward things they want to purchase. These effects, although certainly not direct, are enough to stimulate the market when interest rates are low. Low interest rates are not beneficial for lenders, who are seeing less of a return on their loan than in times when interest rates are high. This means that banks may find themselves having to lower the interest rates accrued on money deposited in the bank in order to maintain a steady profit.

However, interest rates do not really have an effect on how much people save, because an increased amount of disposable income means that they are more likely to spend it than to save it. When interest rates increase, though, foreign investment can increase because people outside of the country want a larger return for their investment and they are more likely to get it in a state of high interest rates. This causes more demand for the dollar, increasing its value in the international market for instance. The opposite happens, though, when the interest rates are decreased. Although much of it is contained within consumers' perception of the economy and their income, interest rates can drive up consumer spending, investment and the amount of loans people take out of the bank.

### 2.4 Access to finance by SMEs

Accessing finance has already been identified as a key element for SMEs to succeed in their drive to build productive capacity, compete and create jobs. Small businesses especially in developing countries like Uganda rarely meet the conditions set by financial institutions which consider SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans. Without finance, SMEs cannot acquire or absorb new technologies nor can they expand to compete globally or even strike business linkages with larger firms (UNCTAD 2002) many factors are believed to be responsible for the refusal of loans and equity fund to SMEs by formal banks.

SMEs firms find it difficult to obtain commercial bank financing, especially long-term loans, for a number of reasons, including lack of collateral, difficulties in proving credit worthiness, small cash flows, inadequate credit history, high interest rates, This is evidenced in the works of Galindo and Schiantarelli (2003), and Beck and Demirgüç-Kunt (2006).

Cork and Nixon (2000) affirm that poor management and account practices are what hamper the ability of smaller enterprises to rise financially. This coupled with the fact that small businesses are mostly owned by individuals whose personal lifestyle has far reaching effects on the operations and sustainability such a business. As a consequence of ownership structure, some of these businesses are unstable and may not guarantee returns in the long run.

According to Kauffmann (2005), access to formal finance is low because of the high risk of default among SMEs and also due to inadequate financial facilities. However another study sums up constraints facing SMEs into two; that is Demand-based SMEs and Supply-based financial Constraints. The supply-based financial constraint is defined as a capital market imperfection that leads to a socially incorrect supply of funds to projects or the incorrect interest rate charged on funds. The demand-based financial constraint is defined as a capital market imperfection in which performance of a firm is adversely affected by a factor internal to the firm. For example, if the firm owners desire to grow the firm faster but the only way they can do this is to relinquish equity and somehow they fail to do so, it is concluded then that the firms demand for funds is demand constrained.

Hulme and Mosley (1996) show that when loans are associated with an increase in assets, when borrowers are encouraged to invest in low-risk income generating activities and when the very poor are encouraged to save; the vulnerability of the very poor is reduced and their poverty situation is sedated. Johnson and Rogaly (1997, p.12) also refer to examples whereby savings and credit schemes were able to meet the needs of the very poor. They state that microfinance specialists are beginning to view improvements in economic security, rather than income promotion, as the first step in poverty reduction (ibid.) as this reduces beneficiaries' overall vulnerability.

Zohir and Martin (2004, p.318) state that many MFI loans are used for agricultural production, trading, processing and transport, resulting in an increase in the use of agricultural inputs and increased output of agricultural production. This leads to enhanced employment opportunities in these sectors for the wider community and a reduction in the prices of such produce due to increased supply. They also state that trading activities financed by MFIs can help to establish new marketing links and increase the income of traders, and this can lead to reduced migration due to increased employment opportunities and increased income

Wright's (2000:14) assertion that, apart from reducing poverty, microcredit improves the welfare of participating households and also enhances their capacity to sustain improvements in living conditions over time.

Some researchers believe that although there should be broad-based access to microcredit for productive purposes, the 'very poor' are not always reached because microcredit programs are not always designed in such a way as to make them accessible to the poor. For Scully (2004: 1) and Bates et al (1996), the idea that microcredit programs help the poorest of the poor or that microenterprises reduce poverty is a myth. Their argument is that microloans are usually so small that they can generate no meaningful revenues.

**2.5 Collateral security**

It plays a very important role in lending in many countries. Collateral can be used to solve multiple economic problems but in the practical world especially in emerging markets. It provides only little benefit banks even in good times because of the difficulty in valuing and realizing collateral. Even collateral in form of residential mortgages can also pose considerable risks depending on real estate market developments and the effectiveness of the legal and judicial system.( International Monetary Fund ,2002).

In a research carried out by Indonesia by Akademika (2006) results show that, most useful collateral include deposits or certificate of deposits, land with certificate of ownership and property with a license to build or Izin Mendirikan Bangunan (IMB). Banks also accept personal or corporate guaranteed account receivables and inventories as collateral though it is uncertain and unlikely that this type of collateral would be valued nearly as highly as land or deposits and thus, alone, would not meet the collateral criteria.

Collateral is a prerequisite when applying for credit. The banks do not disburse collateral-free loans and policy stipulates that collateral be worth 125 per cent of the credit value provided. In terms of ownership, banks are not concerned with whether the applicant or spouse owns the asset being pledged so long as the owner is willing to pledge the asset (Akademia, 2006). This opens the door to a broader range of assets that can be used by SME borrowers in that assets owned by relatives or family will be considered.

Micro credit is most often extended without traditional collateral (Wenner, 2006). He argues that if physical collateral were a requirement for borrowing, most MFIs clientele would be unable to participate due to their extreme poverty levels. Since borrowers do not have physical collateral, MFIs focus on using social collateral via group lending.

This has been the basis for proposals to strengthen property rights, such as land titling programs (Boucher *et al*., 2005). However, he posits that social collateral reputation can substitute physical assets as executive screening mechanisms particularly in low-income areas. For example, Kondo (2003) reports that informal moneylenders operating in urban public markets in the Philippines assess the credibility of prospective borrowers by collecting information from the borrower's clients, suppliers and other creditors.

According to Namakula (2010), most lending agencies particularly MFIs do not insist on collateral. The group guarantees in-group loans act as the collateral for group borrowers. The compulsory savings, which are a perquisite for borrowing, act partly as security. However, collateral is put in writing such that on default by a member, the group members can sell the given security to recover the loan. For individual loans, security is a vital requirement. The MFI takes security like land titles, vehicle logbooks among a few that are kept in custody.

MFIs do not insist on collateral, the groups guarantee loans act as the collateral for group borrowers. The compulsory savings which is a pre-requisite for borrowing, act partly as security. However, collateral is put in writing such that on default by a member, the group members can sell the given security to recover the loan. Social collateral works through reputation effects on group members in which repayment of loans is seen by group members as necessary to maintain their social standing in the community, (Woolcock, 2002). Van (2005), concludes that agents will always form groups with agents of the same type and that agents' types can be distinguished according to the rate at which they are willing to trade increased joint liability commitments.

In a related study, Atieno (2009) elucidates that loan security is one of the important aspects of credit to the small and mediums enterprises. Most lending to small – scale enterprises is security based, without any regard for potential cash flow. However, organizations lending to micro enterprises have devised alternative forms of collateral. These include group credit guarantee where institutions lend to individuals using groups as guarantors and personal guarantors where individuals are given loans based on a guarantor’s pledge. Atieno (2009) further indicated that loan guarantee schemes are increasingly being implemented as a means of encouraging financial institutions to increase their lending to the risky sectors and those without the traditional formal security.

Micro credit is most often extended without traditional collateral (Wenner, 2006). He argues that if physical collateral were a requirement for borrowing, most MFIs clientele would be unable to participate due to their extreme poverty levels. Since borrowers do not have physical collateral, MFIs focus on using social collateral via group lending. Group lending encompasses a variety of methodologies (Woolcock, 2002), but all are based on the principal of joint liability. In essence the group takes over the underwriting, monitoring, and enforcement of loan contracts from the lending institution. Most MFIs lend to low income clients who have very few assets unfortunately the traditional collaterals like land and capital assets are often available. Various initiatives of reducing the risk of loan loss have been developed such as a character lending, peer pressure either alone or as a group with group guarantee (Uganda micro finance industry assessment report, 2008).

# CHAPTER THREE

# METHODOLOGY

## 3.1 Introduction

This section is a narrative on how data relevant to the study through various methods in line with the concept of triangulation in social research. The approach to the study was;

The data collection instruments (methods) were interviews, questionnaires, and documents analyzed. The research tools employed in the study helped to guide questionnaires and checklist. The data collected was managed, analyzed and validated through instruments for data analysis following standard procedures of data collection and analysis. The management of the data collected for analytical purposes was codified according to the themes and each. They were accorded a number for easy validation of data. Meanwhile through selection as one of the key processes in data management and analysis significant information and irrelevant issues were chosen to show arguments (Blaxter .l, et, al, 2006).

## 3.2 Research Design

A research design as defined by Clair and Kothari (2005:31) as the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. Its centrality in the research process was to show all the major parts of the research work to address the research problems.

The case study design was used as an approach in the study for collecting data aimed at exploring an in depth analysis. The study was both qualitative and quantitative in nature. Quantitatively, people’s views were considered.

Documents in form of interviews were used where structured questionnaires with both open ended and close ended questions were set. Categories of participants in this case were the SME owners who have used or are in current use of the FINCA loan services. The purpose of using the case study approach was to have an in depth analysis of the information in a discourse that aimed to combine towards the relevancy in regard to the purpose of study and objectives.

**3.3 Area of study**

FINCA Uganda operates on a village banking model, lending money and accepting savings from low income people organized in groups. It was the first regulated micro credit institution (MDI) in Uganda and is under the supervision of bank of Uganda. It provides loan savings and money transfer services to over 100,000 clients. This is anchored by its  mission: “To provide financial services to Uganda’s lowest income entrepreneurs so that they can create jobs, build assets and improve their standards of living.”

Their loan clients can access loans either individually or in groups depending on their borrowing capacity. Part of protecting their clients is ensuring that repayment policies and procedures are explained clearly and further enforced so as to increase the opportunities on the Uganda’s ‘unbanked’ potential participants. For instance, a member of staff is assigned to keep monitoring a client’s progress with guidance such that money is not lost on redundant expenditures – managed in with a keener entrepreneurship mindset. 3.4 Study population

Population is referred to by Mugenda and Mugenda (2003:9) as: “an entire group of individuals, events or objects having common observable characteristic”. The population under investigation included the SME owner using the FINCA loan scheme services plus the administrators and staff within this sect of FINCA.

### 3.5 Sample size

FINCAs main branch/headquarters located on the western slopes of the Nakasero hill in Kampala was used hence the purposive sampling which refers to selecting a sample from which the maximum can be learned. It was deemed appropriate in this case in order to gain strong insights; this branch was selected on the basis of expected information; basing on the informed research judgment of the researcher as well as having prior contact with respective managers. This enabled the researcher to obtain more valuable information than hoped for. Besides it is a stated fact that respondents find it easier to express themselves freely which helped to generate the required information. For purposes of obtaining the relevant information, 45 FINCA clients and working staff members as depicted in the table were engaged.

. $n = \frac{\text{Total population}}{1+Ne^2}$

$n = \frac{45}{1 + 45(0.05)^2}$

$n = \frac{115}{5.5}$

n = 45 individuals

Where n is the sample size

Source; Primary Data with the help of FINCA Staff

| Nature of Respondents | Population | Expected sample |
|---|---|---|
| Clients | | 30 |
| Staff | | 15 |
| Total | | 45 |

Source; Primary Data

**3.6 Sampling technique**

A simple random sampling technique was used in the selection of the SME owner. This ensures that the SME owners are not left out in the sample, thus, a broader scope of information.

A non-probabilistic sample of the administrator and staff respondents was selected purposefully that was 5 customer consultants, 2 people from the  marketing sect, and 2 administrators who were deemed as resourceful respondents from whom informed opinions were expected to gain a comprehensive understanding of how the loan scheme sect at FINCA was operated, how it was fairing and how the SME owner's under it react to the whole procedure.

**3.7 Data sources**

In the study, both primary and secondary data were used to explain the Influence of microfinance on the growth of small and medium sized businesses. The primary data was obtained from FINCA clients also from the management through the use of self-administered interviews and questionnaires through which the prevailing trends, relationships and the general impact of the loans were studied.

The secondary data nourished information pertaining loans, their impact on the small scale businesses that use them, how the SME owners react to the loan schemes especially that at FINCA plus the interest rates and how they are implemented which was through accessing articles from newspapers, reports journals, internal reports, books and internet sources in: loan schemes, about SME growth etcetera.

### 3.8 Data collection instruments

The methods that were used in data collection included; Questionnaires, Interviews plus Document reviews. These methods were used simply due to the purpose of accuracy and quality of information.

#### 3.8.1 Questionnaires

Semi-structured questions were used as a tool for data collection .this was a mixture of both open and short ended questions which left the respondent free to a variety of answers. Hence where need be the respondent could give several choices of answers and then give specific answers where they are required. Questionnaires saved time and they were quite easy to administer.

The main purpose of questionnaires was to elicit reflective responses that go deeper than the type of surface responses typically yielded by only the structured questionnaires.

#### 3.8.2 Document reviews

Archival data including information from journals, archives, internet sites, books, dissertations and conference presentations,  newspaper articles, and other relevant documents to the study was reviewed (as seen in chapter two). Information from the sources emanated value that  enriched the review of related literature and also provided an insight of the development of how to improve the loan products.

### 3.9 Quality Assurance

To ensure that the researcher collected quality information, the ecological validation was used to carry out the study from the natural environment of the SME owners. Tools like the questionnaires as discussed in the data collection instruments were used and the questions utilized in these tools were simple and drawn from the objectives of the study.

### 3.6 Data collection procedure

An introductory letter from the Faculty of Business Administration and Management at Uganda Martyrs University to FINCA Uganda was first obtained. Then proceeded by preparation of relevant instruments which were used in the field for data collection, pre-tested them, went to the field for data collection, analysed collected data, and wrote a report on the field results. And finally submitted in a final report –the dissertation.

### 3.7 Validity

Validity is the ability to produce findings that are in agreement with theoretical or conceptual values (Amin, 2005). The validity was determined by giving the research instrument to the expert to cross check. The expert was able to review the items and comment on whether the items cover a representative sample of the behaviour domain.

### 3.8 Reliability

Reliability is the dependability or trustworthiness of a research instrument, therefore the reliability of the research instruments was measured using Cronbach Alpha test, were a pilot study involving 20 respondents was carried out.

### 3.9 Data Analysis

In the bid to move from data information, the researcher needed to analyse data using appropriate statistical techniques (Singh, 2007). Data was edited, coded, and entered into computer software for analysis. Analysis was done using SPSS tables and relevant parameters or values – percentages – were generated as part of the analysis.

### 3.11 Ethical issues

Ethical conduct was maintained during the research, the researcher sought those in charge at FINCA plus the chosen SME owners to carry out a study in their area.

The respondents were given a good background about what the research is about and their participation in the study was requested for instance the introductory part of the questionnaire gave them more information about who the researcher is and the whole intention of the research.

The respondent’s confidentiality was protected and nothing was done without their consent. In case of need of anonymity, consideration was clearly put in place.

### 3.12 Study limitations

The limitations that the researcher encountered included;

Shallow information provided in the questionnaires which definitely made it hard to analyze certain bits of information. Despite, some SME owners' involvement in the running of their businesses giving a clear explanation about how they carry out their income generating activities was quite hard and most of all most SME owners do not keep records about the business.

There were financial constraints due to the ever changing society rates which could affect the budget however this will be overcome by adjusting the budget incase this problem in particular occurs and managing with the available resources.

The period of study being quite short was not be able to cover the estimated SME base which was probably solved by concentrating on the small chosen number with high hopes of response.

### 3.13 Conclusion

This chapter has represented the research design, study population, area of study, sample size and selection that the researcher will use to carry out research. It has also represented the different methods and techniques of data collection, validity and reliability and finally it shows the ethical consideration that the researcher will follow when carrying out this research.

# CHAPTER FOUR

# DATA PRESENTATION, ANALYSIS AND DISCUSSION

## 4.0 Introduction

The chapter presents and discusses quantitative and qualitative data that was collected and analysed using SPSS. Data from the questionnaires was analysed, discussed and presented with the help of frequency tables and graphs so as to give a clear view of the influence of MFI on the growth of SMEs n Uganda.

## 4.1 Response rate

**Table 4.1 showing the response rate of the respondents**

| **No of questionnaires given out** | **No of questionnaires returned** | **Percentage (%)** |
|---|---|---|
| 45 | 45 | 100% |

**Source: primary data 2015**

As illustrated in table 4.1, 45 questionnaires were given out and all these were filled and returned by the respondents giving a complete response percentage of 100%.  This constituted of both staff and clients of FINCA Uganda, staff constituted of 5 male and 10 female while clients constituted of 12 male and 18 female.

## 4.2 Background information of respondents

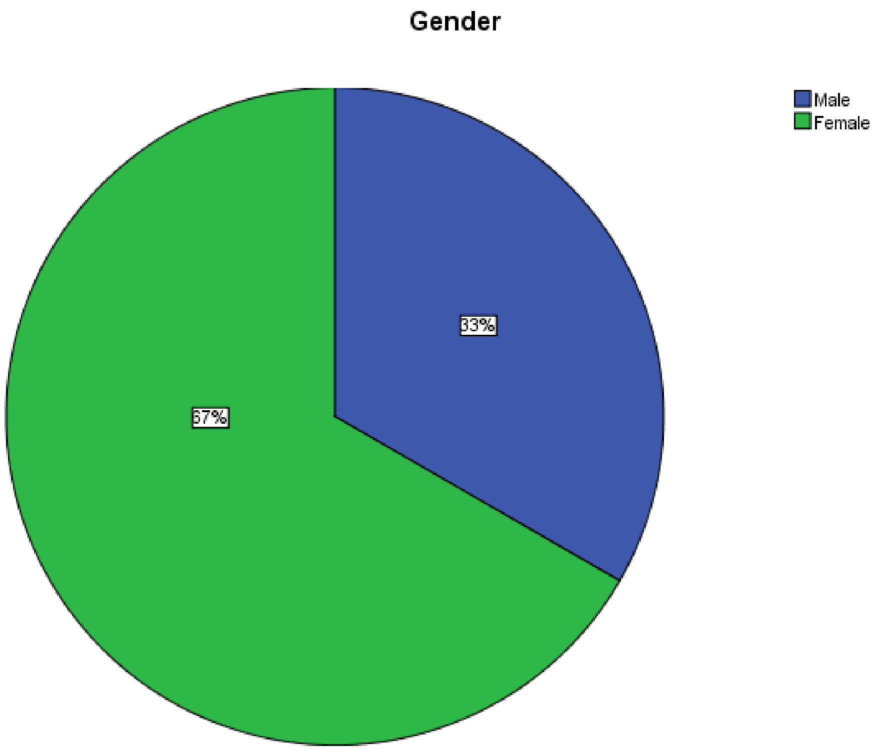
The background information of the respondents included marital status, age of the respondents, and highest level of education attained. This information was presented with the help of tables, graphs and pie charts as shown below.

**Table 4.2: showing the Gender of the respondents**

| Category | No of respondents | Percentage |
|---|---|---|
| Male | 17 | 33 |
| Female | 28 | 67 |
| **Total** | **45** | **100** |

**Source: primary data 2015**

**Figure 4.3: showing gender of the respondents**



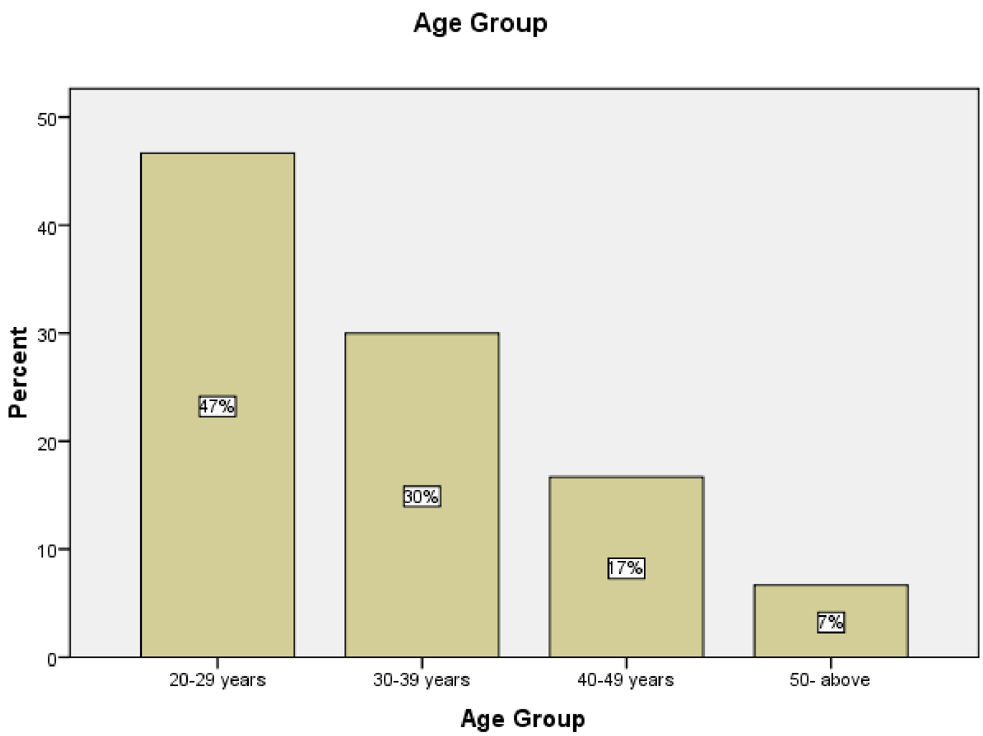

**Source: primary data 2015**

From figure 4.1 and table4.1 above, majority of the respondents were female constituting of 67% while 33% were female. This constituted of both staff and clients of FINCA Uganda, staff constituted of 5 male and 10 female while clients constituted of 12 male and 18 female.

### 4.2.3 Age bracket of the respondents

The age of the respondents as per the questionnaires was grouped into five categories that is; 20-29 years, 30-39 years 40-49 years, and 50+ years. This was done in order to remove any claims of bias among respondents. This was analysed as follows;

**Figure 4.5 showing the age groups of the respondents**



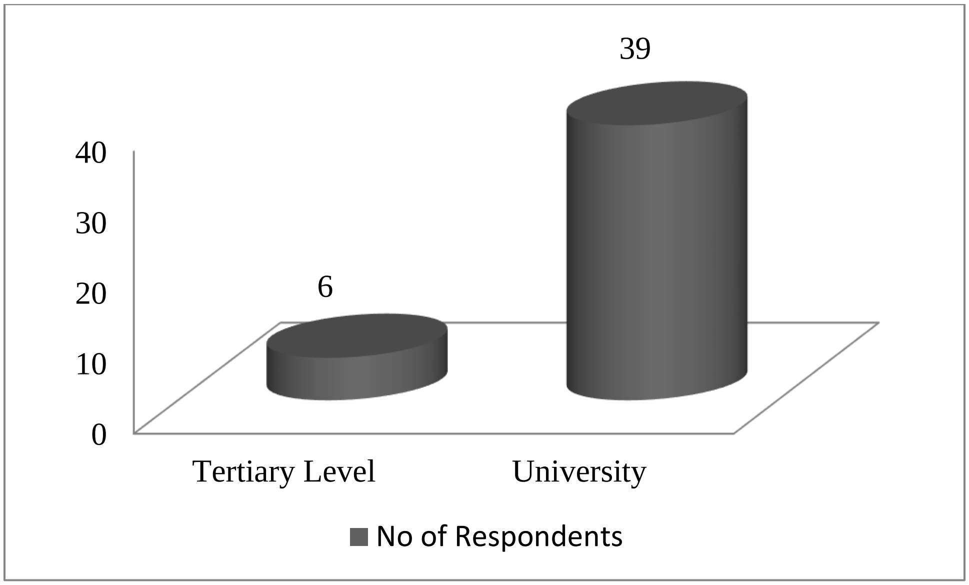

**Source: primary data 2015**

Figure 2 above shows that majority of the respondents were between 20- 29 years (47%), 30% were between 30 – 39 years while 17% and 6% were between 40 – 49 years and 50 and above years respectively.

### 4.1.4 Highest level of education attained by the respondents

Under this, education levels were categorized into UCE level, UACE level, Tertiary level, and university level. Data from the field in line with this question was analysed as follows;

**Figure 4.6 showing highest level of education attained by the respondents**




**Source: primary data 2015**

From figure 3 above, 39 respondents said their highest level of education was at University level and these were the majority, while 6 respondents had tertiary level. This means that respondents were educated and had the ability to read and write as well as the ability to answer the research questions appropriately.

### 4.1.5 How long have you served at FINCA Uganda

**Table 4.4: showing number of years served at FINCA Uganda**

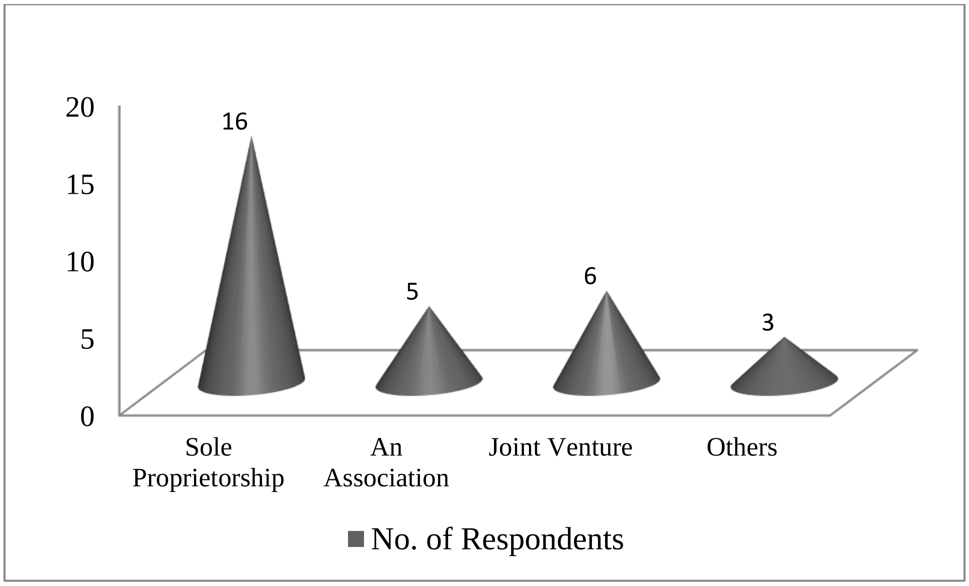
| | **Frequency** | **Percent** |
|---|---|---|
| Less than 1 year | 2 | 13 |
| 1 – 2 years | 4 | 27 |
| 3-5 years | 7 | 47 |
| Above 5 years | 2 | 13 |
| **Total** | **15** | **100** |

**Source: primary data 2015**

From Table 4.3 above, the question was only addressed to FINCA Uganda staff. Majority (47%) of the employees had worked for FINCA Uganda for a time period of 3 – 5 years while 26% had worked for less than a year and above 5 years.

#### 4.1.5 Type of Business structure

**Figure 4: showing the type of business structure owned by the clients of FINCA Uganda**




**Source: primary data 2015**

From figure 4 above, the question was only addressed to FINCA Uganda clients. Majority (6) of the clients had sole proprietorship businesses, while 5, 6, and 3 had an association, joint venture and other businesses respectively.

### 4.3 Discussion of findings based on research objectives

The research objectives discussed here were:

1. To examine the extent to which interest rates by MFI influence the growth of SMEs in Uganda.
2. To examine how credit facilities rendered by MFI influence the growth of SMEs in Uganda.

3. To establish how collateral security effects the growth of SMEs in Uganda.

### 4.3.1 Credit facilities

Respondents were asked a set of questions on the aspect of credit facilities and the following were the results.

**Table 4.4: Mean and Standard deviation of Credit facilities**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Clients can easily access credit from other financial organizations | 45 | 1.00 | 4.00 | 2.111 | 0.885 |
| Clients can easily access finances from FINCA Uganda | 45 | 1.00 | 5.00 | 2.556 | 1.253 |
| Clients are able to pay back loans within the specified period of time | 45 | 2.00 | 4.00 | 2.622 | 0.936 |
| Access to finance boasts employment opportunities within your area | 45 | 2.00 | 5.00 | 4.311 | 0.874 |
| MFI through loans lead to growth of SMEs | 45 | 1.00 | 5.00 | 4.089 | 0.924 |
| Valid N (List wise) | 45 | | | | |

**Source: primary data 2015**

In table 4.4 above are details of the measures of credit facilities under different key statements obtained from the respondents. The statements have been ranked in terms of their means and standard deviations so as to deduce meaning out of the results. Therefore, the details of the table are discussed under sub headings of the corresponding statements tested

**Clients can easily access credit from other financial organizations**

Based on the research findings revealed in table 4.4, respondents disagreed that clients can easily access credit from other financial organizations. This is evidenced by a mean of 2.111 which trends towards a minimum of 1 and a significant standard deviation of 0.885 suggests that there was a significant variation in responses.

The above findings agree with Galindo and Schiantarelli (2003), and Beck and Demirgüç-Kunt (2006) who noted that SMEs firms find it difficult to obtain commercial bank financing, especially long-term loans, for a number of reasons, including lack of collateral, difficulties in proving credit worthiness, small cash flows, inadequate credit history, high interest rates.

**Clients can easily access finances from FINCA Uganda**

From table 4.4, respondents disagreed that clients can easily access finance from FINCA Uganda, as evidenced by a mean of 2.556 which trends towards a minimum of 1 and a significant standard deviation of 1.253 which suggests a significant variation in responses on the question above.

Cork and Nixon (2000) affirm that poor management and accounting practices are what is hampering the ability of smaller enterprises to raise finance. This coupled with the fact that small businesses are mostly owned by individuals whose personal lifestyle has far reaching effects on the operations and sustainability of such a business. As a consequence of the ownership structure, some of these businesses are unstable and may not guarantee returns in the long run.

**Clients are able to pay back loans within the specified period of time**

The research survey from table 4.4, respondents disagreed that clients are able to pay back loans within the specified period of time, as evidenced by a mean of 2.622 which trends towards a minimum of 1 and a significant standard deviation of 0.936 which suggests a significant variation in responses on the above question.

The above findings agree with Kauffmann (2005), access to formal finance is low because of the high risk of default among SMEs and also due to inadequate financial facilities. However another study sums up constraints facing SMEs into two; that is Demand-based SMEs and Supply-based financial Constraints. The supply-based financial constraint is defined as a capital market imperfection that leads to a socially incorrect supply of funds to projects or the incorrect interest rate charged on funds.

**Access to finance boasts employment opportunities within your area**

According to the survey in table 4.5 above, most of the respondents agreed that access to finance boasts employment opportunities within their area's thus reflected by the mean value of 4.311. A insignificant standard deviation of 0.874 suggests that there was variation in responses among the respondents on this question.

Zohir and Martin (2004,) state that many MFI loans are used for agricultural production, trading, processing and transport, resulting in an increase in the use of agricultural inputs and increased output of agricultural production. This leads to enhanced employment opportunities in these sectors for the wider community and a reduction in the prices of such produce due to increased supply. They also state that trading activities financed by MFIs can help to establish new marketing links and increase the income of traders, and this can lead to reduced migration due to increased employment opportunities and increased income

**MFI through loans lead to growth of SMEs**

From table 4.5 above, most of the respondents strongly agreed that MFI through loans lead to growth of SMEs as shown by a mean value of 4.089. A significant standard deviation of 0.925 suggests that there was variation in responses among the respondents on MFI through loans lead to growth of SMEs.

The above findings agree with Wright's (2000) assertion that, apart from reducing poverty, microcredit improves the welfare of participating households and also enhances their capacity to sustain improvements in living conditions over time.

### 4.3.1 Collateral Security

Respondents were asked a set of questions on the aspect of collateral security and the following were the results.

**Table 4.5: Mean and Standard deviation of Collateral security**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Collateral Security influence the lending power at FINCA Uganda | 45 | 1.00 | 5.00 | 4.200 | 0.757 |
| Security is a must to obtain loans from FINCA Uganda | 45 | 1.00 | 5.00 | 3.444 | 1.501 |
| Collateral security demanded by FINCA Uganda can be in any form | 45 | 5.00 | 5.00 | 5.000 | 0.000 |
| Clients can obtain loans from other financial institutions like banks without collateral security | 45 | 1.00 | 5.00 | 1.644 | 1.069 |
| Valid N (List wise) | 45 | | | | |

**Source: primary data 2015**

From table 4.5 above details of the measures of collateral security under different key statements obtained from the respondents. Questions have been ranked in terms of their means and standard deviations so as to ascertain meaning out of the results. Therefore, the details of the table are discussed under sub headings of the corresponding statements tested

**Collateral Security influence the lending power at FINCA Uganda**

From table 4.5, respondents agreed that collateral security influence the lending power at FINCA Uganda, this is supported by a mean of 4.200 which tends towards the maximum value of 5 with a significant standard deviation showing variance in response among respondents.

The above findings are in line with early research of International Monetary Fund, (2002) who contend that collateral security plays a very important role in lending in many countries, they can be used to solve multiple economic problems but in the practical world especially in emerging markets. It provides only little benefit banks even in good times because of the difficulty in valuing and realizing collateral. Even collateral in form of residential mortgages can also pose considerable risks depending on real estate market developments and the effectiveness of the legal and judicial system.

**Security is a must to obtain loans from FINCA Uganda**

From the primary data in table 4.5, respondents agreed to a small extent that security is a must to obtain loans from FINCA Uganda as shown by a mean of 3.444 with a significant standard deviation in response of 1.501.

The finding above agrees with Wenner (2006) though to a smaller extent who said that Micro credit is most often extended without traditional collateral he further argued that if physical collateral were a requirement for borrowing, most MFIs clientele would be unable to participate due to their extreme poverty levels. Since borrowers do not have physical collateral, MFIs focus on using social collateral via group lending schemes.

**Collateral security demanded by FINCA Uganda can be in any form**

From research findings revealed in table 4.5, respondents strongly agreed that collateral security demanded by FINCA Uganda can be in any form and this was evidenced by a mean of 5.000 with standard deviation being 0.000.

Basing on the above findings, Akademika (2006) results show that, most useful collateral include deposits or certificate of deposits, land with certificate of ownership and property with a license to build or Izin Mendirikan Bangunan (IMB). Banks also accept personal or corporate guaranteed account receivables and inventories as collateral though it is uncertain and unlikely that this type of collateral would be valued nearly as highly as land or deposits and thus, alone, would not meet the collateral criteria.

**Clients can obtain loans from other financial institutions like banks without collateral security**

Table 4.5, shows that respondents strongly agreed clients can obtain loans from other financial institutions like banks without collateral security as revealed by a mean of 1.644 and a standard deviation of 1.069 showing variance in response in the above question.

(Akademia, 2006) asserts that collateral is a prerequisite when applying for credit. The banks do not disburse collateral-free loans and policy stipulates that collateral be worth 125 per cent of the credit value provided. In terms of ownership, banks are not concerned with whether the applicant or spouse owns the asset being pledged so long as the owner is willing to pledge the asset .This opens the door to a broader range of assets that can be used by SME borrowers in that assets owned by relatives or family will be considered.

### 4.3.1 Interest Rates

Respondents were asked a set of questions on the aspect of collateral security and the following were the results.

**Table 4.6: Mean and Standard deviation of Interest Rates**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Interest rates effect the borrowing will of clients | 45 | 5.00 | 5.00 | 5.0000 | .00000 |
| Interest rates do effect the productivity of SMEs | 45 | 5.00 | 5.00 | 5.0000 | .00000 |
| Interest rates encourage adverse selection of loans seekers | 45 | 1.00 | 1.00 | 1.0000 | .00000 |
| Valid N (List wise) | 45 | | | | |

**Source: primary data 2015**

From table 4.5 above details of the measures of Interest rate under different key statements obtained from the respondents. Questions have been ranked in terms of their means and standard deviations so as to ascertain meaning out of the results. Therefore, the details of the table are discussed under sub headings of the corresponding statements tested

**Interest rates effect the borrowing will of clients**

From research findings revealed in table 4.6, respondents strongly agreed that Interest rates effect the borrowing will of clients can be in any form and this was evidenced by a mean of 5.000 with standard deviation being 0.000

Ingram (2011) states that interest rates are important because they control the flow of money in the economy. High interest rates curb inflation but also slow down the economy. Low interest rates stimulate the economy, but could lead to inflation. When interest rates are high, people do not want to take loans out from the bank because it is more difficult to pay the loans back, and the number of purchase of real assets goes down. The opposite is also true. The effects of a lower interest rate on the economy are very beneficial for the consumer. When interest rates are low, people are more likely to take loans out of the bank in order to pay for things like houses and cars.

**Interest rates do affect the productivity of SMEs**

In table 4.6, respondents strongly agreed that Interest rates affect the productivity of SMEs and this was evidenced by a mean of 5.000 with standard deviation being 0.000

**Interest rates encourage adverse selection of loans seekers**

From research findings revealed in table 4.6, respondents strongly disagreed that Interest rates encourage adverse selection of loans seekers and this was evidenced by a mean of 1.000 with standard deviation being 0.000

The above findings are not in agreement with findings of Weiss (1981), Stiglitz (1989) and Besley (1994), who argue that high interest rates encourage adverse selection of loan seekers. Those who take high risk and get their loans approved usually have high default rates. The second school of thought state that high interest rates do not affect demand for credit.

# CHAPTER FIVE

# SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

## 5.0 Introduction

This chapter presents a summary of the findings, conclusions and recommendations. The summary given and overall conclusions are made in accordance with the research objectives. From the research results, the researcher was able to draw appropriate conclusions and recommendations.

## 5.1 Summary of Findings

### 5.1.1 Collateral security and growth of SMEs

From the findings in chapter four, it was found out that collateral security influence the lending power of FINCA Uganda, security is a must to obtain loans form FINCA Uganda, collateral security demanded by FINCA Uganda can be in any form. However it was also found that clients cannot obtain loans from other financial institutions like banks without collateral security.

### 5.1.2 Credit facilities and growth of SMEs

### 5.1.3 Interest rates and growth of SMEs

## 5.2. Conclusions

From the findings above, it can be concluded that collateral security, interest rates and access to credit have a positive impact on the development of SMEs although the magnitude of the effect varies thus FINCA Uganda affect the development of SMEs.

## 5.3 Recommendations

i. From the study, it is pertinent that collateral requirement should be given due attention. According to Nan Kaung (2007), collateral requirement can have significant negative effects on bank's lending. He advises financial institutions to be considerate when they are administering collateral as a requirement before they issue out loans. The same idea is pointed out by Mukherjere (2011), were he advises lending institutions to waive off collateral security requirement when they lend. Financial institutions should be considerate when they demand collateral from borrowers. They should therefore come into an agreement with borrowers such that they issue to them loans with the affordable collateral.

ii. The management of lending institutions should ensure that they carry out a research on consumer needs so as to establish ideal interest rates to be charged. This will go a long way in helping them to know the needs of the consumers so as to be competitive in credit lending because most SMEs/ owners prefer being charged low interest rates hence will go for the lowest interest provider on credit facilities. Lending institutions should also advise borrowers on how to appraise their projects for viability so that they can deliver and avoid loan repayment problems. This will go a long way helping the business owners realize the objectives of the business and the credit to yield high returns. Banks should engage professional marketers of credit facilities to the SMEs which will increase demand for loans by SMEs. They should also encourage feedback from loan consumers. Flexible interest rates should be charged on credit facilities to the SMEs.

iii. There should be good collateral administration. The financial institutions should emphasize the importance of collateral to them and even to the borrowers. Collateral requirement should not be seen as a pressuring tool to the borrowers but should be viewed as a monitoring tool and an income generating tool for the two parties. For instance collateral substitutes like; vehicle logbooks can be held by the financial institution and physical property like; vehicles can be left in hands of the borrower and used it to finance the loans.

iv. The owners and management of SMEs should always monitor their loan usage to avoid misappropriation. This should start even before accessing the credit by prior planning for the budget and sticking to that budget. In the event of misappropriation they should replace the amount used for other purposes on time so as to stick to purpose of the loan and avoid loan repayment problems. Financial institutions should also have follow up programmes to make sure clients have put the loan to the stated purpose.

## 5.4 Areas of further Study

Arising from this study, the following directions for future research in finance are as follows: First, this study focused on SMEs located in Kampala and therefore, generalizations cannot adequately extend to other SMEs outside Kampala. Future research should therefore focus on all SME's in Uganda.

A broad based study on interest rates and performance of both private and public Business Enterprises should also be carried out to give broader picture on the same.

A study should also be done on the effect of interest rates on loan repayment by the small scale borrowers and establish whether there is any positive relationship. This should also capture the effect on performance of these loans and the overall growth of the business especially in the Slum areas in Kampala County.

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## Appendices

### Appendix 1

Dear Respondent,

The researcher of this study is ALINDA ANNE a student of Uganda Martyrs University pursuing a Bachelor's degree in Business Administration and Management. This research is based on FINCA Uganda and is about "The influence of microfinance on the growth of small and medium sized businesses."

The research is purely for academic purposes and your responses are of great importance. Kindly spare a few minutes to give the required answers to this questionnaire. All the information given will be treated with the outmost confidentiality. Thank you for your time.

Please answer the questions below by ticking on the most correct answer.

**Background information of the respondents**

- **GENDER** MALE ☐

  FEMALE ☐

- **AGE GROUP**

| **20-29 years** | **30-39 years** | **40-49 years** | **50-above** |
|---|---|---|---|
| | | | |

| | | | |
|---|---|---|---|
| | | | |

- **Highest Level of Education**

(a) UCE

(b) UACE

(c) Tertiary institution

(d) University Level

- **Time period Served at FINCA-Uganda?**

(a) 1-2 years

(b) Less than 5 years

(c) 3- 5 years

(d) Above 5 years

- **Type of owned business structure**

(a)Sole Proprietorship

(b) An Association

(c) Joint Venture

(d) Other

- **Credit Facilities**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| Strongly agree | Agree | Neutral | Disagree | Strongly disagree |

| | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| Clients can easily access credit from other organisations. | | | | | |
| Clients can easily access finances from FINCA Uganda. | | | | | |
| Clients are able to pay back loans within a specified period of time. | | | | | |
| Access to finance boasts | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| employment opportunities within your area. | | | | | |
| MFI's through loans lead to the growth of SME's. | | | | | |

- **Collateral Security**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| Strongly agree | Agree | Neutral | Disagree | Strongly disagree |

| | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| Collateral security influences the lending power at FINCA. | | | | | |
| Security is a must to obtain a loan from FINCA Uganda. | | | | | |
| Collateral security demanded by FINCA Uganda can be in | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| any form. | | | | | |
| Clients can obtain loans from other financial institutions like banks without collateral security. | | | | | |

- **Interest rates**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| Strongly agree | Agree | Neutral | Disagree | Strongly disagree |

| | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| Interest rates affect the borrowing will of the clients. | | | | | |
| Interest rates do not affect the productivity of SME's. | | | | | |
| Interest Rates encourage adverse selection of loans seekers. | | | | | |

## Appendix II

## Interview guide.

- What Challenges do you face whenever you are acquiring the loan?

- How can FINCA improve on the services it provides?

- What motivated you to start this kind of business?

- What type of assistance have you got from FINCA?
- By what percentage has the assistance from FINCA helped you achieve what it was intended for?