DEBT FINANCING BY COMMERCIAL BANKS AND THE PROFITABILITY OF SMALL AND MEDIUM SIZE ENTERPRISES (SMEs) IN KAMPALA

(A Case Study of Retail Businesses in Rubaga Sub County)

BY

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ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
CB	Commercial Banks
CBR	Central Bank Rate
CGAP	Consultative Group to Assist the Poorest
GDP	Gross Domestic Product
KCCA	Kampala Capital City Authority
ICBERF	Investment Climate and Business Environment Research Fund
INSEE	Institute of Statistics and Economic Studies
MFI	Micro Finance Institutions
MoFPED	Ministry of Finance Planning and Economic Development
OECD	Organisation for Economic Co-operation and Development
SME	Small and Medium Sized Entreprises
UIA	Uganda Investment Authority

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CHAPTER ONE
INTRODUCTION

1.1 Introduction

According to Bataa (2008), the role of Small and Medium Size Enterprises (SMEs) in the development process remains at the forefront of policy deliberations in developing countries as in developed countries. Bataa posits that the advantages claimed for SMEs are various, including the encouragement of entrepreneurship; the greater likelihood that SMEs will utilize labor intensive technologies and thus have an immediate impact on employment generation, they can usually be established rapidly and put into operation to produce quick returns and that they may well become a countervailing force against the economic power of larger enterprises. In fact, Deakins (2008) inferred that the development of SMEs accelerates the achievement of wider socio-economic objectives, including poverty assuagement. On the other hand, CEEDR (2007) established that the ability of SME to grow depends highly on their potential to invest in restructuring, innovation and qualification. All of these investments need capital and therefore access to finance. Against this background the unswervingly recurring criticism of SMEs about their problems regarding access to finance is a highly relevant constriction that endangers the economic growth of Uganda and other developing countries on the whole.

This study will therefore establish the factors influencing commercial bank debt financing as an approach aimed at accelerating the profitability of Small and Medium Enterprises in Kampala (A case study of retail businesses in Rubaga Sub County). The factors influencing commercial bank debt financing which are the independent variables include; interest rates, collateral requirements, experience of the entrepreneur, knowledge of financial services and government policy while profitability as the dependent variable will be measured using changes in the level of sales and assets and number of branches. This is explained in the conceptual framework in figure 1.

In addition to the introduction, this chapter will also deal 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 hypotheses, the scope of the study, the significance of the study, justification of the study and operational definitions of terms and concepts.

1.2 Background of the study

1.2.1 Historical Background

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 (Abdulsaleh, 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 (ADB, 2012). 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 (Abdulsaleh, 2013).

According to data from the World Bank, many of the countries in Sub-Saharan Africa report a high number of SMEs in the economy (World Bank, 2011). 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 most difficult to do business. However, the business environment in several African countries has improved substantially over the last decade (World Bank, 2011). Moeover, 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 (Fjose, 2010). The same author further avows that growth opportunities in Sub-Saharan Africa are severely disadvantaged by access to finance. He however counsels that the obvious long-term solution for improved access to finance is policy improvement on areas such as property rights, regulations on bankruptcy and financial market reforms.

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 (Kamweru, 2011). 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. This process is seen as paramount in amplifying private sector-led growth through supporting the SME sector (Odongo, 2014). Calice (2012) recommended that if Uganda was to become competitive through growth of the private sector, it was imperative that more attention is placed on addressing the key limitations to SME profitability and competitiveness.

1.2.2 Theoretical background

A number of empirical studies have used the lifecycle model as their favored approach to understanding the fiscal behavior of SMEs (Phelps, 2007; Nofsinger, 2011 and Holzl, 2009). In line with these studies, Fatoki and Asah (2011) observed that SMEs that have been in business fore more than five years have a far better chance of being successful in their credit applications compared with SMEs established for less than five years. From the banks' perspective, experienced entrepreneurs are believed to be better performers than less experienced entrepreneurs, it is therefore cogent to factor experience into the process of appraising the solvency of SMEs (Gompers, 2010).

In the same regard, Nofsinger and Wang (2011) put forward that the experience of the entrepreneur is one factor that explains the difference in debt financing levels available to SMEs while Fatoki and Asah (2011) believe that the knowledge of financial services recompenses SMEs in that they can easily prepare requirements for accessing finance from commercial banks. Equally, La Rocca (2011) established that access to debt finance mainly in European and American markets is influenced by the positive association between the debt ratio and the asset structure, an association that is greatly enhanced as the firm celebrates more birthdays. Likewise, Fatoki and Asah (2011) postulated that relatively young SMEs are characterized by a lower portion of tangible assets in their total assets and are therefore more likely to encounter difficulties in applying for outside finance because of their incapacity to provide the collateral required.

Despite the effort that has been made to theorize SME financial behavior resulting in the different financing patterns followed by SMEs at different profitability and growth stages, it seems that different theories suggest different approaches. However, there is general agreement on the effect of SME characteristics and those of entrepreneurs on the financing methods chosen and employed by SMEs at different stages of growth and profitability (Abdulsaleh, 2013).

1.2.3 Conceptual background

Finance has been recognized in many business surveys as the most important factor determining the survival and growth of small and medium –sized enterprises in both developing and developed countries. According to De la Torre (2009), debt financing is a system of funding in which a company takes delivery of credit [which includes long term debt (repayable in more than a year) and short term loans (repayable within a year)] and gives its promise to repay the credit while access to finance is the ease with which SMEs can get credit to undertake fruitful investments to swell their business fortunes and to acquire the latest technologies, thus guaranteeing their competitiveness and that of the nation as a whole or it can be defined as the nonexistence of price and non-price barriers in the use of financial services (Frasch, 2013). On the other hand, Srinivas (2015) defines Small and Medium Size Enterprises (SMEs) as registered businesses with less than 250 employees that contribute heavily to employment and GDP, often have great difficulty accessing financial services in many emerging markets and grow in ways linked to the formalization of an economy.

In a study by Atupele (2013), using company level statistics from the World Bank Enterprise Survey, results indicated that firm size, accessibility to information and firm profitability considerably determine the use of debt financing, while firm age and industry contrary to other studies (Fatoki and Asah, 2011) are not important in determining the use of debt financing. The results also indicated that there are noteworthy differences in the use of debt financing between small and medium firms, with small firms using less debt compared to medium firms. Correspondingly, Rocha et al (2011) in a study about the status of bank financing to SMEs in the Middle East and North Africa (MENA) based on a survey of 139 banks in 16 countries found out that in spite of a positive perception of the allure of the sector, the SME sector in the region remained mostly underserved. Direct government intermediations through public banks, credit guarantee schemes and other forms of subsidized financing were suggested to play a major role in SME lending, partly recompensing for the low level of private sector involvement, which in turn reflects the MENA's weak financial infrastructure.

In Uganda the SMEs sector contributes 20% to Gross Domestic Product and it provides employment to over 1.5 million people which accounts for 90% of total non-farming private sector workers (ADB, 2012). The benefits of the small and medium enterprises in the Ugandan economy cannot be overstated. Small and medium enterprises play a substantial role in employment and income generation, producing import substituting options that significantly drive the Ugandan economy. Predictably though, Odongo (2014) exposed impediments like unsatisfactory liquidity, ineffectual financial efficiency of resource utilization, high risk of solvency leading to financial distress and high lending terms of financial institutions were linearly related to the financial performance of SMEs with the lending terms explaining 26.6% in performance variations of SMEs that borrowed in Uganda accordingly handicapping their growth efforts. Therefore, this impact study on SME profitability in consequence of debt financing is geared towards establishing whether the debt financing from commercial banks bridges the SMEs profitability gap in Uganda.

1.2.4 Contextual background

In the face of the largely fast pace by which access to financial services for SMEs are being developed, significant segments of the SME sector do not yet benefit from the spreading out and deepening of commercial banks' outreaches (IMF, 2007 and 2008). In attempting to gain access to financial services, SMEs continue to face constraints caused by many factors. For instance in Norway, about 60 percent of small companies (1-20 employees) die within 5 years. Conversely, during this period a large number of the companies grow out of this category, employing between 20 and 100 persons. A very small share, 0.2 percent, display remarkable profitability and employ more than 100 after 5 years (Fjose, 2010).

Nearer to home, ADB (2012) pointed out that the major challenge facing many developing countries, especially in Sub Saharan Africa, is coming up with suitable development strategies that will capture the financial services' requirements of Small and Medium Enterprises (SMEs) which constitute about 70 percent of the business sector in the region. This indication aligns with Mashenene and Rumanyika (2014), Mashenene *et al* (2014) and ADB (2012) findings that in similar fashion elsewhere in the world, SMEs have been constrained with difficulties to access debt finance from commercial banks.

Similarly, in Uganda, although there is a high rate of business start-ups, Uganda is also among the countries with the highest number of SMEs that perform poorly and close business before the end of the first year in business (UIA, 2013; Namatovu et al., 2010). Expectedly, SMEs in Uganda are presently being faced with many serious difficulties such as shortage of capital for expanding and renovating equipment, low productivity and competitiveness, lack of experience in terms of marketing, production management, and financial management (Turyahebwa, 2013).

The difficulty of meeting the specified Collateral requirements by banks has been cited as a major cause of these financing problems, coupled with misuse of funds meant to assist SMEs grow into sustainable ventures, among other challenges (Mwangi, 2011). This study aims at providing an insight into the debt financing problem for Ugandan SMEs and how Debt financing can be gainfully utilized in facilitating profitability and growth of SMEs.

1. 2 Statement of the problem

According to enterprise-level data collected by the World Bank (2011), SMEs in Sub-Saharan Africa are more financially constrained than in any other developing region. Only 20 percent of SMEs in Sub-Saharan Africa have a line of credit from a financial institution compared, for example, with 44 percent in Latin America and the Caribbean, and only 9 percent of their investments are funded by banks versus 23 percent in Eastern Europe and Central Asia.

In Uganda, the trade finance industry is playing a critical role in providing a range of financial and non-financial services to both urban and rural communities. The services are through the provision of products such as, loans, deposits taking, savings, micro-insurance, money transfer services and financial education (Nahamya, 2013). However, a number of obstacles have continued to constrain the financiers' further engagement with the SME segment. These include SME-related factors such as high risk of solvency, low productivity and competitiveness, lack of experience in terms of marketing, product and financial management, macroeconomic factors, business regulation, the legal and contractual environment, the lack of a more proactive government attitude towards the segment, some areas of prudential regulation and some bank-specific factors such as unmanageable collateral requirements and high interest rates (Atupele, 2013).

In effect, the key constraints to growth which MSMEs feel confront them are financial. They centre on both 'limited access to finance' (74.3%), and the 'cost of finance' (73.2%). In effect a fundamental challenge is the extent to which commercial banks and other financial institutions have stringent requirements around security (collateral) which MSMEs are not able to meet. Moreover, numerous SMEs owners (91%) raise their own start-up capital compared to only 9% who take a loan to start the businesses in Uganda (National-Small-Business-Survey-report, 2015). Accordingly, the National-Small-Business-Survey-report asserts that those who take loans mostly rely on family and friends (39%), microfinance institutions (MFIs) (26%), SACCOs (13%) but very few take loans from CBs (10%). Most of the previous studies regarding debt financing have tended to group together the constraints regarding debt financing whether from MFIs or CBs (Turyahebwa, 2013: Kira, 2013, Maziku, 2012 and Makoni, 2014). In reality, the conditions and requirements for debt financing from MFIs and CBs differ markedly. These findings alone provide the rationale of this study for investigating the structure of the SME lending market in Kampala, with the aim of understanding the relationship, the main drivers and obstacles to SME debt financing of retail businesses from commercial banks and their operational approaches.

1.3. Purpose of the study

The objective of this study is to establish the factors that influence commercial bank's debt financing decisions for SMEs and the effect on SME growth in Kampala, Uganda (A case study of retail businesses in Mengo Trading Center).

1.4 Objectives of the study

1. To investigate the relationship between commercial interest rates and profitability of SMEs in Kampala
2. To find out the relationship between collateral requirements for debt acquisition and profitability of SMEs in Kampala
3. To examine how knowledge of financial services and experience of the entrepreneur affect the profitability of SMEs in Kampala
4. To analyze the relationship between government policy and the profitability of SMEs in Kampala

1.5 Research questions

1. What is the relationship between commercial interest rates and profitability of SMEs in Kampala?
2. Is there a relationship between collateral requirements for debt acquisition and profitability of SMEs in Kampala?
3. To what extent does knowledge of financial services and experience of the entrepreneur affect the profitability of SMEs in Kampala?
4. How does government policy affect the profitability of SMEs in Kampala?

1.6 Hypothesis of the study

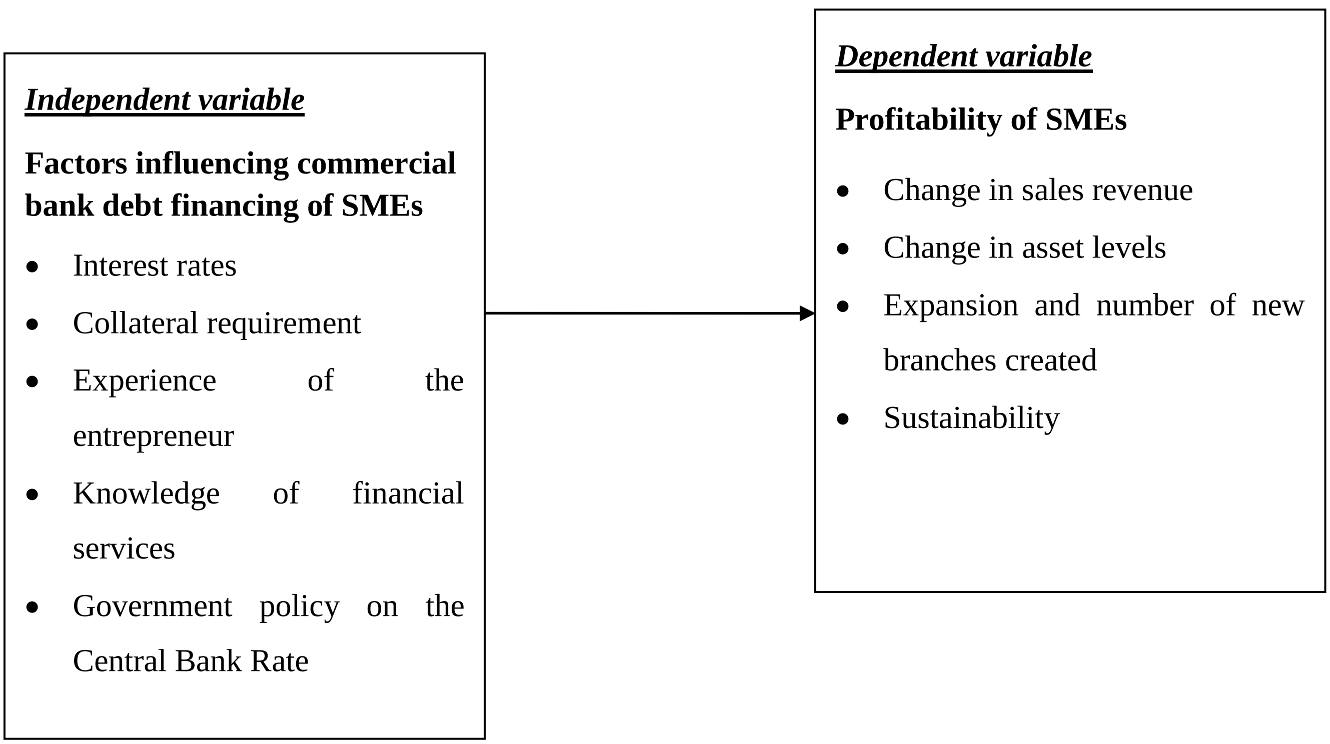
1. Low commercial Interest rates boost the profitability of SMEs in Kampala
2. Complex collateral requirements for debt acquisition affect the profitability of SMEs in Uganda
3. Inadequate knowledge of financial services and the inexperience of the entrepreneur affect the profitability of SMEs in Kampala

4. Government policy has no effect on the profitability of SMEs in Kampala

1.7 Conceptual framework

The study seeks to establish the factors and extent to which the factors influence commercial bank debt financing and the profitability of SMEs in Kampala. . The factors influencing commercial bank debt financing which are the independent variables include; interest rates, collateral requirements, experience of the entrepreneur, knowledge of financial services and government policy while growth as the dependent variable will be measured using changes in sales revenue and asset levels, expansion and sustainability. The conceptual framework can be summarized in figure 1 below.

Figure 1: Conceptual Framework



Source: INSEE, 2015

1.8 Significance of the study

1. Traders; the findings from the study are expected to empower the commercial banks in critiquing some of the policies governing financing and gauge whether they are generating the intended results. This in the long term will provide such users; a base on which to modify these policies to suit the demands of the different stakeholders **(entrepreneurs and business owners**) hence accelerating the profitability of SMEs in Kampala.

2. Commercial banks; It will also help commercial banks design and refine their range of products tailored to the needs and demands of SMEs.

3. Government; The study intends to aid the Central Government to body out the different avenues it can take up as a measure to enhance and boost the growth of SMEs in Uganda.

4. Researchers; The research findings and analysis are of great significance to those who purpose to do further research on this topic. This research is also expected to add to the current literature.

1.9 Justification of the study

Due to the fact that financial crises tend to hit small firms harder than large firms, the findings for this study can help in guiding formulation of policies and strategies to facilitate the growth of SMEs with the aid of finances from commercial banks. This research study is necessary to assess if providers of credit are doing enough to avail small businesses with their services and products to SMEs, and if not, what can be done to ensure this process is smooth for all stakeholders.

1.10 Scope of the study

1.10.1 Geographical Scope

The research study will be carried out in Rubaga Sub County, Rubaga Sub County in Kampala District. In this study, focus is on identifying the factors influencing commercial bank debt financing in accelerating the profitability of SMEs in Rubaga Sub County.

1.10.2 Time scope

The study to establish the factors influencing commercial bank debt financing in accelerating the growth of SMEs in Rubaga Sub County will analyse experiences of SMEs' owners for a period of 5 years from 2010-2014.

1.10.3 Context scope.

The researcher will attempt to establish the factors and extent to which they influence commercial debt financing in accelerating the growth of SMEs in Rubaga Sub County. This will help to bring out the correlations between various commercial bank debt financing bottlenecks and policies and the profitability of SMEs.

1.11 Operational definitions

Small and Medium Size Enterprises (SMEs) are defined as registered businesses with less than 250 employees that contribute heavily to employment and GDP, often have great difficulty accessing financial services in many emerging markets and grow in ways linked to the formalization of an economy (Srinivas, 2015) .

Debt Financing is defined as the practice of borrowing funds from outside an organization from such institutions as Commercial Banks, Money lenders, Micro finance Institutions and SACCOs. It includes long term debt (loans repayable in more than a year) and short term loans (loans repayable within a year) (Frasch, 2013).

Retail Businesses are businesses that sell commodities in small quantities to consumers operated individually or by families (Insee, 2015)

Interest Rate also known as the Cost of Finances (COF) is the cost and interest and other charges involved in the borrowing of money to build or purchase assets.

Collateral is property or other assets that a borrower offers a lender to secure a loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

In this chapter, the study makes an account of what has been published on factors influencing commercial debt financing and the profitability of SMEs. It will specifically review how external financing and growth of SMEs have evolved theoretically and conceptually and it will also involve an actual review of the objectives of the study.

2.2 Theoretical Review

2.2.1 Debt Financing: The Life Cycle Theory

The stage model or firm life cycle approach describes the development of the firm as a linear sequential process through a number of stages. The number of stages is not standardized. A model based on three phases of growth and a five stage evolution-revolution models have been proposed. The financial life cycle model incorporates elements of trade-off, agency, and pecking order theories, and describes sources of finance typically advanced by funders at each stage of a firm’s development (Srinivas, 2015).

At start-up, the commonly held view is that firms have difficulty accessing debtl finance due to information opacity, low asset base and inexperience (Fjose, 2010). The most important and commonly-used sources of finance at this stage are personal savings of the firm owner, and finance from friends and family members (Gompers, 2010). The contribution of the firm owner in nascent firms is not confined to equity, but commonly includes the provision of quasi-equity in the form of personal assets used as collateral to secure business debt (Calice, 2012). Whilst a firm may obtain sufficient capital to initiate trading, a lack of planning may lead to problems of undercapitalization in the earliest stages. In extreme cases, particularly in the face of competition, the firm may not be able to continue in business (Gompers, 2010).

As successful firms survive nascent and start-up phases, and mature through growth stages, personal funding becomes relatively less important as investment finance is increasingly sourced from retained profits. Furthermore, accumulation of a trading history facilitates access to increased sources and amounts of debt financing, particularly long term bank debt financing. Thus, it is common for SMEs to have high levels of short-term debt in their infant stages (Nofsinger, 2011). Short-term debt is neither sufficient nor appropriate for firms requiring large amounts of additional debt finance for investment. However, these requirements are more suitably fulfilled by long-term debt, or by raising external equity through a private placement or an initial public offering of common stock.

Firms requiring large amounts of external equity are characterized by the pursuit of a high profitability and growth strategy, and may be involved in the development of products or services based on new technology, such as NTBFs for example (Frasch, 2013). A consequence of the sale of firm equity for the owner is loss of control and managerial independence, although a number of authors indicate that this outcome may be compatible with the firm owner's goals (La Rocca, 2011). On reaching maturity, firms have acquired a trading history, and typically have access to a broad range of financing sources. Sources of finance accessed at this stage are generally determined by preferences of firm owners, rather than supply side restrictions. A number of firms may then enter a stage of decline due to diminishing returns, whereupon the firm may be liquidated or taken over (Fatoki, 2011)

2.2.2 Application of the Life Cycle Approach to the SME Sector

The financial growth life cycle model presents firms on a size/age/information continuum, and describes the increasing array of financing options available to the firm as it grows. The model incorporates changes in availability of information and collateral in describing sources of finance available to firms over time (Gompers, 2010). The model thus conceptualizes the sequencing of funding over the life cycle of the firm centered on information opacity and following a financial pecking order. Smaller, more informationally opaque firms are depicted to the left side of the continuum relying on initial insider finance, trade credit, and/or angel finance. As firms advance along the continuum, they gain access to increased sources of external debt and equity capital (Nofsinger, 2011). Ultimately, firms may access greater amounts of capital in public debt and equity markets. Similar to earlier approaches, the model does not specify age categories for each stage of development, nor does it consider truncation at any point in the life cycle (Gompers, 2010). Unlike models such as Weston and Brigham's model, it does not specify stages of development of the firm, and whilst it includes a number of sources of external equity and debt not included in previous models, retained profits are not incorporated into the model and contrary to predictions of the financial growth life cycle model, external sources of finance exceed internal sources for the youngest firms (Calice, 2012).

Furthermore, La Rocca (2011) argues that the contribution of the firm owner increases initially and then decreases in firms over 12 years old. The initial increase in use of insider financing is explained by firm owners employing retained earnings for investment because of potential difficulties in raising external finance explained by the monopoly-lender theory (Zedini, 2009). The subsequent decrease in use of internal sources is explained by older firms sourcing increasing amounts of external debt due to reputation effects (Fatoki, 2010). Nofsinger (2011) conducted an empirical examination of the life cycle model by testing a multinomial logistic regression model employing data collected in the 1998 NSSBF. Results from this study partially support the model, although Nofsinger concluded that the financial growth life cycle of SMEs cannot be encompassed in a "one size fits all" universally applicable model.

2.3 Conceptual Review

2.3.1 Small and Medium Size Enterprises

To date there is no commonly acknowledged definition of small and medium enterprises (IFAC, 2011). The definition varies across countries and industries. In Uganda, Small and Medium Enterprises are officially defined on the basis of both the number of people employed and the annual turnover of the enterprise (UIA, 2013). Ministry of Finance, Planning and Economic Development defines a small enterprise as an enterprise employing a minimum of 5 people and a maximum of 50 people; and/or has an annual sales/revenue turnover of a maximum of Ugandan Shillings 360 million and total assets of a maximum of Ugandan Shillings 360 million, while a medium enterprise is defined as an enterprise employing between 50 and 100 people; and/or has an annual sales/revenue turnover of more than Ugandan Shillings 360 million and total assets of more than Ugandan Shillings 360 million (MFPED, 2008). In Uganda the common terminology for SMEs is small business (UIA, 2013). The contribution of SMEs to Uganda economy cannot be over emphasized since SMEs contribute over 90% of total non-farm private sector employment, constitute approximately 20% of the national GDP, contribute over 20% of incomes of the labour force, and have great potential for reducing poverty levels (ADB, 2012).

Namatovu et al. (2010) observed that majority of the enterprises are found in restaurants and food processing, garages for motorcars and motorcycles, retail and whole sale trade, metal fabrication, furniture assembling, schools and transport services.

2.3.2 Role and benefits of SMEs

There is a general consensus that the performance of SMEs is important for both economic and social development of developing countries. From the economic perspective, SMEs provide a number of benefits (Kira, 2013).

SMEs have been noted to be one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low-income countries. These enterprises have been recognized as the engines through which the growth objectives of developing countries can be achieved (Mwangi, 2011). They are potential sources of employment and income in many developing countries. SMEs seem to have advantages over their large-scale competitors in that they are able to adapt more easily to market conditions, given their broadly skilled technologies. They are able to withstand adverse economic conditions because of their flexible nature (Maziku, 2012). SMEs are more labour intensive than larger firms and therefore have lower capital costs associated with job creation (Makoni, 2014). They perform useful roles in ensuring income stability, growth and employment. Since SMEs are labour intensive, they are more likely to succeed in smaller urban centers and rural areas, where they can contribute to a more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Due to their regional dispersion and their labour intensity, it is argued, small-scale production units can promote a more equitable distribution of income than large firms. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus facilitating long-term economic growth (Turyahebwa, 2013).

SMEs contribute to a country's national product by either manufacturing goods of value, or through the provision of services to both consumers and/or other enterprises. This encompasses the provision of products and, to a lesser extent, services to foreign clients, thereby contributing to overall export performance. SMEs also account for about 90% of the formal business entities in Uganda, contributing 80% of GDP and providing about 61% of employment (World Bank, 2011).

From an economic perspective, however, enterprises are not just suppliers, but also consumers; this plays an important role if they are able to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demands of their clients. Demand in the form of investment plays a dual role, both from a demand-side (with regard to the suppliers of industrial goods) and on the supply side (through the potential for new production arising from upgraded equipment). In addition, demand is important to the income-generation potential of SMEs and their ability to stimulate the demand for both consumer and capital goods (Odongo, 2014).

2.3.3 Financing for SMEs in Uganda

(a) Banking Sector Financing: Commercial banks constitute the main providers of financial services for enterprises. In Africa, they used to be dominated by foreign banks, but since the 1980s, a significant number of private-owned banks have developed in most countries.

Commercial banks offer a wide range of financial services including savings, deposits, credits, transfers, insurance arrangements, and even leasing. The main lending mechanism is short-term working capital; however, the availability of other financial services depends on the nature of the deposits that are being used for funding, as well as the demand for it (Mwangi, 2011). Given their profit-making principles, commercial banks find difficult to provide financial services to **SMEs** because SMEs are considered high risk clients (Fjose, 2010). Poor or incomplete business plans, when at all presented, make difficult the task of assessing the financial situation of such firms and their prospects for success. Second, transaction costs are inversely related to loan size, making lending in small amounts unprofitable. Third, restrictive financial policies impede commercial banks to set up their own mechanism of loan recovery, therefore limiting how much they can lend and to whom (Zecchini and Ventura , 2009).

(b) Micro-financing: This industry has proved to be a reliable delivery vehicle for financial services to SMEs. They consist of licensed institutions, NGOs co -operatives as well as a large collection of associations ranging from women and youth clubs to loosely organized bodies. They offer savings, payments and insurance services to their clients (Mwangi, 2011). The strength of MFIs is that they serve the rural areas at low costs. Their service delivery is flexible, which makes it easy for weak SMEs to access financial services from them. Their weaknesses, though, lie in their weak operational and management information systems, poor internal controls, limited access to technical assistance, and dependence on donor funding. A centre has been set up at the Uganda Institute of Bankers to address the issue of capacity building of these MFIs (Mashenene, 2014).

(c) Venture Capital Financing: Venture capital is equity investment provided by an outsider who is not the owner of the company. The concept behind venture capital is very simple. Instead of obtaining debt or bank finance, venture capitalists provide equity capital for other businesses, therefore sharing risks. It is a form of long-term investment for start-up and growing businesses that are seen as having a significant potential for economic growth (World Bank, 2011). The benefits of venture capital go beyond the provision of long-term finance. Since they share risks, venture capitalists, unlike banks, get actively involved in the functioning of the firm, from management to shop-floor operations. Given their knowledge gained from investing in other companies with similar growth challenges, venture capitalists or business angels can help their investees in overcoming the specific bottlenecks that hamper their performance. Following profit-making principles, venture capitalists seek high-return opportunities while minimizing risks. In the developed world, business angels have played a significant role in the success of small export-oriented high-tech firms, particularly in the fields of electronics and ICT (Cressy, 2006).

(d) Leasing: Leasing has been an alternative means of financing capital investment of SMEs with minimum initial outlay. In Uganda, the industry is still too small and young comprising only one leasing company. A lease is a contract between an owner of equipment (the lessor) and another party (the lessee) giving the lessee possession and use of a specific asset in return for payment of specified rentals over an agreed period. The lessee selects the equipment and the lessor purchases it for the former's use (Odongo, 2014).

(e) **Capital markets:** The development of stock markets is the most sophisticated phase in the evolution of any financial sector. In the last years, stock markets have been created through Africa partly due to stringent privatization policies and the establishment of capital market authorities. Some are country-specific while others are regional or pan-African. Uganda's capital market became fully fledged with the inception of the Uganda Stock Exchange (USE) in 1998. However, most SMEs cannot take advantage of the Exchange because of listing rules regarding disclosure requirements, which require companies to provide credible information to investors. The banking sector has offered equity financing to a few successful SMEs. For example, SMEs such as UGACHICK LTD and COMMERCIAL MICROFINANCE LTD have received equity financing from Development Finance Company of Uganda (DFCU), East African Development Bank (EADB) and the European Investment Bank (EIB) (Nahamya, 2013).

2.3.2 Small and Medium Enterprises profitability and growth

The aim or goal of any firm is to make profits and later grow or expand its operation (Mashenene, 2014). The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state. The growth of a firm can be determined by supply of capital, labor and appropriate management and opportunities for investments that are profitable (Fjose, 2010).

Accessing finance has been identified as a key element for SMEs to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries. Without finance, SMEs cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms. The effects of debt financing on the profitability of SMEs need to be understood in terms of business capital and stock growth (ADB, 2012).

2.3.3 Interest rates/ cost of capital

Whited (2010) in his contemporary study on rural finance argued that the cost of money is intended to compensate a contractor for the capital cost of employing certain facilities in the performance of contract. The cost of money charged by lending institutions includes operating costs, administrative costs, and an acceptable rate of return.

Odongo (2014) established that cost of money may be fixed for the term of the loan, or adjusted to reflect changing market conditions. He adds that the cost of money is looked at on the SMEs borrowing side as the charges paid for borrowing from financial institutions and mention four main components of cost of money which are reflected as cost of funds, loan loss expenses, operating expenses, and profits.

2.3.3 Government policy

Abdulsaleh (2013) established that in both developed and developing countries, governments have recognized that the SME sector faces constrained access to external financing which may negatively affect its crucial role in achieving national development goals. As such, many governmental initiatives and programs have been implemented to ensure SMEs have easier access to financing, of which credit guarantee loans, factoring programs and subsidized fees are typical examples.

According to Mensah (2004), government official schemes are those introduced by government either alone or with the support of donor agencies to increase the flow of financing to SMEs. It has been argued that such programs and schemes have the capability to ease the access of SMEs to additional credit (La Rocca, 2011). However, Zecchini and Ventura (2009) maintain that government schemes aim at assisting access to finance for SMEs can be effective only under well-specified conditions. In addition, as SMEs are subjected to credit rationing due to their small size and information asymmetry Zecchini and Ventura (2009) suggested that in order to be effective such schemes should aim at lowering the degree of discrimination against SMEs borrowers in terms of lending costs and unmet demand for fund. Moreover, as for SMEs operating in the export sector, Abdulsaleh (2013) recommended that it should be taken into account that not all firms are at the same phase of export development, thus a set of programs targeting firms at different stages of export development is essential.

One example of governmental assistance programs in industrialized countries is that of Small Business Financing Program in Canada (Gompers, 2010). Under this program, the Canadian government may guarantee up to 85 percent of loans less than $C250000. During financial year 2005–06, this program enabled SMEs to attain more than 10,000 loans with total value exceeded $C1 billion. Another example is from the UK. Launched in 1981, the Small Firms Loan Guarantee Scheme aims at facilitating SME access to finance by providing guarantees for SMEs loans (OECD, 2000). Over the period 1998–99, approximately 45 000 loans to SMEs were guaranteed with a value of £189 million.

In developing countries, different pictures emerge. In Croatia, a developing and transition economy, the government implemented the National SME Loan Scheme jointly with eight local commercial banks in 2000. The program aimed at increasing the supply of financing targeting SMEs and decreasing the cost of borrowing. However, contrary to expectations, the program suffered from a low rate of loan approvals with only 5% and 29% of applicants approved in the first two years; 2008 and 2009, respectively (Gompers, 2010). This was attributed to the inconsistency in lending criteria employed by the banks involved in the program.

To the contrary, another example positively illustrates the role of such programs, is the Kilimanjaro Cooperative Bank Scheme targeting rural SMEs in the region of Kilimanjaro in northern Tanzania. In his evaluation of this program, Calice (2012) concluded that in terms of loan productivity the Kilimanjaro Cooperative Bank Scheme outperformed all other schemes from Asia, Latin and Central America and the Middle East with 500 active borrowers for each credit officer and an efficiency ratio of 30%. Three major reasons rationalize government intervention on behalf of SMEs in finance markets, namely, credit market failure, price distortions and dynamic externalities (Zecchini and Ventura , 2009). Nonetheless, government direct intervention to enhance SME access to finance may also lead to undesirable consequences (World Bank, 2011). Some indirect mechanisms and policies can help achieving these programs' objectives. The role of tax legislation is a case in point. In addition, it is assumed that in order to be effective SME financing scheme should meet two principal criteria (Mensah, 2004). First, provide SMEs with their financial needs. Second, they should be sustainable.

2.4 Actual Review

Challenges of Accessing External Financing

Mashenene (2014) & Kwaning (2015) recently argued that traditionally, the focus is on obstacles created by commercial banks or equity funds, or on imperfections in the broader institutional environment. However Mwangi (2011) argues that SMEs also make decisions about financing and display attitudes that have an important bearing on financing decisions He adds that constraints may therefore also appear on the demand side of the financing marketplace. The economics literature on enterprise financing has identified some ostacles that may prevent SMEs from obtaining adequate financing. These obstacles are as follows:

2.4.1 High Interest rates and profitability of SMEs

Zecchini and Ventura (2009) argued that today, there's widespread agreement that most MFIs should operate sustainably, keeping their costs as low as possible and charging interest rates and fees high enough to cover those costs. Inability to access finance may be one of the reasons why we do not see a robust correlation between SME prevalence and economic growth and financial constraints are particularly preventing small firms from reaching their growth potential in terms of financial performance (Wanjohi, 2009). The authors further asserts that in most situations SMEs ought to pursue financial sustainability by being as efficient as they can but MFIs charge high cost of money to cover the costs of their lending and other services. Rosenberg (2009) concurs with Zecchini and Ventura (2009) that the cost of money charged to SMEs represents money taken out of clients' pockets, and it is unreasonable if it not only covers the costs of lending. Even the cost of money that only covers costs and includes no profit can still be unreasonable if the costs are excessively high because of avoidable inefficiencies and resulted to poor consistence financial performance of SMEs. There is an inverse relationship between cost of money and financial performance because the low cost of money can lead to improved performance on SMEs activities while high cost of money leads to stagnated performance and SMEs businesses collapsed in the short period due to non-existence of financial records (Wanjohi, 2009).

In Uganda Commercial banks average lending rates remain high averaging between 18% - 26% this has mainly be due to lack of competition in the banking sector. This was brought about by the following: few banks controlling a large market share, high operational inefficiency, high operational costs and the high risk of borrowers (Mashenene, 2014).

2.4.2 Effect of Collateral requirements on the profitability of SMEs

As the provision of collateral plays an indispensable role in easing SME access to debt finance. SMEs that have more fixed assets tend to utilize higher financial leverage (Nofsinger, 2011). The reason for this is that these firms can borrow at lower interest rates as their loans are secured with these assets serving as collateral. This explains why La Rocca (2011) describes collateral as the lender's second line of defense. In their investigation of the role of collateral and personal guarantees using a unique data set from Japan's SME loan market, Fatoki (2011) found that a positive relationship between the use of collateral and the strength of the borrower–lender lending relationship results in easier SME access to commercial bank debt finance.

A similar conclusion was reached by Odit and Gobardhun (2011) when examining the factors determining the use of financial leverage by SMEs in Mauritius. They concluded that access to debt finance is affected by the positive association between the debt ratio and the asset structure. Furthermore, they revealed that SMEs with a lower portion of tangible assets in their total assets are more likely to encounter difficulties in applying for outside finance because of the inability to provide the collateral required.

When granting loans, commercial banks protect themselves with assets (mostly real estates) collateral that is two to three times the value of the loan. The conventional requirements usually exclude the SMEs because they often lack assets. Many banks, particularly the transnational ones, do not accept collateral that is far from the main urban centers (World Bank, 2011).

2.4.3 Experience of the owner/ age of the firm and how it influences the profitability of SMEs

Turning to experience, as measured by the number of years in an industry, Abdulsaleh (2013) found that experience also enhances the availability of credit. In fact, Nofsinger and Wang (2011) hypothesized that the experience of the entrepreneur is one factor that explains the difference in debt financing levels available to SMEs. The findings of the study proved this hypothesis. They further explained that prior experience in the industry positively correlates with the share of debt financing in the firm and added that the cumulative experience of the owner–manager plays a crucial role in overcoming some of the problems that hinder SME access to debt finance, including information asymmetry and moral hazard. From the lender's perspective, as experienced entrepreneurs are believed to be better performers than less experienced entrepreneurs, it is then rational to factor experience into the process of evaluating the creditworthiness of SMEs (Gompers, 2010).

Kamweru (2011) argues that firms that are younger have no reputation and no established credit history that providers of external finance can use to evaluate their credit worthiness; as such they are more constrained in the use of external financing. On the other hand, he contends that older firms have a well-established credit history and have built a good reputation with providers of external finance, as such are less constrained in the use of external finance. The reputation and the credit history which older firms establish over the years in doing business reduce the problem of information asymmetry and help the firms to easily access external financing (Frazer (2005), Petersen and Rajan (1994), Abor and Biekpe (2009), Diamond (1989), Beck et al (2008), Maurizio et al (2009)).

Owing to lack of business experience of many small owner-managers in the early years of the business, business risk may be more significant than large firms. Small firms generally have smaller financial reserves to draw on in times of crisis and are also relatively highly geared compared to larger firms due to the difficulty and expense of attracting new equity finance. Thus, such firms are characterized not only by higher business risk but also higher financial distress risk. Banks tend to respond to this risk by adopting a capital – gearing rather than an income-gearing approach to lending. Thus, rather than focusing their attention on evaluating the income streams flowing from an investment project, they may focus more on the value of collateral available in the event of financial distress. This creates a problem for small firms in that they often do not have significant fixed assets to secure on their early years of establishment (World Bank, 2011)

2.4.4 Government policy influence on SMEs' profitability

There are certain regulatory elements that hinder the SMEs sectors. Red tape associated with starting a business significantly hinders business startups and this process to start a business is the very first hurdle that new entrepreneurs face (ADB, 2012). Access to finance then becomes almost impossible with the high Central Bank rate which contributes to high commercial bank interest rates that significantly disembowel any dreams of getting the business off the ground. In Uganda for the last 5 -10 years, the CBR has averaged between 12-13% (Odongo, 2014).

2.4.5 Emerging gaps

A substantial amount of surveyed literature above, both in theoretical and conceptual contexts emphasize interest rates, collateral, age of the firm and government policy as a critical factors influencing commercial bank debt financing in accelerating the profitability of SMEs. In fact these studies have tended to group together the constraints regarding debt financing whether from MFIs or CBs (Turyahebwa, 2013: Kira, 2013, Maziku, 2012 and Makoni, 2014). In reality, the conditions and requirements for debt financing from MFIs and CBs differ markedly.

Moreover, this literature citation is rather generalist and does not specifically and singularly address itself to a hodgepodge of variables influencing the profitability of SMEs with an uncharacteristic focus on Kampala district. Besides, the centre of interest of this literature does not include a broad continuum of financing types such as venture capital, leasing, and other financing avenues. This creates scope, methodological, content and geographical gaps that this study sets out to bridge.

CHAPTER THREE
RESEARCH METHODOLOGY

3.0 Introduction

Chapter three includes a review of the research methods and design appropriateness, a discussion of the population and sample. In addition, Chapter three explains in detail the methods that will be used in the gathering of the data and the various stages the researcher will go through to acquire the information. In this chapter the researcher elaborates on the area of study, sample size, methods of data collection, data presentation, interpretation and analysis.

3.1 Research Design

Sekeran (2009) defines research design as the scheme, outline or plan that is used to generate answers to research problem. It can also be defined as the master plan specifying the methods and procedures for collecting and analyzing the needed information.

Across-sectional survey design will be used to identify the opinions of the sampled SMEs' proprietors about the factors influencing their access to commercial bank debt financing and how it affects the profitability of their businesses. The design is chosen because it will enable the researcher to capture a lot of information in a short period of time. It will also help avoid bias and refrain from using complicated statistical formulae. This is in agreement with Sekeran (2009), who contends that cross-sectional survey may be carried out to obtain information about preferences, attitudes, practice and concerns or interests of a group of people on a given issue and the results extrapolated to the entire population.

Cross-sectional survey is also chosen because it can be used to gather data from a sample population at a particular time; (Sekeran, 2009). For this particular study, cross-sectional design will be used to gather data from proprietors and employees of SMEs in Rubaga Sub County.

3.2 Study population

Sekeran (2009) defined population as basically, the universe of units from which the sample is to be selected. The term 'Units' is employed because it is not necessarily people alone who are sampled. It can also be defined as the entire group of people, events, or things of interest that the researcher wishes to investigate. According to the Census of Business Establishments in Uganda of 2011, a sampling frame of 454,104 enterprises was identified from the whole country.

The study will use data that will be collected from retail businesses located in Rubaga Sub County in Kampala. The population of retail businesses in Rubaga Sub County is just 10.6% (194 establishments) of those in Kampala (1830) (National Small Business Survey Report, 2015). These SMEs will be selected because they are growth oriented (businesses with 3 or more employees) in order to understand the constraints to profitability.

3.3 Sample Size

Sekeran (2009) describes sample as a subset of the population. It comprises of some members selected from it.ie some of the elements of the population form the sample. Also is defined as a segment of the population selected for investigation.

Rubaga Sub County in Kampala has an estimated population of 194 retail SMEs. The study will consider any SME proprietor/ employee regardless of age and gender. This will be done in order to minimize bias. The sample size will be determined using Cochran's correlation formula as edited by Bartlett *et al* 2000.

$$n = \frac{N}{1 + N(e)^2}$$

Where

- n is the desired sample size
- N is population of the study
- *e*, is the confidence interval of the study.

  It therefore followed that

  = 194 / 1+194 $(0.05)^2$

  = 194 / 1.485

  = 130 respondents.

  The targeted sample is 130 respondents.

Within the population a sample of 130 enterprises will be selected as a representative of the whole population. In addition of 5 employees from 5 commercial banks will be interviewed (selected by convenience sampling) to give their technical views on the subject matter. This will help the researcher to get an administrative opinion on the issues raised in this study.

3.4 Sampling Techniques

To determine the number of respondents the researcher will use the simple random sampling technique where respondents will be selected from zones. The simple random sampling will be in order to ensure that the sample is unbiased. Triangulation will be employed.

The study will be carried out using the purposive method of sampling for the financial institutions. This is dictated by the nature of the study which is aimed at getting specific information from specific individuals. The Convenience method of sampling will also be used for taking on proprietors that are readily available. A total of 130 respondents will be requested to fill the questionnaires.

3.5 Data Collection Methods

Key Informants interviews:

These are interviews conducted with key individuals (respondents from commercial banks) within the target population. These will provide the researcher with detailed, qualitative, qualitative information about impressions, experiences and opinions of respondents from financial institutions about commercial bank debt financing issues (UCLA Centre for Health Policy Research, Retrieved 2015)

Observation method:

This is a systematic data collection approach. This method of observation involves prolonged engagements in the areas of study and a continuous recording of the observations. It is important to note that there is Participant observation and non-participant observation. The researcher will use the above method through some visits to the study area. This will make it possible to clearly monitor what takes place within the SMEs. The researcher will use the observation method because it involves a high element of accuracy and could easily get firsthand information. This method is also cheap in terms of money. It will also be easy to acquire data especially on those questions which would otherwise remain unanswered using the questionnaire method. Observation as a method of data collection will make it possible for continuous monitoring. The immersion and prolonged involvement into the study area will lead to the development and fostering of free and open speaking to members. This will be aided by video and audio recordings.

Questionnaire method:

A questionnaire is a list of written questions and can be completed in two basic ways; completed by respondents without the presence of the researcher (Postal Questionnaire) or the structured questionnaire where respondents verbally respond to questions in the presence of the researcher. A total of 130 questionnaires will be used and properly monitored so that they are returned. With the questionnaire method the researcher will be able to easily reach out to large numbers of respondents in a short period of time.

3.6 Data collection instruments

Primary data will be obtained from respondents by the researcher through interviews, administration of questionnaires. Secondary data will be obtained from documented statements. Interviews will also be conducted among the selected financial institutions while the questionnaires will be addressed to the enterprises. As regards secondary data, annual reports and other published material will be used. These will include loan manuals, financial reports and any other documents that will be relevant to the study.

3.7 Pre-testing (Validity and Reliability)

Validity of instruments

Validity refers to the truthfulness of findings or the extent to which the instrument is relevant in measuring what it is supposed to measure. Validity here refers to the extent to which the instrument accurately measures what it is intended to measure (Sekeran, 2009). This study will utilize triangulation to ensure validity of research findings prior to the administration of the research instruments. Content validity ratio will be employed to determine the content validity index using the formula below:

CVI = Total Number of items rated by all respondents / Total number of items in the instrument

A CVI of 0.7 and above is considered satisfactory.

Reliability

Reliability measures the consistency of research instruments to come out with the same result each time it is used under the same condition (Sekeran, 2009). The reliability of the research instruments will be ascertained through pre-testing to cross check the consistency and accuracy of the questions and answers obtained. A Cronbach alpha test will be particularly carried out to establish the reliability of the questionnaire. If R sqd (Alpha) value is equal to 0.7 or it is above, then the instrument was considered satisfactory (Cronbach, 1951).

3.8 Data collection procedure

The researcher will obtain a letter of recommendation to conduct the research from the School of Business and Management of Uganda Technology and Management University (UTAMU) to ensure that the ethical guidelines are followed throughout the data collection process and to help access the employees at their place of work. Each questionnaire will contain an introductory letter requesting for the respondent‘s collaboration in providing the required information for the study. The study will use both secondary and primary data. Primary data will be collected through use of observation, questionnaires and interviews while secondary data will be sourced from documented statements and reports on small and medium enterprises for additional analysis

3.9 Data Analysis

3.9.1 Data processing

Data from the field will be sorted, coded and organized in tables to reveal the percentage scores of the different study attributes

Editing: The researcher will edit the data collected for accuracy and completeness.

Coding: The researcher will code the pre-coded questions so that all answers obtained from different respondents are classified into meaningful categories.

Frequency tabulation: This will involve placing the number of responses falling into a particular category and recording the responses using tallies so as to come up with a statistical table. This is intended to simplify organization of raw data for easy interpretation.

3.9.2 Qualitative Analysis

Data from key informants will be analyzed in three ways i.e. thematic verbatim and case studies. Thematic verbatim will involve condensing individual responses into similar themes and integrating them into interview schedule for easy analysis. In verbatim, the researcher will record statements, comments or remarks of the respondents. This will involve direct quotation of the words, statements or comments of the respondents. In case study, interesting and relevant stories will be captured and placed in a box or frame. The use of the qualitative design is aimed at giving deeper insights of the issues expected to be uncovered by the qualitative research methods.

3.9.3 Quantitative Analysis

The Pearson's correlation coefficient and multivariate regression analysis will be carried out using the SPSS program to establish the relationship between the two variables. In presenting the findings, tables and figures will be used. The frequency distribution tables will be used to tabulate data to show percentages calculated

Quantitative data collected using questionnaires will be analyzed using descriptive statistics, where frequencies and percentages were obtained. This is because this kind of analysis allows measurement and description of the relationship between two variables (Amin, 2005). Correlation analysis will be essentially used to measure the direction, strength and significance of the relationship between the factors influencing external financing and growth of SMEs.

3.10 Measurement of variables

In this section the researcher seeks to assign codes to empirical properties of the variables that will determine the type of statistical analysis that can be conducted, and, therefore, the type of conclusions that can be drawn from the research. Interview questions that that can lead to only two responses will be assigned two codes that is; 0 and 1, whereas interview questions that can lead to more than two responses will take on codes beginning from 1. Respondents with the same code of response will then be aggregated into one data table that will be used in the analysis. Respondents will be expected to answer yes or no for some questions, strongly agree, agree, strongly disagree and disagree for the other questions. Responses to ages will be in group format to allow for grouping at the data collection level.

Simple correlation design will be used to explain the factors influencing SMEs' access to debt financing (independent variable) and their effect on SME growth (dependent variable) in Kampala. This is in accordance with Amin (2005), who states that simple correlation study can be used to determine the relationship between two variables. The independent variable will measure parameters such as interest rates, collateral requirements, age of the business and issues of government policies (CBR) among others. The dependent variable, growth will measure variables such as changes in level of assets, level of sales, profitability and number of branches. Data will be analyzed using descriptive frequencies and percentages. The analytical package that will be used is SPSS -17.0.

3.11 Ethical Considerations

The objective of ethics in research is to ensure that no one is suffers adverse consequences from the research activities (UCLA Centre for Policy research, 2015). The researcher‘s aim is to ensure that the rights of the respondents are not violated. This will be done with the following in mind;

- ✓ No provision for respondents’ actual names on questionnaires
- ✓ Respondents should consent to being included in the study
- ✓ Providing adequate reasons as to why the study is being carried out.

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APPENDICES

APPENDIX 1: QUESTIONNAIRE

My name is Nyanzi Joseph Ssentamu, an Executive Masters of Business Administration student at Uganda Technology and Management University. I am doing a study on commercial debt financing and profitability of SMEs in Rubaga Sub County, Kampala. Please answer freely the questions below about your experiences on the research problem. The information provided will be treated with the highest degree of confidence, and at no point should you respond to a question you do not feel comfortable answering. When the questionnaire is completed, it should be submitted to the researcher. Thank you very much.

Researcher's Signature……………………………….Date……………………………………..

Section A: Background Information

1. Sex

a) Male ( )

b) Female ( )

2. Marital Status

a) Single ( )

b) Married ( )

c) Divorced ( )

d) Separated ( )

3. Level of education

a) Informal Education ( )

b) Primary ( )

c) Secondary ( )

d) College ( )

e) University ( )

4. Name of your business ---

5. What position do you hold in the organization (optional) ------------------------------

5. When did your firm start business ---

6. With what form of financing did you start your business?

   Bank loan [ ] Sacco [ ] Micro finance loan [ ] Family and friends [ ] personal savings [ ]

7. What type of business organization is your firm? Tick where appropriate

Sole Proprietor { } Partnership { } Limited Company { }

8. How many employees do you have in the business? (Full time and Part time basis including directors and owners)

Do you have a KCCA license?

Yes { } No { }

Section B: Key Challenges Faced by SME in accessing finance

9. Do you hold and operate a Bank account?

Yes { } No { }

10. If yes, how long have you been operating the account?

Less than a year { } 1 to 5 years { } 5 to 10 years { } Over 10 years { }

11. Have you borrowed funds to finance your business from any financial institution?

Yes { } No { }

13. If borrowed from a financial institution, how easy has it been for you to access loans from credit institutions?

Extremely difficult ( ) Very difficult ( ) fairly easy ( ) Very easy ( ) extremely easy ( )

14. Did the financier give the loan that you applied for?

Yes { } No { }

15. If no, what were your problem(s)?

a) Insufficient collateral

b) Inexperience/ young business

c) High interest rates

d) Other (please specify) ____

16. If yes, did the financier give full amount of loan applied? If not what was the reasons for giving less than applied? Yes [ ] No [ ]

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17. Were you able to meet all the conditions required by the Bank?

Yes { } No { }

18. In your opinion what requirement (s) was (were) difficult to fulfill to enable you get the loan?

a) --

b) ---

c) ---

19. Did you fulfill all the condition(s) above or how was requirement waived?

Yes { } No { }

20. How long did it take the bank to give the loan?

Less than a week [ ] One Month [ ] Three Months [ ] Over 3 months [ ]

21. In your opinion, were you satisfied with the process from start to the end?

Yes [ ] No [ ]

22. If no, what would you cite as the most challenging stage of the loan process?

Meeting sales people [ ] Valuation of collateral [ ] Confirmation of loan amount [ ]

Section C: Effect of Debt financing on Profitability

23. How many branches of your business do you have? 1-3 [ ] 4-8 [ ] 9-12 [ ]

24. How many branches have you opened up in the last five years? 1-3 [ ] 4-8 [ ] 9-12 [ ]

25. How many branches did you open up as a result of loans from a bank? 1-3 [ ] 4-8 [ ] 9-12 [ ]

26. Would you describe your sales revenue as increasing or falling in the last five years due to the loans? Increasing [ ] Falling [ ]

27. How many assets have you acquired or repaired because of the loans 1-3 [ ] 4-8 [ ] 9-12 [ ]

Section D: Financial institutions informants' responses

28. What problems prevent SMEs from getting loans in your opinion?

a) Insufficient collateral

b) Inexperience/ young business

c) High interest rates

d) Information about the types of the loans available

d) Other (please specify) ____

29. What has the institution ease access to finance by SMEs?

a. Extensive adverts

b. Free financial specialist consultations

c. Community outreaches

d. Promotions

e. Any other____

30. Has the government created an enabling environment for SMEs to access finance easily through the Central Bank Rate? What more can be done to enable SMEs easily access credit?

Yes { } No { }

Explain

____

____

____

Thank you very much, may God bless you abundantly.

The End

APPENDIX 2: Work plan

Project Task	**Activity**	**Duration**	**Dependency**
Research Planning / Setup	A	5days	
Questionnaire Design	B	4 days	A
Sampling	C	1 day	A,B
Data Collection	D	130 days	A,B,C
Data Preparation, tabulation, analysis	E	20 days	A,B,C,D
Compilation of the report	F	10 days	A,B,C,D,E

APPENDIX 3: Budget

ITEM	**COST' shs**
Travel (public means)	150000
Subsistence allowance	200000
Data Analysis	50000
Stationery and secretarial costs	20000
Report production (printing and binding)	80000
Total	500000