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THE RELATIONSHIP BETWEEN ACCESS TO FINANCES AND SMES PERFORMANCE IN WOBULENZI TOWN COUNCIL, LUWERO DISTRICT

Nyantika Mosomi Godfrey

Abstract

This study aimed to establish the relationship between access to finances and SMEs' performance in Wobulenzi town. The researcher used descriptive, cross-sectional, and correlation research designs with both qualitative and quantitative approaches. A sample of 162 respondents was used. The methods for data collection was the self-administered questionnaire. There was a significant relationship between access to finance and SMEs performance in Wobulenzi town council, in which the study found loan size (r. value = 0.656; p.=0.000); interest rate (r.=0.663; p.=0.000) and loan period and SMEs performance (r.=0.558; p.=0.000). Therefore, the study recommends that to improve SMEs' performance, the owners need to keep servicing their loans on time to maintain a good relationship with the MFIs.

Key Words: SMEs, finance, performance, interest rate, loan period and loan size

INTRODUCTION

There are various for the Small and Medium Enterprises (SMEs) to access finance that affects their performance. As a result, SMEs' importance has attracted a lot of attention internationally in relation to access to finance and performance-concerning a few years (Aquino, 2010). The study of Beck and Kunt (2006) showed that although there were causally links between SMEs and economic development, they find out substantial evidence that SMEs have less access to formal external sources of finance potentially explained the lack of SMEs' contribution growth. For instance, in Europe and USA where SMEs contribute to the economy but face challenges with interest rates for loans acquired, it affects their performance. They further noted that leasing, mortgaging, and factoring are useful in facilitating finance access, although they limit SMEs from receiving large sums of funds.

Beck and Demirguc-Kunt (2006) found that new SMEs' growth was limited to access to finance due to collaterals and loan periods and for the payback period. Changes in business access to finance have either a negative or positive effect on SMEs' growth or failure in much of Africa (World Bank, 2006). Herrington et al. (2009) argue that access to finance is a significant problem for South African entrepreneurs and other African countries. Lack of financial support was the second most reported contributor to low new firm creation and failure after education and South Africa training. FinMark Trust's (2006) study found that only 2% of new SMEs in South Africa can access bank loans. Foxcroft et al. (2005) found that 75% of bank credit applications by new SMEs in South Africa are rejected due to the inability to handle loan size and provide collaterals demanded. This suggests that new SMEs without finance may not be able to survive and grow.

In the East African Community, SMEs play a much more significant role in developing the country economy and alleviating the poverty participating in the global development but have challenges with access to loans due to significant demands. For example, in Kenya SMEs, makeup well over 90% of the country's private sector. However, they cannot access banks' loans due to high demands for collaterals (EAC, 2009).

The current evidence shows that small and Medium Enterprises (SMEs) form the bulk of Uganda's private sector. According to the Uganda Investment Authority (2008), there are challenges faced by SMEs face in Uganda. These challenges include the limited access to finance, the lack of entrepreneurial and managerial skills, no training for marketing and business financial planning, less banking and borrowing history due to lack of proper recording process and systems, and a culture that disrespects business contracts
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SMEs are considered as one of the fastest-growing sectors in Uganda, but their challenge is a high rate of failure, since over 10,000 people who start a business every year, 40% fail within a year and 80% within five years (Hatega, 2007). Despite efforts by the government to provide support to SMEs to attain performance and sustainability through different government programs, there has been a marginal improvement caused in SMEs' performance (BoU Report, 2009). SMEs in Uganda still report stagnated and or reducing profits, sales growth, market share, and low return on investment and low value for money, making them less competitive in both local and international markets (BoU Report, 2009).

SMEs' performance is low in many developing countries, Uganda inclusive, in terms of assets growth, sales growth, and liquidity growth over some time (Sudhir & Subrahmanya, 2009). Ogut (2010) notes that most SMEs that start in Uganda end up in a poor financial state, leading to an inadequate performance with low asset growth and sales growth, which has resulted in the collapse of some. Despite government economic reforms such as the business Uganda development scheme, microfinance outreach plan, UNIDO master craftsman program, SMEs are still failing to perform well and grow. Studies by Bukenya and Kinatta, 2012; Hatega, 2007and Kampumure, 2009 emphasized management skills and did not look at financial access that they recommend for further studies.

Luwero district statistics report (2013) shows that SMEs in the district have not been doing well as reflected with a high rate of stunt asset growth in towns like Bombo 13%, Zirobwe with 18 Wobulenzi 27%. Statistics further reveal that less than 23% of the SMEs in Wobulenzi have reinvested in terms of capital they had begun with for the last three years, whereas over 40% of the SMEs cannot survive for five to ten years the market. In this case, as the IMF report (2006) argues, access to finance might envisage the inadequate performance of SMEs in Wobulenzi as a number (31%) have closed down due to lack of sustainability, as a result of low sales and asset growth. The OECD (2012) shows that Luweero district is among the first five districts that lack documented evidence and information about the business, health, agriculture, and education despite the government inputs in the same area. Sources of funding for SMEs businesses are always unique and characterized by uncertainty, which affects their performance. The main issue addressed was the relationship between access to SMEs' finance and account in Wobulenzi town?

Literature Review

The high borrowing costs reflected by high-interest rates are perennial complaints among most borrowers and constrain credit accessibility because borrowers need a return on their investment. Many borrowers who proceed to access loans at such rates have under-gone liquidation or lost their highly valuable collateral to lenders due to defaulting on repayments (Sudhir, Bala, and Subrahmanya, 2009). Consequently, credit constraints limit firms' size and their growth, profits, activations, and liquidations; the scope of operation may also be limited. Since agriculture is the backbone of most developing economies, credit constraints to the sector are of first-order importance for these economies' performance. Capital market imperfections can impair the aggregate accumulation of capital, the rate of return on investment, innovation,

and expansion (John, 2004). That has led farmers in rural areas to rely on the less efficient and expensive informal credit markets and, hence, limited the agricultural sector's exploitation.

When credit terms are favorable, they encourage borrowing and, therefore, expand the capital base, leading to increased business activity. In contrast, unfavorable credit terms not only discourage borrowing but also decrease the business growth of a borrowing enterprise because they become huge direct expenses without cash discount, which reduces revenue (Kaplan, 2006). Habibulla (2010) and John (2011) found that MFIs loans increased MSEs operators' income and poor people in Bangladesh and Zimbabwe, respectively. The studies focused on business performance in terms of increased sales, acquisition of assets, and technology. In contrast, household research focused on the income growth from the firms to generate profit to pay for wages and salaries to establish a link between the availability of microfinance lending and the poor's overall well-being. Thus, both research and practice have seen increasing concern about microfinance Institutions' lending and MSEs performance. The study reviewed was based on medium and large enterprises whereas the current study looks at the SMEs, thus the study would gain knowledge on how the vies are applicable to the study area. Besides, the evidence emerging from various studies such as Mkazi (2007) about the MFIs lending on MSEs performance has so far researched mixed results. Thus inconclusive, mainly for developing countries. In spite of this, previous studies did not provide sufficient justification for the link between microfinance institutions' lending and MSEs performance in developing countries like Kenya. Therefore, whether microfinance in despite lending improves or worsens SMEs' performance is still worthy of other studies, as the one undertaken.

Carpenter and Petersen (2002) argued that firms whose financial needs exceed their internal resources may be constrained to pursue potential growth opportunities. Therefore, insufficient internally generated liquidity is one of the frequently cited factors for the causes of micro and small business failure in developing nations. Access to credit or loan enables the MSEs owners to pay for the cost of capital equipment, expansion, or renovation of buildings. Similarly, UWFT (2005) found that most MSEs that accessed adequate funds from microfinance institutions increased their volume of sales and the profit. The study also found MSEs acquired assets using MFIs loans. According to a study by UNDP (2002), MSEs in Kenya were able to acquire fixed assets and technologies using MFIs. The study showed a significant positive relationship between the amount of loan and MSEs achievement of goals. Makokha (2006) revealed that the inadequacy of capital hindered the expansion of businesses. The study further found that larger loans enabled MSEs to graduate to medium enterprises. This argument is supported by Otto, Muli, and Ong'ayo (2010) in their study that indicated that those MSEs that received large loans frequently had a larger labor force than those MSEs that received smaller loans. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short, and immediate repayment periods, and achieving scale can contribute to micro and small enterprises' sustainability.

The majority of SMEs still face inadequate financing to support their private initiatives. This is due to the high transaction costs and SMEs' inability to provide collateral required by banks (Beyene, 20,02). The shortage of finance and the high cost of loan funds negatively affect the financial performance of SMEs. Indeed, it is reported that the persistent constraints on SMEs financing, and the restrictive terms and conditions on approved loans, are a universal and significant problem among SMEs in developing countries. In the presence of favorable credit terms, access to finance is enhanced. Hence a firm is able to make diversification of investments to increase the income. Higher sales volume from goods production will lead to increased revenues and profitability, which means improved financial performance.

For Manos, Murinde, and Green (2012), cash ratio exhibits a firm's ability to settle its short-term liabilities in real-time. They reported that it is highly likely that highly liquefied

firms tend to embrace short-term borrowing compared to SMEs with less efficient liquidity synergies. Numerous studies contend that leverage and liquidity will display a negative relationship as SMEs generate their internal efficiencies to finance their short-term obligations while avoiding interest costs. However, it should be noted that, as firms grow their asset portfolios, they generate appetite from the lenders, who emphasize the collateral of the financing process. There is a significant relationship between the asset capacity of firms and long-term debts. In long-term financing, Deloof (2003) asserted that firms' capital structure plays a significant role in establishing lending and borrowing relationships between SME owners and financiers. The collateral strong positive relationship between SMEs' asset structures (as measured by the proportion of fixed assets to total assets) and long-term debt.

The review of the literature shows mixed results. Some studies argue that access to finance significantly and positively does contribute to the development and growth of businesses, especially SMEs. In contrast, other studies indicated that access to finance does not show any sign of change. Due to mixed results, it is worthy of investigating the relationship between access to finance and SMEs' performance in Wobulenzi.

METHODOLOGY

Research Design

The study adopted descriptive, cross-sectional, and correlation research designs with both qualitative and quantitative approaches. Mugenda and Mugenda (2003) denote that descriptive survey design in research describes the problem or phenomenon. The study also utilized both qualitative and quantitative techniques of inquiry. The quantitative aspects were used to capture quantifiable patterns, and the qualitative part was used to explore the issues at hand in-depth. On the other hand, correlation research design helped determine whether there is any relationship and to what degree a relationship existed between two or more variables: access to finance and SME financial performance in Wobulenzi town.

Population and Sample size

The study covered 280 licensed SMEs in Wobulenzi. This was derived from the Town Council Financial Records of the financial year 2012/2013. The study specifically targeted the SMEs within Wobulenzi, from which a sample was calculated. The study considered a sample size of 162 businesses, which included service providers and retail businesses. The simple random sampling technique was used in selecting the SMEs to participate in the study.

The study used a self-administered questionnaire, structured with both open and closed questions. The objective was analyzed using Pearson correlation to establish the relationship between access to finance and financial performance.

RESULTS AND DISCUSSION

The study aimed to examine the relationship of access to SMEs' finance and performance in Wobulenzi town, Luwero district. Three significant independent variables: Loan size, Interest rate, and loan period, were used to ascertain its impact on SMEs' performance.

Table 1: Relationship between access to finances and SMEs performance Correlations

		SMEs Performance
Loan size	r. value	.656**

	p. value	.000
Interest rate	r. value	.663**
	p. value	.000
Loan Period	r. value	.558**
	p. value	.000

Legend n=160

1.00-1.79 Very low; 1.80-2.59 low; 2.60-3.39 Moderate; 3.40-4.19 High; & 4.20-5.00 very high

Findings from Table 1 show that the three independent variables (Loan size, Interest rate, and loan period) had a significant relationship with SMEs' performance. The study found loan size having a significant relationship with SMEs' performance. The findings showed (r. value = .656; p.=0.000), which implied that loan size affects SMEs' performance. Since the p. value was less than α 0.05. The null hypothesis was rejected. The alternative hypothesis was accepted that there is a significant relationship between access to finance and the performance of SMEs in the Wobulenzi town council.

The findings are in line with Habibulla (2010) and John (2011), who in their studies, found that MFIs loans increased the income of SME operators and poor people in Bangladesh and Zimbabwe, respectively. Their studies focused on business performance in terms of increased sales, acquisition of assets, and technology, while household studies focused on increased income from firms as profit or wages and salaries to establish a link between the availability of microfinance lending and the overall well being of the poor. Otto, Muli, and Ong'ayo (2010) indicated that those MSEs that received large loans frequently had a larger labor force than those MSEs that received smaller loans. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods, and achieving scale can contribute to micro and small enterprises' sustainability. There is a significant relationship between the asset capacity of firms and long-term debts. In long-term financing, Deloof (2003) asserted that firms' capital structure plays a significant role in establishing lending and borrowing relationships between SME owners and financiers. As such, there is a strong positive relationship between the asset structures of SMEs (as measured by the proportion of fixed assets to total assets) and long-term debt.

Concerning interest rate and SMEs performance, a significant relationship was found, whereby (**r.=0.663; p.=0.000**) implied significant relationship. Interest rates may hinder a business from acquiring loans. The high borrowing costs reflected by high-interest rates are perennial complaints among most borrowers and constrain credit accessibility because borrowers need a return on their investment. Many borrowers who proceed to access loans at such rates have under-gone liquidation or lost their highly valuable collateral to lenders due to defaulting on repayments (Sudhir, Bala, and Subrahmanya, 2009). No wonder Beyene (2002) argues that a shortage of finance and the high cost of loan funds negatively affect SMEs' financial performance. Indeed, it is reported that the persistent constraints on SMEs' financing, and the restrictive terms and conditions on approved loans, are a universal and significant problem among SMEs in developing countries.

Similarly, a significant relationship was found between the loan period and SMEs' performance (**r.=0.558; p.=0.000**). The findings indicated that the loan period had a substantial relationship with SMEs' performance. When credit terms are favorable, they encourage borrowing and, therefore, expand the capital base, leading to increased business activity. In contrast, unfavorable credit terms not only discourage borrowing but also decrease the business growth of a borrowing enterprise because they are directly associated with a cash discount, which reduces revenue (Kaplan, 2006).

Table 2: Access to finance affects SMEs performance Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.763[a]	.582	.574	.33912

a. Predictors: (Constant), Loan Period, interest rate, Loan size

The results show the extent to which the access to finance affects SMEs' performance, the study found (R=763; R^2=.582). This means that access to finance has a good contribution to SMEs' performance. Findings show the R^2=582x100=58.2%, which means that access to finance can account for 58% of the SMEs' performance in Wobulenzi, whereas the remaining 41.8% can be accounted for the factors that were not handled in this study. Beck and Demirguc-Kunt (2006) found that new SMEs' growth was limited to access to finance due to collaterals and loan period, and for the payback period. Changes in business access to finance have either a negative or positive effect on SMEs' growth or failure in much of Africa (World Bank, 2006).

Conclusion

Concerning the study findings, it was concluded that: there is a significant relationship between access to finance and SMEs performance in the Wobulenzi town council. Access to finance predicts SMEs' performance in Wobulenzi as a number of them have closed down due to lack of sustainability due to low sales, stock turnover, and asset growth.

Recommendations

Based on the findings, it can therefore be recommended that to improve the performance of SMEs, and there is a need by the owners to keep servicing their loans on time to maintain a good relationship with the MFIs. This will help to receive favorable terms when they wish to borrow again because of the excellent track record. In return, this will help them maintain adequate liquidity because they can always access cash resources from their MFIs when the need arises.

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Nyantika Mosomi Godfrey
MBA in Accounting and finance
Bugema University, **Kampala, Uganda**
nyamosomi@gmail.com