

**DEBT FINANCING BY COMMERCIAL BANKS AND THE PROFITABILITY OF
SMALL AND MEDIUM SIZE ENTERPRISES A CASE STUDY OF RETAIL
BUSINESSES IN MAYUGE TOWN COUNCIL.**

BY

OCHWO GASITAFASI

BU/UP/2017/338

BUSITEMA UNIVERSITY

SUPERVISOR

MR. WAMPANDE JOWALIE

**A DESERTATION SUBMITTED TO FACULTY OF MANAGEMENT SCIENCES IN A
PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF
BACHELOR'S IN BUSINESS ADMINISTRATION**

DECEMBER 2020

DECLARATION

I, OCHWO GASITAFASI, hereby declare that this research report is my original work and has never been submitted or published to any Institution of higher learning for any award.

Sign

.....

OCHWO GASITAFASI

Date

APPROVAL

This is to certify that this research report has been compiled and submitted by Ochwo Gasitafasi a student of Busitema university registration number BU/UP/2017/338 under my approval as the University supervisor.

Sign:

Name: **WAMPANDE JOWALIE**

Date:

DEDICATION

With profound difference and honor, I dedicate this piece of work to my family members for the great support rendered to me during the research period and since my child hood. I dedicate this research to the Staff members of Busitema University. On a special note i also dedicate this research to my supervisor, Mr. Wampande Jowalie for his endless guidance and my Lastly, to my friends and fellow researchers at busitema university specifically Mandela Salim, Bichekwa Ronald, Kia Vicky Sharon and Wanyama Kelvin without forgetting Faith and Doreen for the corporation and love exhibited, may the almighty lord God award you according to his abundancy. Amen!

Contents

DECLARATION	ii
APPROVAL	iii
DEDICATION	iv
ACKNOWLEDGEMENT	viii
ABSTRACT.....	ix
CHAPTER ONE	1
1.0 Introduction	1
1.1 Background of the study	1
1.2 Statement of the problem	2
1.3 Theoretical background	3
1.4 Conceptual framework	3
1.5 Purpose of the study	5
1.1.1 Research questions	5
Significance of the study	6
1.1.3 Justification of the study	6
1.1.4 Scope of the study	6
1.1.5 Geographical Scope	6
1.1.6 Time scope	6
1.1.7 Context scope	7
1.2 Operational	7
CHAPTER TWO:	8
LITERATURE REVIEW	8
2.1 Introduction	8
2.2 Theoretical Review	8
2.2.2 Application of the Life Cycle Approach to the SME Sector	9
2.3 Conceptual Review	9
2.3.1 Small and Medium Size Enterprises	9

2.3.2 Role and benefits of SMEs.....	10
2.3.3 Financing for SMEs in Uganda.....	11
2.3.2 Small and Medium Enterprises profitability and growth.....	13
2.3.3 Interest rates/ cost of capital	13
2.3.3 Government policy.....	13
2.4.1 High Interest rates and profitability of SMEs.....	14
2.4.2 Effect of Collateral requirements on the profitability of SMEs.....	14
2.4.3 Experience of the owner/ age of the firm and how it influences the profitability of SMEs.....	15
2.4.5 Emerging gaps.....	16
CHAPTER THREE:	17
RESEARCH METHODOLOGY	17
3.0 Introduction.....	17
3.1 Research Design	17
3.2 Study population	17
3.3 Sample Size.....	18
3.5 Data Collection method	19
3.7 Pre-testing (Validity and Reliability)	20
3.8 Data Collection Methods	20
3.9.0 Data analysis plan	21
3.9.1Qualitative Analysis	21
3.9.2 Quantitative Analysis.....	22
3.10 Measurement of variables	22
3.11 Ethical Considerations.....	23
CHAPTER FOUR :	24
DATA ANALYSIS AND PRESENTATION OF FINDINGS.....	24
4.0 Introduction.....	24

4.1 Response Rate	24
4.2 Demographic Information	24
4.2.1 Gender of Respondents	24
CHAPTER FIVE:	41
INTERPRETATION OF FINDINGS, SUMMARY, CONCLUSION AND RECOMMENDATIONS	41
5.0 Introduction.....	41
5.1 Interpretation of the findings.....	41
5.1.2 Effects of collateral requirement on the profitability of SMEs.	41
5.1.3 Effects of government policy on the profitability of SMEs.	41
5.2 Summary of the findings	42
5.3 CONCLUSION	42
5.4 Recommendations	42
5.4.1. Recommendations for further studies	43
5.5 Limitations of the study	43
References	44

ACKNOWLEDGEMENT

I extend my sincere thanks to my father Mr. Ochwo Gasitafasi family who were so supportive to me during my research process. My special thanks go to my Supervisor Mr. WAMPANDE JOWALIE for the excellent support, continuous guidance and mentorship that always kept me on track. I extend my appreciation to all Mayuge Town Council for the amazing corporation exhibited which made my research smooth and easy. With great pleasure, I thank my University Supervisor Mr. WAMPANDE JOWALIE for the continuous guidance and support during my research period.

Lastly, I thank all my lecturers specifically Mr. Esuku Joseph, Emojong Ronald, Emusugut Desterio and all other staff members of Busitema University for all the assistance and knowledge that they have imparted in me since I joined the ivory tower in 2017. I will always be proud of Busitema University for uplifting me and making me reach greater heights in education and I would recommend them to continue with this service to help others with the same spirit.

May God bless you all!

ABSTRACT

This study was to establish the extent to which debt financing of SMEs by commercial banks on the profitability of SMEs in mayuge town council. Specifically, the study sought to determine the effect of interest rates on the profitability of SMEs, to determine the effect of collateral requirements on profitability of SMEs and also to establish the effect of government policies on the profitability of SMEs. The study used descriptive correlation, comparative and cross-sectional survey designs. Data collected from 80 respondents using self-administered questionnaires as the key data collection instruments. Data was analyzed using frequency counts, means, and SPSS. The findings revealed that there was an effect of interest rates on the profitability of SMEs, the effect of collateral requirements on the profitability of SMEs. The debt financing brings about effective, efficiency operations of the business which leads to profitability of SMEs. Recommendations based on the findings were that SMEs should embrace the use of independence in order to ensure profitability, SMEs should also focus on financial accounting and expertise programmed in order to improve on the profits.

LIST OF FIGURES

Figure 1: Conceptual Framework;.....	4
Figure 2;Showing gender	25
Figure 3;Showing age bracket	27
Figure 4;showing level of education.....	28
Figure 5;Showing the positions held.....	31
Figure 6; showing type of business.....	33
Figure 7; showing effects of interest rate on the profitability of SMEs.....	36
Figure 8;showing the effects of collateral requirements on the profitability of SMEs.....	38
Figure 9; effects of government policy on the profitability of SMEs.....	40

LIST OF TABLES

Table 1;showing gender;.....	25
Table 2;Showing age bracket.....	26
Table 3;Showing the level of education.....	28
Table 4 showing position held;.....	30
Table 5Table 4.5 Period Served in the Business.....	32
Table 6; showing Type of Business	32
Table 7;Table 4.7 Effects of interest rates on the profitability of SMEs	35
Table 8; Effects of Collateral Requirements on the profitability of SMEs.....	37
Table 9; Effects of Government Policy on SMEs Profitability	39

CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter deals with the background to the study, the statement of the problem, the purpose of the study, the objectives of the study, the research questions, the scope of the study, the significance of the study, justification of the study and operational definitions of terms and concepts.

1.1 Background of the study

Undoubtedly, access to finance from commercial banks is essential for the ongoing and sustainable growth and profitability of small and medium enterprises sector (SMEs), particularly retail businesses, through its role in enabling the creation of new businesses and nurturing the innovation process as well as stimulating the growth and development of existing businesses, which in turn, boost national economic growth (Abudulsaleh, 2013) Indeed, in the right business atmosphere, SMEs can grow into large firms, changing the game locally, carving their forte globally. This process starts with supportive administrations that create the right policy milieu, and then grows from there (World Bank, 2011) In fact, in India, Andhra Pradesh state authorities first began providing the IT sector with incentives in 1998. As a consequence of that, the city of Hyderabad presently anchors a flourishing futuristic industry whose many SMEs and other players have changed the face of India's fifth-largest state (World Bank, 2011).

High number of SMEs in the economy. Unfortunately, the cost of operating these businesses remains high in general as Sub-Saharan Africa is still ranked as the region in the world where it is According to data from the World Bank, many of the countries in Sub-Saharan Africa report a most difficult to do business. However, the business environment in several African countries has improved substantially over the last decade. Moreover, in many African countries, the retailing activity is distributed widely among a large number of more or less formal SMEs, while e.g. in China, economic activity is to a much larger extent organized in larger entities, both within manufacturing, agriculture and services (T, 2010). The Ugandan situation is such that even with the substantial contribution of small and medium enterprises to the Ugandan economy, the potential of the SMEs has not been envisaged fully and this is a distress for all stakeholders in the economy. Consequently, commercial bank debt financing, short and long term has become increasingly important in Uganda and world over as a major strategy in the development agenda for poverty reduction and in the promotion of Small and Medium Enterprises.

References

- Fatoki, O., & Asah, F. (2011). The Impact of Firm and Entrepreneurial Characteristics on Access to Debt Finance by SMEs in King Williams' Town, South Africa. *International Journal of Business and Management*, 6(8), 170-179.
- Fatoki, O., & Odeyemi, A. (2010). The Determinants of Access to Trade Credit by New SMEs in South Africa. *African Journal of Business Management*, 4(13), 2763-2770.
- Fjose, T. (2010). *SMEs and growth in Sub Saharan Africa*: Menon Business Economics.
- Frasch, R. (2013). *Debt financing for your start up*. June 12, 2013. Forbes, USA
- Gompers, P., Kovner, A., Lerner, J., & Scharfstein, D. (2010). Performance persistence in entrepreneurship. *Journal of Financial Economics*, 96(1), 18-32.
- Hölzl, W. (2009). Is the R&D behaviour of fast - growing SMEs different? Evidence from CIS III data for 16 countries. *Small Business Economics*, 33(1), 59-75
- International Monetary Fund. 2007 and 2008. *International Financial Statistics*, Washington, D.C: IMF
- INSEE. (2015). *Retail outlets under concession contract; Measuring and Understanding*, France
- Investment Climate and Business Environment Research Fund. (2013). *The Impact of Microfinance Service Delivery in the Growth of SMEs in Uganda*. Kampala, Uganda: Nahamya
- Kamweru, M.R. (2011). *Challenges faced by Small and Medium Entreprises in Accessing Finance*. Kiambu, Kenya
- Kira, A. R. (2013). The Evaluation of the Factors Influence the Access to Debt Financing by Tanzanian SMEs. *European Journal of Business and Management*, 5(7), 1-24

- Makoni, P.L. (2014). Finance and Firm Characteristics in Tanzania. *Banks and Bank Systems*, 9(4), 92-98.
- Mashenene, R.G. (2014). *Constraints of Accessing Debt Financing from Commercial Banks among Small and Medium Enterprises in Tanzania: A review of Literature*. EAR15 Swiss Conference, 2545, 978-1-63415-477-2
- Maziku, M. (2012). Credit Rationing for Small and Medium Scale Enterprises in Commercial Bank Mashenene, R.G. (2014). *Constraints of Accessing Debt Financing from Commercial Banks among Small and Medium Enterprises in Tanzania: A review of Literature*. EAR15 Swiss Conference, 2545, 978-1-63415-477-2
- Maziku, M. (2012). Credit Rationing for Small and Medium Scale Enterprises in Commercial Bank Loan Market. *Presented at REPOA's 17th Annual Research Workshop held at the Whitesands Hotel, Dar es Salaam, Tanzania; March 28-29, 2012.*
- Mensah, S. (2004). A Review of SME Financing Schemes in Ghana. Paper presented at *the UNIDO Regional Workshop of Financing Small and Medium Scale Enterprises*, Accra, Ghana.
- Mwangi, P.W. (2011). Access to Finance and Performance of Small and Medium Enterprises. Wandegeya, Kampala
- National Small Business Survey of Uganda, March, 2015
- Nofsinger, J. R., & Wang, W. (2011). Determinants of Start-Up Firm External Financing Worldwide. *Journal of Banking and Finance*, 35(9), 2282-2294. <http://dx.doi.org/10.1016/j.jbankfin.2011.01.024>
- Phelps, R., Adams, R., & Bessant, J. (2007). Life cycles of growing organizations: A review with implications for knowledge and learning. *International Journal of Management Reviews*, 9, 1, 1- 30
- Sekeran, K. (2009). *Research Methods for Business, A Skill Building Approach*. UK: John Wiley and Sons.
- Srinivas, H. (2015). *What are Small and Medium Sized Enterprises?* Global Development Research Center, United Kingdom
- Turyahebwa, A., Sunday, A. & Ssekajugo, D. (2013). Financial Management practices and Business Performance of Small and Medium Enterprises in Western Uganda. *African*
- Abdulsaleh, A. M, & Worthington, C.A. (2013). Small and Medium Sized Enterprises Financing: A Review of Literature. *International Journal of Business and Management*, 8(14), 1833-3850

INSEE. (2015). Retail outlets under concession contract; Measuring and Understanding, France

Investment Climate and Business Environment Research Fund. (2013). *the Impact of Microfinance Service Delivery in the Growth of SMEs in Uganda*. Kampala, Uganda: Nahamya

African Development Bank Group. (2012). *Bank Financing to Small and Medium Enterprises in East Africa. Findings of a survey in Kenya, Tanzania, Uganda and Zambia*: Calice

African Development Bank. (2010). *Uganda Result Based Country Strategy Paper 2011-2015*

Atupele, N.M. (2013). Analysis of External Financing Use: A study of Small and Medium Enterprises in Malawi. *International Journal of Business and Management*, 8(7), 18353850

Bataa, G. (2008). Improving Access to Finance for SME: International Good Experiences and Lessons for Mongolia. No. 438. IDE-JETRO

Calice, P., Chando, V. M., & Sekioua, S. (2012). Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia. *Working Paper, Africa Development Bank Group*.

CEEDR. (2007). the Impact of Perceived Access to Finance Difficulties on the Demand for External Finance: A Literature Review, Report for the Small Business Service, DTI, and London

African Development Bank. (2010). *Uganda Result Based Country Strategy Paper 2011-2015*

Atupele, N.M. (2013). Analysis of External Financing Use: A study of Small and Medium Enterprises in Malawi. *International Journal of Business and Management*, 8(7), 18353850

Bataa, G. (2008). Improving Access to Finance for SME: International Good Experiences and Lessons for Mongolia. No. 438. IDE-JETRO

Calice, P., Chando, V. M., & Sekioua, S. (2012). Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia. *Working Paper, Africa Development Bank Group*.

CEEDR. (2007). the Impact of Perceived Access to Finance Difficulties on the Demand for External Finance: A Literature Review, Report for the Small Business Service, DTI, and London

- Boyer, T.; Blazy, R. 2014. Born to be alive: the survival of innovative and non-innovative French Micro-start-ups, *Small Business Economics* 42: 669–683
- Beck, T.; Demirgüç-Kunt, A.; Levine, R. 2000. A new database on financial development and structure, *World Bank Econ Rev* 14:597–605.
- Beck Maksimovic, V. 2006. The determinants of financing obstacles, *Journal of International Money and Finance* 25: 932–952. <https://doi.org/10.1016/j.jimonfin.2006.07.005>
- Beck, T.; De La Torre, A. 2007. The basic analytics of access to financial services, *Financial Markets, Institutions and Instruments* 16(2): 79–117. <https://doi.org/10.1111/j.1468-0416.2007.00120.x>
- Business Environment and Enterprise Performance Survey (BEEPS). 2012–2014. [Online], [cited January 2016]. Available from Internet: <http://ebrd-beeps.com/>
- Belas, J.; Kljucnikov, A.; Vojtovic, S.; Sobekova-Majkova, M. 2015. Approach of the SME entrepreneurs to financial risk management in relation to gender and level of education, *Economics and Sociology* 8(4): 32–42.
- Abdulsaleh, A. M, & Worthington, C.A. (2013). Small and Medium Sized Entreprises Financing: A Review of Literature. *International Journal of Business and Management*, 8(14), 1833-3850
- African Development Bank Group. (2012). *Bank Financing to Small and Medium Entreprises in East Africa. Findings of a survey in Kenya, Tanzania, Uganda and Zambia: Calice*
- African Development Bank. (2010). *Uganda Result Based Country Strategy Paper 2011-2015*
- Atupele, N.M. (2013). Analysis of External Financing Use: A study of Small and Medium Entreprises in Malawi. *International Journal of Business and Management*, 8(7), 1835-3850
- Bataa, G. (2008). Improving Access to Finance for SME: International Good Experiences and Lessons for Mongolia. No. 438. IDE-JETRO
- Calice, P., Chando, V. M., & Sekioua, S. (2012). Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia. *Working Paper, Africa Development Bank Group*.
- CEEDR. (2007). The Impact of Perceived Access to Finance Difficulties on the Demand for External Finance: A Literature Review, Report for the Small Business Service, DTI, London.
- Cronbach, L. J. (1951). *Coefficient alpha and the internal structure of tests*. *Psychometrika*, Vol.16, pp; 297- 334.

Deakins, D., North, D., Baldock, R and Whittam, G. (2009). SMEs' Access to Finance: Is there still a debt finance gap? *Institute for small business and entrepreneurship*. V-3. Belfast, N. Ireland.

De la Torre, A., Martinez, M., & Schmukler, S. (2009). *Drivers and Obstacles to Banking SMEs: The*