MAKERERE UNIVERSITY

CREDIT TERMS, ACCESS TO FINANCE AND FINANCIAL PERFORMANCE OF SMES IN KAMPALA

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MARCH, 2012
DECLARATION

I, Nyangoma Pamela Susan declare that this is my original dissertation and has never been submitted anywhere and in any Institution of higher learning for academic purposes.

NYANGOMA PAMELA SUSAN

2008/HD10/14119U

Signature ……………………… Date……………………
APPROVAL

This dissertation has been submitted with the approval of my supervisors whose signatures are appended against their respective names below:

Dr. Nixon. A. Kamukama       Mr. David Nyamuyonjo

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

Date................................. Date.................................
DEDICATION

I dedicate this research work to my heavenly father, my loving parents, siblings, nephews and nieces, the rest of my relatives and all my classmates who shared the dream of attaining a masters degree with me.
ACKNOWLEDGEMENT

I am very thankful to the Almighty God for giving me knowledge and wisdom to complete this study. To my parents and family who have persistently encouraged me to pursue further studies and given me education to face this competitive world I will be forever grateful may God richly bless you!

My sincere appreciation goes to my supervisors Dr. Nixon. A. Kamukama and Mr. David Nyamuyonjo for your intellectual guidance and mentoring that you have given me right from the beginning of this study to its conclusion may God bless and propel you to greater heights.

Finally to my classmates and friends who shared their knowledge and guidance with me during the course of this study may God bless the works of your hands and fulfil your hearts desires.
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This study was motivated by the difficulty faced by SMEs in accessing credit from commercial banks to sustain business growth and financial performance. The purpose of the study was to establish the extent to which credit terms and access to credit have affected financial performance of SMEs in Kampala. The study was guided by the following objectives; to establish relationship between credit terms and financial performance of SMEs in Kampala, to establish the effect of credit terms and access to credit on financial performance of SMEs in Kampala and to establish the relationship between access to credit and financial performance of SMEs in Kampala.

The study was based on a correlation survey design. Primary data was collected using self administered questionnaires issued to respondents who were owners/managers of the business. A sample size of 384 respondents was selected from a population of 110,714 SMEs using simple random sampling method. Data was analyzed using SPSS version 17. Correlation and regression analysis was carried out to establish the association among the variables.

The results indicated a significant positive association among the variables of credit terms, access to credit and financial performance of SMEs. Credit terms contribute 33.1% of the variance in financial performance in SMEs. Regression analysis revealed that access to credit contributed 54.3% of the variance in financial performance of SMEs. In order to improve access to credit by SMEs, commercial banks and other lending institutions need to adjust credit terms in line with what borrowers can afford.
CHAPTER ONE

1.0 Introduction

This chapter presents an overview of the research starting with the background to the study, statement of the problem, purpose of the study, objectives of the study, research questions, scope of the study, significance of the study, conceptual framework and its description.

1.1 Background to the study

Credit terms are standards applied by commercial banks in determining the ability to repay loans. These terms help in assessing credit worthiness of borrowers and hedge against the risk of loss in case of non repayment. They include collateral, interest rate and repayment period (Agarwal, 2006). Access to credit refers to the availability of a supply of reasonable quality financial services at a reasonable cost. Business financial performance is the ability of the business to contribute to job and wealth creation through business start up, survival and growth (Sandberg, 2002).

Improved access to credit helps businesses grow and advance their financial performance (Claessens, 2006 and Bamford, 1997). On the other hand acquisition of such credit has proved to be difficult due to credit terms that are perceived to be unfavorable. According to Kakuru (2008), in Uganda collateral is up to a tune of 150% of the loan, the repayment period is as short as 24 months, and interest rates range from 23% to 30% per month.

Although there have been several business start-ups in the recent past, a number of them have failed to continue. There was a decline in registered business from 800,000 in 2001 to 25,000 in 2007 as noted by (GoU, 2010; Kasekende and Opondo, 2003). According to Hatega (2007), Small and Medium sized Enterprises (SMEs) are estimated to constitute 90 percent of the businesses in Uganda. A small-scale enterprise is an enterprise or a firm employing less than 5 but with a maximum of 50 employees where as a medium sized enterprise is considered a firm, which
employs between 50-100 workers (Kasekende & Opondo 2003). Eighty percent of the SMEs in Uganda are located in urban areas and are largely involved in trade, agro-processing, and small manufacturing (Hatega, 2007).

Despite the important role that SMEs are expected to play in the economy of Uganda, there are a number of constraints which act as barriers to the emergence and growth of a sustainable small and micro enterprises sector. The Ministry of Finance, Planning and Economic Development (2000), UNCTAD (2002) and Stevenson and St. Onge (2005) emphasize that the major constraints that the SME sector faces include: operations as an informal sector, the size of their operations is too small to enable enjoyment of economies of scale, poor production technology, limited access to markets, limited managerial skills, government bureaucracy and limited access to banking facilities.

SMEs contribute approximately 75 percent of the gross domestic product and employ approximately 2.5 million people, signifying their importance in the economic development of Uganda. Their success is therefore paramount to the country. This success however depends on their access to credit. The researcher therefore seeks to investigate the effect of credit terms on financial performance of SMEs.

1.2 Statement of the problem

Over the years performance of SMEs has been deteriorating and majority of them have closed down. This trend of performance could be as a result of SMEs failure to access credit from financial institutions probably due to unfavourable credit terms. Most of the businesses are reported to be failing within the first five years while only 5 to 10% survive and make it to maturity (Private Sector Foundation Uganda, 2006). Although factors noted here are important in explaining SMEs’ financial performance, the extent to which they have influenced performance in SMEs is not well known.
1.3 Purpose of the study
The purpose of the study was to establish the effect of credit terms and access to finance on financial performance of SMEs in Kampala.

1.4 Objectives of Study
(i) To establish relationship between credit terms and financial performance of SMEs in Kampala
(ii) To establish the relationship between access to credit and financial performance of SMEs in Kampala
(iii) To examine the effect of credit terms and access to credit on financial performance of SMEs in Kampala

1.5 Research Questions
(i) What is the relationship between credit terms and financial performance of SMEs?
(ii) What is the relationship between access to credit and financial performance of SMEs?
(iii) What is the effect of credit terms and access to credit on financial performance of SMEs?

1.6 Scope of study
1.6.1 Subject scope
The researcher sought to investigate the effect of credit terms and access to credit on financial performance of SMEs. The study was limited to credit terms and access to credit as independent variables, and SME financial performance as a dependent variable.

1.6.2 Geographical scope
The research was carried out in Kampala district. Kampala was chosen because it was one of the regions with the highest concentration of businesses. Kampala had 29% of the businesses in the country compared to the rest of the whole central region which had 30%. As a district, it had the highest distribution of employment at 35% (UBOS, 2010/2011).
1.7 Significance of the study

The study will add to existing literature on financial performance of SMEs, credit terms and access to finance in Uganda.

The study will provide information and knowledge about the importance of creditworthiness to SMES which will help them improve their chances of getting credit.

The study will relay information to commercial banks about perceptions of their services by business enterprises which will help them improve service delivery.

1.8 Conceptual framework

The conceptual framework was developed from studies (Agarwal, 2006; Nakiyingi, 2010; CGAP, 2009; Kelley & Nakosteen, 2005; McMahon, 2001; Miller, 1988; Birley & Westhead 1994).

![Conceptual framework diagram]

Figure 1: Conceptual framework for the study of the effect of credit terms and access to credit on financial performance of SMEs.
1.8.1 Description of the model

The conceptual framework depicted in Figure 1 shows credit terms and access to finance as independent variables, while financial performance of SMEs is a dependent variable.

The framework shows the effect of credit terms and access to credit on SME financial performance. Also shown is the relationship between credit terms and financial performance of SMEs. The relationship between access to credit and financial performance of SMEs is also illustrated. According to Agarwal (2006), credit terms are measured in terms of interest rate, collateral and repayment period. Access to finance is measured by amount borrowed/volume and frequency of access which is the number of times one can access credit (Nakiyingi, 2010 and CGAP, 2009). Financial performance of SMEs is measured by total sales, profitability, and liquidity (Kelley, 2005; McMahon, 2001; Miller, 1988; Birley & Westhead 1994). Credit terms are conditions set by commercial banks in advancement of credit to meet working capital and short-term liquidity management. Access to credit depends on the ability of the business to meet credit terms set by commercial banks. Therefore improved access to more financial capital can help firms expand more and maintain financial stability, leading to improved financial stability (Claessens, 2006 and Bamford, 1997).
CHAPTER TWO
LITERATURE REVIEW

2.0 Introduction

This chapter examines available literature on the relationships between the different variables used in this study. The researcher will review literature on the relationship between credit terms and financial performance, the effect of credit terms and access to credit on financial performance of SMEs and the relationship between access to credit and financial performance of SMEs in Kampala.

2.1 Credit terms

Credit terms refer to standards or negotiated terms (offered by a seller to a buyer) that control the monthly and total credit amount, maximum time allowed for repayment, discount for cash or early payment, and the amount or rate of late payment penalty (Kakuru, 2007). According to Agarwal (2009), credit terms include factors such as interest rate, collateral and loan repayment periods.

Collateral required by commercial banks in developing countries has been a contentious issue in SME financing. However, real-estate collateral provides an incentive and a justification to lend and repay, as well as a means to offset losses in case of default (Otero and Lopez, 2001; Aryeetey, 1994). Stiglitz and Weiss (1981) in their credit rationing theory argue that in an equilibrium market with problems that are commonly found in financial markets, it would be rational for banks to engage in credit rationing. Due to problems of asymmetric information and agency, banks have difficulty distinguishing good risks from bad risks and in monitoring borrowers once funds have been advanced (Organization of Economic Cooperation and Development, 2006).

2.2 Access to credit

Access to credit is defined as an absence of price and non-price barriers in the financial services (IBRD/World Bank, 2008). Financial access is measured by number of loans in a given
Period/frequency and average loan amount/volume relative to per capita income (CGAP, 2009). There is growing consensus in the literature that small businesses as opposed to larger firms face specific constraints in raising external finance as observed by (Berger, 1998). SMEs do not have access to public capital markets and hence depend on banks for funding. When there is a difference between the demand for funds by SMEs and the supply of funds, a financing gap is said to occur. A clear distinction must, however, be made between “actual gaps” and “perceived gaps”. An actual financing gap is said to exist if firms that merit financing cannot obtain it due to the existence of market imperfections (OECD, 2006). The fact that some enterprises experience difficulties in accessing financing is not an indication of the existence of an “actual gap”.

2.3 Financial performance of SMEs

An organization’s financial performance can be measured by total sales, liquidity, and profitability (Kelley and Nakosteen, 2005; McMahon, 2001; Miller, Wilson and Adams 1988; Birley and Westhead 1994). The performance of SMEs is their ability to contribute to job and wealth creation through business start up, survival and growth (Sandberg, 2002). Maintaining optimal liquidity demonstrates that there are economies of scale associated with the cash levels required to confront the normal transactions of the firm. Sales growth is often used as a measure of performance. Thomas and Mason (2007) have argued that if sales increase, profits will eventually follow. Information on financial performance is useful in predicting the capacity of the enterprise (Levasseur, 2002).

2.4 Effect of credit terms and access to credit on financial performance of SMEs

Due to the high collateral requirements, unfavorable interest rates and untimely delivery of credit SMEs are reluctant to obtain loans. In addition, access to credit by SMEs is limited since banks have failed to expand SME loans due to imperfect information, high transaction costs, large number of borrowers and low returns from investments. This will result in reduced financial performance in terms of sales, profits and liquidity (Olutunla and Obamuyi, 2008).
Atieno (2006) and Steel (2004) have further explained that limited access to credit can also negatively affect profitability and financial survival if firms operate under poor economic conditions and high interest rates. On the other hand, if credit is accessible and reasonably priced, firms can address their liquidity constraints in turn aiding profitability (Laferarra, 2003).

In assessing the creditworthiness of borrowers, banks apply standard and stringent requirements to determine the performance of the business and the ability to repay the loans. Suppliers of credit may also choose to offer high interest rates and credit rationing that would leave significant numbers of potential borrowers without access to credit (Stiglitz and Weiss, 1981). Lack of available external finance can result in firms being unable to adequately fund operations and pursue market opportunities hence hindering their performance (OECD, 2006).

2.5 The relationship between credit terms and financial performance of SMEs

The majority of SMEs still face inadequate financing to support their private initiatives. This is due to the high transaction costs and inability of SMEs to provide collateral required by banks (Beyene, 2002). Shortage of finance and the high cost of loan funds negatively affect financial performance of SMEs. Indeed, in UNCTAD (1995), 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 presence of favourable credit terms, access to finance is enhanced. Hence a firm can invest in more ventures and increase its sales volume. Higher sales volume and production will lead to increased revenues and profitability which means improved financial performance (Kogut, 1985; Grant, Jammie and Thomas, 1988).

Berger and Udell, (1995) argue that, given the strong relationship between lenders and borrowers it is highly unlikely that the borrower fails to honour his debt, otherwise it would be very difficult to find other banks willing to grant loans at the credit terms. Consequently when SMEs meet their loan obligations financial performance is improved.
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 creditworthiness, 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).

2.6 The relationship between access to credit and financial performance of SMEs

SMEs face difficulty in accessing finance from financial institutions, due to an information gap, which prevents them from knowing how and where to obtain this finance on acceptable terms, and the risk associated with their failure to pay back funds. The implication is that small businesses face funding limit, and are discriminated against in credit markets, which leads to large firms crowding out smaller firms in the market. The lack of adequate funding means that SMEs will experience low incomes, low profits and low capital formation. However, improved access of credit by SMEs resulting from their ability to meet commercial bank credit terms, leads to survival, increased sales, higher profitability and low cost of doing business (Ogujiuba, 2004; Ojo, 1992 and CBN, 2007).

Small and medium enterprises (SMEs) are always constrained in accessing capital, especially from the formal financial institutions. The lack of accessibility to finance the enterprises, therefore, is attributed to both the supply and demand factors in lending. On the supply side, banks are reluctant to grant loans to SMEs because of lack of reliable information on borrowers, low transparency of operations and poor accounting standards, lack of discipline in the use of credit facilities, the perception of the SME sector as risky, and difficulties in enforcing loan contracts. On the demand side, borrowers are constrained by the absence of collateral, improper bookkeeping, high rates of loan diversion and their inability to prepare feasibility studies. In less developed countries where there is a dearth of information on the operations of SMEs, there is always risk aversion by the financial institutions in funding the sector (Ogujiuba, 2004).
Due to limited access to long-term loans SMEs find it difficult to finance their capital investment and daily operational needs. SMEs have to pay a higher rate of interest and comply with more restrictive requirements on institutional credit obtained by them (Aryeetey, 1994 and Webster, 1991). In the presence of favourable credit terms, there is improved access to credit and therefore financial performance will be enhanced.

Additionally, the coefficient of loan amount is associated with financial performance of SMEs. This implies that bank loan is positively related to firm’s profitability and that profits of SMEs tend to increase with increasing amount of loans. This further confirms the work of McMahon, (1993) that the financing decision impacts upon the profitability of an enterprise, and as stated by Keasey and Watson (1991), the use of banks’ financing by SMEs is associated with higher business performance.
CHAPTER THREE
METHODOLOGY

3.0 Introduction
This chapter discusses the method by which this study was undertaken. It included identifying a research design that was used, study population, sampling method and size, data sources, data collection instruments, their reliability and validity, measurements of study variables, data processing analysis and anticipated limitations of the study.

3.1 Research design
The study adopted a cross-sectional survey design because of limited resources in terms of time and finances. Quantitative and qualitative study approaches were used. Correlation, regression and factor analysis were used to establish the relationship between credit terms, access to credit and financial performance of SMEs. The researcher used a survey and field research to gather quantitative and qualitative data respectively.

3.2 Study population
The study population consisted of SMEs in Kampala which are estimated to be 110,714 from sectors of trade, service and manufacturing (Uganda Bureau of Statistics, 2010/2011).

3.3 Sampling method, procedure and size
The researcher used stratified sampling to divide the population into strata according to the different business sectors of trade, service and manufacturing. Simple random sampling was used to select respondents from each stratum. Owners/managers were interviewed. The sample size was 384 SMEs according to the tables developed by Krejcie and Morgan (1970).

3.4 Data sources
Primary data was used. It was gathered from respondents through administering questionnaires.
3.5 Data collection instrument

The researcher used structured self-administered questionnaires covering all the variables in the study. In these questionnaires, a five point Likert scale was used to ease data processing and analysis. The scale was marked 1-5 where; 1 represented strongly disagree and 5 strongly agree.

3.6 Validity and reliability of the instrument

Cronbach alpha (Cronbach, 1951) reliability coefficient of 0.6 points and above was used to measure the internal consistency or average correlation of items in a survey instrument to gauge its reliability. The higher the score, the more reliable the generated scale is. For instance, Nunnally (1978) argues that a 0.7 alpha coefficient is an acceptable reliability coefficient.

Table 1 Validity and reliability of the instrument

<table>
<thead>
<tr>
<th>Study variables</th>
<th>Reliability coefficient</th>
<th>CVI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Terms</td>
<td>.870</td>
<td>0.716</td>
</tr>
<tr>
<td>Access to credit</td>
<td>.881</td>
<td>0.897</td>
</tr>
<tr>
<td>Financial performance of SMEs</td>
<td>.944</td>
<td>0.732</td>
</tr>
</tbody>
</table>

Source: Primary Data

The content validity index was computed and all items scored above 0.7 as shown in the table 1 above. The instrument was also checked for accuracy, reliability, consistency and completeness using the alpha cronbach test (cronbach, 1951). The acceptable reliability results were those of 0.6 points and above as shown in table 1 above.

3.7 Measurement of study variables

Credit terms were measured in terms of interest rate, collateral and repayment period using measures developed by (Agarwal, 2006). Access to credit was measured by amount borrowed/volume and frequency of access/number of times credit was received in a given period (Nakiyingi, 2010 and CGAP, 2009). Financial performance of SMEs was measured by total sales,
liquidity and profitability as per measures developed by (Kelley & Nakosteen, 2005; McMahon, 2001; Miller, Wilson & Adams, 1988; Birley and Westhead 1994).

3.8 Data processing and analysis

The data collected was computerized, sorted, edited, classified and coded. The resultant data was entered using statistical package for social scientists (SPSS version 17) for analysis. This generated frequency tables for demographic and descriptive data. The relationship between the study variables was established using correlation. Regression analysis was used to determine the prediction potential of the model.

3.9 Challenges of the study

Failure to answer questions because it was considered time consuming for the respondents. The researcher endeavored to capture rapport and make appointments convenient to the respondents.

Lack of cooperation from respondents, especially those who considered the information confidential and thought the survey was for purposes of revenue collection. The researcher therefore assured the respondents of confidentiality of their information that it is solely for academic purpose for which it was used.

Insufficient financial resources in terms of transport and stationery costs. However the researcher endeavored to use personal resources to ensure the research is completed.
CHAPTER FOUR
RESULTS & FINDINGS OF THE SURVEY

4.0 Introduction
This chapter contains the results and the interpretation relating to the sample characteristics of the survey respondents. The presentation was guided by the research objectives and the statistics were generated with the aim of generating responses from the research questions. The presentation was guided by the following research objectives;

i) To establish relationship between credit terms and financial performance of SMEs in Kampala;

ii) To examine the effect of credit terms and access to credit on financial performance of SMEs in Kampala;

iii) To establish relationship between access to credit and financial performance of SMEs in Kampala.

4.1 Sample Characteristics

4.1.1 Gender distribution of the respondent
The results in table 1 below were generated to explore the distribution of the gender of the respondents.

Table 2: Gender of the respondents

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>137</td>
<td>47.7</td>
<td>47.7</td>
<td>47.7</td>
</tr>
<tr>
<td>Female</td>
<td>150</td>
<td>52.3</td>
<td>52.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>287</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: primary Data

From table 2 above, results revealed that the majority of the respondents were female constituting 52.3% compared to their male counterparts representing 47.7% in the sample. This shows that
female respondents were more cooperative than the male respondents who mostly claimed they were too busy.

4.1.2 Number of employees

Table 3: Number of employees

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>116</td>
<td>40.4</td>
<td>40.4</td>
</tr>
<tr>
<td>2 to 4</td>
<td>90</td>
<td>31.4</td>
<td>71.8</td>
</tr>
<tr>
<td>5 to 8</td>
<td>35</td>
<td>12.2</td>
<td>84.0</td>
</tr>
<tr>
<td>9 to 10</td>
<td>28</td>
<td>9.8</td>
<td>93.7</td>
</tr>
<tr>
<td>More than 10</td>
<td>18</td>
<td>6.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>287</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Primary Data

From table 3 above, results showed that most of the employees are between 0-1 representing 40.4%, between 2-4 employees constituting 31.4%, 5 to 8 employees comprising of 12.2% and the least were between 9 to 10 and more than 10 representing 9.8% and 6.3% respectively in the entire Sample. This implies that majority of the businesses were small sized enterprises.
4.1.3 Age of owner/manager

Table 4 Age of owner/manager

<table>
<thead>
<tr>
<th>Age of owner/manager</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>28-37</td>
<td>195</td>
<td>67.9</td>
<td>67.9</td>
<td>67.9</td>
</tr>
<tr>
<td>38-47</td>
<td>74</td>
<td>25.8</td>
<td>25.8</td>
<td>93.7</td>
</tr>
<tr>
<td>48-57</td>
<td>6</td>
<td>2.1</td>
<td>2.1</td>
<td>95.8</td>
</tr>
<tr>
<td>58+</td>
<td>12</td>
<td>4.2</td>
<td>4.2</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>287</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: primary Data

From table 4 above, findings revealed that majority of the respondents were in the age group of 28-37 years representing by 67.7%, followed by 38-47 constituting years 25.8% and least were in the age bracket above 58 years and 48-57 years constituting 4.2% and 2.1% respectively. This implies that most owner/managers of the businesses are between 28 and 37 years of age.

4.1.4 Ownership of the business

Figure 2: Ownership of business
From figure 2 above, findings revealed that ownership of most businesses was sole proprietorship representing 90.24% and least were partnership owned comprising of 9.76% in the entire sample.

### 4.1.5 Kind of business the firm is engaged in

**Table 5: Kind of business the firm engaged in**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>18</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
</tr>
<tr>
<td>Services</td>
<td>66</td>
<td>23.0</td>
<td>23.0</td>
<td>29.3</td>
</tr>
<tr>
<td>Trade</td>
<td>203</td>
<td>70.7</td>
<td>70.7</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>287</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Source: primary Data*

From table 5 above, findings show that most of the respondents are engaged in the trade kind of business constituting 70.7% followed by service type of business representing 23.0% and the least were observed to be in the manufacturing kind of business comprising of 6.3% in the entire sample. This meant that trade was the most dominant business activity carried out by SMEs while manufacturing was the least dominant activity.
4.1.6 Length of existence in business

Figure 3: How long has this business been in existence

Results from figure 3 above, revealed that most of the organizations have been in existence for a period less than 10 years constituting 54.70%, followed by 10 years and above representing 34.15% and the least have been in existence for a period less than 5 years representing 11.15% in the entire sample. This signifies higher stability levels in businesses that have existed longer and therefore stand a better age to access credit than those existing for shorter periods and therefore improved financial performance.
4.1.7 Owner/manager’s level of education

From figure 4 above, out of the 287 owners/managers, 44.53% had diploma level of qualifications, 24.64% qualified with degrees, 16.06% qualified with A-level and least of the owners/managers qualified with O-level and PLE level of qualifications constituting 10.58% and 2.19% respectively. This implies that the majority of the respondents had post graduate qualification, meaning that the population sample was made up of learned and experienced owner/managers.
4.1.8 Largest amount ever borrowed

From figure 5 above, results indicated that majority of the respondents’ single largest amount ever borrowed was less than 5 million representing 52.36% followed with less than 10 million constituting 37.82% and the least of the respondents single largest amount ever borrowed was 25 million or more and less than 25 million representing 5.09% and 4.73% respectively.
4.1.9 Number of times the firm has borrowed

Table 6: Number of times firm has borrowed money from commercial banks

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-less than 3 times</td>
<td>260</td>
<td>90.6</td>
<td>90.6</td>
</tr>
<tr>
<td>3-less than 5 times</td>
<td>27</td>
<td>9.4</td>
<td>9.4</td>
</tr>
<tr>
<td>Total</td>
<td>287</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: primary Data*

From table 6 above, results revealed that number of times firms has borrowed money from commercial banks is less than 3 times constituting 90.6% and the least less than 5 times comprising of 9.4% in the entire sample.

4.2 Rotated Component Factor Analysis

4.2.1 Rotated Component Factor Analysis for credit terms

This was used in data reduction to identify factors that explain each construct in the study variables. Factor analysis was used to extract factors that measure credit terms using the principal Component Analysis and Varimax Rotation Methods.

Table 7: Rotated Component Matrixa for credit terms

<table>
<thead>
<tr>
<th>Rotated Component Matrixa for credit terms</th>
<th>Component</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presence of collateralizable assets in this firm helps in business’ growth</td>
<td>.891</td>
</tr>
<tr>
<td>The Security required to get loans limits the firm’s ability to borrow from commercial banks</td>
<td>.858</td>
</tr>
<tr>
<td>This firm has sufficient collateral to get credit from commercial banks</td>
<td>.818</td>
</tr>
<tr>
<td>The firm has reliable security guaranteed to access credit</td>
<td>.746</td>
</tr>
</tbody>
</table>
The firm feels collateral required by commercial banks is .411 favourable.

This firm can afford the interest rates charged by commercial banks .653.

The firm has enough information on interest rates charged .644.

Interest rates remain fixed for the whole repayment period .602.

This firm feels interest rates charged are reasonable .576.

This firm’s repayment period varies according to the loan size. .723.

The firm’s ability to repay loans is always satisfactory .631.

The loan repayment period given to this firm is convenient .474.

<table>
<thead>
<tr>
<th>Eigen Values</th>
<th>3.043</th>
<th>1.858</th>
<th>1.588</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Variance</td>
<td>25.355</td>
<td>15.484</td>
<td>13.212</td>
</tr>
<tr>
<td>Cumulative percentage of variance</td>
<td>25.355</td>
<td>40.839</td>
<td>54.051</td>
</tr>
</tbody>
</table>


*Source: primary Data*

Key

1- Collateral
2- Interest rate
3- Repayment period

Factor analysis yielded three components which were interpreted as collateral (25.355%), interest rate (15.484%) and repayment period (13.212%) explaining 54.051% of the variance in credit terms.

The researcher observed that the presence of collateral assets in firms helped in business growth explained by (.891). Security required by firms to get loans limited their ability to borrow from commercial banks (.858). Firms were required to have sufficient collateral to enable them get credit from commercial banks (.818). In addition firms with reliable security were guaranteed to access credit (.746). The firms also felt collateral required by commercial banks was favourable loans (.411).
Further analysis observed that firms could afford interest rates charged by commercial banks (.653). Firms had enough information on interest rates charged by commercial banks (.644). Also interest rates remained fixed for the whole repayment period (.602). The firms felt interest rates charged were reasonable (.576).

Also observed was that the firm’s repayment period varied according to the loan size (.723). Finally the firm’s ability to repay loans was always satisfactory (.631). The loan repayment period given to firms, was convenient (.474).

4.2.2 Rotated Component Factor Analysis for Access to credit

Factor analysis was used to extract factors that measure access to credit using the principal Component Analysis and Varimax Rotation Methods.

**Table 8: Rotated Component Matrix for access credit**

<table>
<thead>
<tr>
<th>Access to credit</th>
<th>Component 1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>The firm often gets the loan size it requires</td>
<td>.821</td>
<td></td>
</tr>
<tr>
<td>Access to loans helps in growth of the firm’s business</td>
<td>.730</td>
<td></td>
</tr>
<tr>
<td>The amount of credit the firm has been getting from banks is on the increase</td>
<td>.692</td>
<td></td>
</tr>
<tr>
<td>The firm can access a loan at any time of need</td>
<td>.549</td>
<td></td>
</tr>
<tr>
<td>This firm gets incentive from banks after paying back loan in terms of increase in loan amount</td>
<td>.534</td>
<td></td>
</tr>
<tr>
<td>This firm can get a loan as many times as it is needed</td>
<td>.708</td>
<td></td>
</tr>
<tr>
<td>Length of relationship between this firm and suppliers of credit is important in accessing credit</td>
<td>.611</td>
<td></td>
</tr>
<tr>
<td>Frequency of access to loans helps in growth of the firm’s business</td>
<td>.523</td>
<td></td>
</tr>
<tr>
<td>This firm’s credit history helps it access credit</td>
<td>.512</td>
<td></td>
</tr>
</tbody>
</table>
Factor analysis yielded two components which were interpreted as amount borrowed/ volume (20.131) and frequency of access/ number of times (14.601%) explaining 34.732% of variance in access to credit.

On amount borrowed/volume the researcher observed that firms often got the required loan sizes (.821). Access to loans helps in growth of the firm’s business (.730). The amount of credit the firm had been getting from banks increased (.692). The firm could access a loan at any time of need (.549). Firms got incentive from banks after paying back loans in terms of increased loan amounts (.534).

Also observed in terms of frequency of access/number of times was that firms could get loans as many times as needed (.708). The length of relationship between firms and suppliers of credit was important in accessing credit (.611). Frequency of access to loans helped in growth of the firm’s business (.523). This firms’ credit history helped in accessing credit (.512).

4.3 Relationship among the variables

Correlation analysis measures the degree of relationship between two or more variables. Correlation analysis was done to determine the relationships among the independent variables that is; credit terms and access to credit and the dependent variable; financial performance of SMEs.
The zero order correlation was used to establish the relationship between variables. The Pearson correlation test was employed to execute this (see table 9 below).

**Table 9: Pearson zero order Correlations**

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to credit (1)</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit terms (2)</td>
<td>0.394**</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>Financial performance of SMEs (3)</td>
<td>0.543**</td>
<td>0.331**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**Correlation is significant at the 0.01 level (2-tailed).**

*Source primary data*

4.3.1 To establish the relationship between credit terms and financial performance of SMEs

Results from the table 10 above shows that there was a significant positive correlation between credit terms and financial performance in SMEs (r = 0.331, p<0.01). This means improved credit terms are associated with enhanced financial performance.

4.3.2 To establish relationship between access to credit and financial performance of SMEs

Findings further shows that there was a significant positive association between access to credit and financial performance in SMEs (r = 0.543, p<0.01). This means that access to credit was associated with enhanced financial performance.

4.3.3 To establish the effect of credit terms and access to credit on financial performance of SMEs

Multiple regression was used to determine the extent to which combination of independent variable (Credit terms) and mediating variable (Credit Access) explain the dependent variable (financial Performance). This is shown in table 10 below.
### Table 10: Regression of credit terms and access to credit on financial performance of SMEs

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Constant)</td>
<td>1.426</td>
</tr>
<tr>
<td></td>
<td>Access to credit</td>
<td>.482</td>
</tr>
<tr>
<td></td>
<td>Credit terms</td>
<td>.169</td>
</tr>
</tbody>
</table>

**a. Dependent Variable: financial Performance of SMEs**

R Square .312

Adjusted R Square .305

F Statistic 45.479

Sig. .000

**Source: Primary Data**

Regression analysis revealed the extent to which credit terms and access to credit predicted financial performance in SMEs. Results from table 11 above, indicate that the combination of access to credit and credit terms account for 30.5% of the variance in financial performance of SMEs (Adjusted R Square .305). Furthermore, access to credit was observed to be the most significant predictor of financial performance of SMEs (Beta .489, sig = 0.000). It implies that a positive change in access to credit leads to 0.489 (48.9%) positive change in financial performance of SMEs. In addition credit terms was also observed to be a significant predictor of financial performance of SMEs (Beta .138, sig = 0.000). It implies that a positive change in credit terms leads to a similar 0.138 (13.8%) positive change in financial performance of SMEs. The overall model was significant at (Sig. =.000)
CHAPTER FIVE
DISCUSSION OF RESULTS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction
This chapter presents the discussion, conclusion and recommendations drawn from the study findings of chapter four. In this chapter the study objectives are discussed, conclusions and recommendations are made. Areas for further study are also suggested.

5.1 Discussion of research findings

5.1.1 Relationship between credit terms and financial performance of SMEs
Results indicated that there was a significant positive association between credit terms and financial performance of SMEs. This finding is consistent with Kogut (1985); Grant, Jammine and Thomas(1988), who affirm that in presence of favourable credit terms, access to finance is enhanced with improved liquidity to finance their capital investment and daily operational needs. Hence a firm can invest in more ventures and increase its sales volume. Higher sales volume and production will lead to increased revenues and profitability which means improved financial performance. This implies that in the presence of favorable credit terms, financial performance of SMEs will be enhanced with ease of acquisition of loans. Similarly, stringent credit terms make it difficult for firms to access loans.

5.1.2 Effect of credit terms and access to credit on financial performance of SMEs
Results indicated that there was a significant positive association of credit terms and access to credit on financial performance of SMEs. It was revealed that favorable credit terms facilitated ease of access to credit by SMEs and therefore improved financial performance in terms of sales liquidity and profitability. This position is supported by La Ferrara, (2003), who argued that if credit is accessible and reasonably priced, firms can address their liquidity constraints in turn aiding profitability. On the other hand, SMEs are reluctant to obtain loans due to the high
collateral requirements, high interest rates and untimely delivery of credit. This has resulted in reduced financial performance in terms of sales, profits and liquidity (Olutunla and Obamuyi, 2008). Atieno (2006) and Steel (2004) have further explained that limited access to credit can also negatively affect profitability and financial survival if firms operate under poor economic conditions and high interest rates.

5.1.3 Relationship between access to credit and financial performance of SMEs

Findings revealed that there was a significant positive association between access to credit and financial performance of SMEs. The results were consistent with existing literature that easy credit accessibility by SMEs’ facilitates further growth and expansion of their businesses (Berger and Udell, 2006). More so, Schmidt & Kropp (1998) assert that for SMEs, reliable access to short term and small amounts of credit are more valuable and emphasizing it may be more appropriate in credit programs aimed at such enterprises' success. This means that in the presence of improved access to credit financial performance will be enhanced. This was in line with Ogujiuba (2004); Ojo (1992) and CBN (2007), who argue that improved access of credit by SMEs leads to survival, increased sales, higher profitability and low cost of doing business.

However, SMEs have been unable to obtain finance from financial institutions, due to an information gap, which prevents them from knowing how and where to obtain this finance on acceptable terms, and the risk associated with their failure to pay back funds. The implication is that small businesses face funding limit, and are discriminated against in credit markets, which leads to large firms crowding out smaller firms in the market. The lack of adequate funding means that SMEs will experience low incomes, low profits and low capital formation.

5.2 Conclusions

In conclusion, it was observed that there was a positive significant association among the study variables which included credit terms, access to credit and financial performance of SMEs.
Discussion of findings indicate that favorable credit terms including interest rates, collateral and repayment periods enabled businesses to access required amounts of credit thus leading to improved financial performance in terms of sales volumes, profitability and liquidity management. However, unfavorable credit terms such as high interest rates, lack of collateral security and short repayment periods deprived some enterprises from accessing credit therefore leading to failure of business.

Furthermore, there are other factors that were found to influence financial performance of SMEs not limited to this study such as information gap between lenders and borrowers and transaction costs involved. When there is an information gap, SMEs are unable to know which how and where to obtain this finance on acceptable terms, and the risk associated with their failure to pay back funds leads to stringent credit terms and therefore difficult in accessing finance and high transaction costs also influence access to finance and eventually affect firm performance negatively.

5.3 Recommendations

In light of the findings, discussions and the conclusions, the following recommendations are hereby stated;

The findings of the paper imply that the government should formulate policies that will compel commercial banks to relax their restrictive regulations and operations which may discourage borrowing and offer more credit facilities for SMEs.

The government should empower the SMEs to access and get credits from the commercial banks through formal and informal entrepreneurship education for SMEs to develop their managerial capabilities, accounting skills and overall, be more credit worthy.

Furthermore, initiatives to support emerging businesses should be intensified in order to achieve sustainable socio-economic growth. Initiatives such as giving entrepreneurs incentives inform of
capital from the government and more business associations like Uganda manufacturer’s association should be encouraged.

Business entrepreneurs should be encouraged to upgrade their managerial competencies by going for training courses and attending business development services that will improve their skills and knowledge. This will enable them compete favorably in the competitive environment.

Based on the findings, it can therefore be recommended that in order to improve the financial performance of SMEs, there is need by the owners to fulfil the set credit terms in order to maintain a good relationship with the commercial banks. This will help to receive favourable terms when they wish to borrow again because of the good track record. This in return will help them maintain adequate liquidity because they can always access cash resources when need arises.

5.4 Areas for further research

This study focused on credit terms, access to credit and financial performance of SMEs in Kampala.

However, areas for further research are suggested below:

Effect of managerial competence, information availability and other factors that affect the general performance of SMEs.

Criteria followed by commercial banks in issuance of loans to SMEs.

There is need to research further on the external factors that have an impact on the access to credit by the Small and Medium Enterprises like the adequacy of the financial systems, regional imbalances in the economy among others.
REFERENCES


APPENDIX 1

MAKERERE UNIVERSITY
MAKERERE UNIVERSITY BUSINESS SCHOOL
Questionnaire for the research study on Credit terms, Access to Credit and Financial performance of SMEs in Kampala District

Dear Respondent,

Thank you for volunteering to complete this questionnaire. Your responses are important and your thoughtful considerations are highly appreciated.

I am a postgraduate student of Makerere University Business School conducting a research on “Credit Terms, Access to credit and Financial Performance of Small and Medium sized Enterprises (SMEs) in Kampala”. This research is a pre-requisite for the award of the degree of Masters of Science in Accounting & Finance. Your responses will contribute greatly to achieving the research aim and objectives of this study which will be of benefit to SMEs. All responses received will be treated with utmost confidentiality, and will only be for the purposes of this research work. Kindly answer these questions as objectively as possible so that the results of the data analysis are fairly accurate.

Thank you very much for your cooperation.

Section 1: General information about firm

1.1 Name of firm: ............................

1.2 Location:

  Central  □  Nakawa  □  Makindye  □  Rubaga  □  Kawempe  □

1.3 Ownership:

  Sole Proprietorship  □  Corporations  □  Partnerships  □

  Limited liability Companies  □
1.4 Number of employees:
   1 □ 2 to 4 □ 5 to 8 □ 9 to 10 □ More than 10 □

1.5 Gender of owner/manager
   Male □ Female □

1.6 Age of owner/manager
   18-27 □ 28-37 □ 38-47 □ 48-57 □ 58+ □

1.7 For how long has this business been in existence?
   Less than a year □ 1 – less than 5 years □ 5 – less than 10 years □
   10 and above years □

1.8 What kind of business is the firm engaged in?
   Manufacturing □ Services □ Trade □
   Others (Specify) □ ………………………………………

Section 2: Level of education attained

2.1 Owner/Manager’s level of education:
   PLE □ O-Level □ A-Level □ Diploma □ Degree □
   Other (Specify) □ ………………………………………

Section 3: Access to credit

3.1 My firm has borrowed money from commercial banks
   Never □ 1 – less than 3 times □ 3 – less than 5 times □
   5 – less than 10 times □ 10 or more times □

3.2 The single largest amount ever borrowed was
   Less than 1 Million □ 1 – less than 5 Million □ 5 – less than 10 Million □
   10 – Less than 25 Million □ 25 Million or more □
3.3 The total amount the firm has borrowed is

Less than 1 Million ☐ 1 – less than 5 Million ☐ 5 – less than 10 Million ☐
10 – Less than 25 Million ☐ 25 Million or more ☐

Please mark the given statements according to your level of agreement. The numbers 1-5 represent levels of agreement from strongly disagree to strongly agree as detailed in Table 1 below.

Table 1: Levels of agreement

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>disagree</th>
<th>uncertain</th>
<th>agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

| 3.4 | The firm can easily get credit from commercial banks |
| 3.5 | Frequency of access to loans helps in growth of the firm’s business |
| 3.6 | The firm often gets the loan size it requires |
| 3.7 | The firm has enough information on credit availability |
| 3.8 | The firm can get a loan at any time it is needed |
| 3.9 | Credit policies of commercial banks influence the firm’s decision to get credit |
| 3.10 | The Security required to get loans limits the firm’s ability to borrow from commercial banks |
| 3.11 | The firm has reliable security guaranteed to access credit |
| 3.12 | Access to loans helps in growth of the firm’s business |
| 3.13 | Length of relationship between this firm and suppliers of credit is important in accessing credit |
| 3.14 | The amount credit the firm has been getting from banks is on the increase |
| 3.15 | The firm’s ability to repay loans is always satisfactory |
### Section 4: Credit Terms

Please mark the given statements according to your level of agreement. The numbers 1-5 represent levels of agreement from strongly disagree to strongly agree as detailed in Table 1.

<table>
<thead>
<tr>
<th></th>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1</td>
<td>This firm can afford the interest rates charged by commercial banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.2</td>
<td>The loan repayment period given to this firm is convenient</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.3</td>
<td>The firm feels collateral required by commercial banks is favourable</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.4</td>
<td>The interest rates paid remain fixed for the whole repayment period</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.5</td>
<td>This firm has sufficient collateral to get credit from commercial banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.6</td>
<td>Presence of collateralizable assets in this firm helps in business growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.7</td>
<td>This firm’s credit history helps it access credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.8</td>
<td>This firm always uses the loan according to its original purpose</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.9</td>
<td>Most loans obtained by the firm have to be paid back within one year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.10</td>
<td>This firm gets incentive from banks after paying back loan in terms of increase in loan amount</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.11</td>
<td>This firm has never defaulted on any loan obligation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.12</td>
<td>This firm can acquire a bigger loan amount as long as its collateral can be increased.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.13</td>
<td>This firm’s repayment period varies according to the loan size.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.14</td>
<td>The interest rates offered to this firm’s short repayment periods are fixed compared to those of longer repayment periods.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Section 5: Financial Performance of SMEs

Please rate the performance of the firm by ticking the appropriate box.

5.1 The firm’s return on assets is: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.2 The firm’s return on equity is: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.3 The firm’s net profit is: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.4 The firm’s gross profit is: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.5 The firm’s return on sales: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.6 The firm’s receivables turnover: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.7 The firm’s inventory turnover: less than 3% [ ] 3-6% [ ] 6-9% [ ] 9-12% [ ] above12% [ ]

5.8 The firm’s cash ratio is: less than 1:6 [ ] 1:6-1:5 [ ] 1:5-1:3 [ ] 1:3-1:1 [ ] above1:1 [ ]

5.9 The firm’s quick ratio is: less than 1:6 [ ] 1:6-1:5 [ ] 1:5-1:3 [ ] 1:3-1:1 [ ] above1:1 [ ]

5.10 The firm’s current ratio is: less than 1:6 [ ] 1:6-1:5 [ ] 1:5-1:3 [ ] 1:3-1:1 [ ] above1:1 [ ]

Thank you for your time and responses.
### APPENDIX 2

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SAMPLE SIZE DETERMINATION
Source: Krejcie, R. V., & Morgan, D.W. (1970). Note: N is population size and S is sample size