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Access to Micro-Credit and the Growth of Small and Medium Enterprises (Smes) In Uganda

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ABSTRACT

The purpose of the study was to establish the relationship between access o micro credit and the growth of small and medium scale enterprises in Uganda.

The study was guided by the following research objectives; to examine access to micro credit and the growth of small and medium enterprises in Uganda, to examine the rate of growth of SMEs accusing micro credit facilities in Uganda and to establish the relationship between access to micro credit and growth of SMEs in Uganda.

The study was a cross sectional survey with respondents comprising of small enterprises' owners, employees from lending institutions and SMEs, workers as well as customers. Persons from government agencies like USSA and UIA were also selected for this study. The data was collected using self administered questionnaires within the confines of Kampala- industrial area. The data was analyzed using frequency tables and charts spearman rank correlation was used to establish the relation between the study variables.

Results of the study showed there was a significant positive relationship between access to micro credit and the growth of SMEs in Uganda.

The researcher recommends that SMEs owners should acknowledge the contribution of credit facilities towards the growth of their enterprises and thus should devise means to overcome the challenges of inadequate collateral a high rates of interest entrenched in accusing credit facilities from micro credit lending institutions targeting at SMEs as their niche should also soften their lending terms. This is likely to increase access to micro credit facilities and accelerate sustainable growth of SMEs

Key Words : Micro Credit, Growth and Performance, SMEs

Introduction

Access to micro-credit is still a high hurdle for small enterprises (SMEs) looking forward to invest modest amounts (like $500-$5000) in capital equipment. Such enterprises hardly qualify for traditional bank loans, because they require small amounts than are accommodated by commercial leasing companies. Small enterprises (SMEs) usually have to purchase capital equipment for cash-up front. This significantly increased business risks demoralizing upcoming enterprises and eats into the firms' revenue (profits) and undermines business growth.

A number of microfinance institutions (MFI) in Uganda engaged in providing financial services in form of micro-credit to various entrepreneurs, through profitable operations that fostered growth of both internal and external customers. MFIs policies generally embraced primarily providing credit and saving services to the people who engaged in farming and operating micro-enterprises that dealt in providing goods to the local community and accepting business deposits from the public (MFI ACT 2003).

The major beneficiaries of micro-credit from MFIs range from small, medium to up-scale entrepreneurs in both urban and pen-urban centers. SMEs played an important role in the economy and are increasingly being seen as the seed bed for future growth (Helmsing and Kolstee (ed), 1993).

In Uganda, SMEs may constitute 90% of the private sector, employ more than 2.5 million people and contribute 75% to GDP (ministry of finance, 2008). SMEs are however, faced with a myriad of constraints and the most prevalent ones are; the lack of access to capital, lack of access to market information and technology and the low quality of human resources (Kamugisha, 2009). These constraints substantially limited the performance of SMEs in terms of sustainable growth rate within the context of globalization. The government created an enabling environment so as to improve or promote the performance of enterprises in the private sector. For instance exchange rate liberalization, tax incentives deregulation of interest rates as well as trade liberalization. Nevertheless, a significant gap still exists in the enterprise sector for easily accessible micro-credit facilities needed to promote the performance of the dynamic SMEs.

SMEs acted as "vehicles" for economic growth as they contributed tremendously to the gross domestic product (GDP), generated employment and spread investment risks through accelerating diversification, to realize these contributions, SMEs needed to generate sufficient revenue, and maintain sustainable growth. That is they should be "going concerns".

Sustainable growth was vital because it enabled enterprises to venture in other viable investments, expand operations and meet long term business objectives. However, most enterprises have not realized this

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objective inform of sustainable growth, slow growth in SMEs in Uganda as evidenced by Tullip and Bitekyerezo (1993) evidence that 50% of SMEs in Uganda failed in the first two years of existence. This has been greatly attributed to inaccessibility of credit from the formal sources.

Access to credit as a constraining factor was entrenched within numerous requirements for instance, collateral, interest rate and evaluation of financial proposals all which was addressed by the entrepreneur, otherwise if such a situation continues, SMEs might continually experience cash flow and budgeting constraint and thus forego some planned undertaking which might seriously hinder the growth of the sector. There fore , the study aimed at establishing the relationship between access to micro-credit facilities and the growth of small and medium enterprises (SMEs) in Uganda.

Review of Literature

Micro credit is financial innovation that is generally considered to have originated with the Grameen bank in Bangladesh. In Uganda, the concept of micro-credit is not a new term as it dates far back to 1980s and has been used by many to refer to small but crucial loans.

According to ledger wood (2002), micro-credit is a developmental tool which arose in the 1980s as a response to doubts of subsidized credit to the poor farmers.

The term points at the extension of loan facilities to those in poverty designed to spur entrepreneurship. Such individuals lack sufficient collateral, steady employment and a verifiable credit history (information) and therefore can't meet even the most minimal qualifications to gain access to traditional credit from the traditional lending institutions available.

Micro-credit (loan facilities) are extended by numerous micro-credit lending institution over the country. By the year 2000, there were almost thirty two (32) micro-credit institutions that provided their services to numerous SMEs entrepreneurs in Uganda, though statistics today reveal that the number has more than doubled and this is to the benefit of SMEs, since they form an inch market for the micro credit lending institutions.

Adams Graham and Von Pischken 2001, noted that providing the poor with access to financial services is one of the ways to help increase their incomes and productivity. This therefore, has got a multiplier effect, micro-credit and cooperative programs have more effectively played the role with a focus of helping the majority poor become self employed and thus "escape" poverty.

Many of such programs provide credit using social mechanisms like group based lending to reach out easily to their clients and as a mechanisms to prevent possible loan defaults.

"Accessibility" is a general term used to describe the degree to which a product, device, service or environment is accessible by as many people as possible. It's also

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viewed as the “ability to access” and possibly benefit from some or entity.

Therefore, in the context of “access to micro-credit” accessibility encompasses the ability to identify and obtain information pertaining credit itself and credit usage. That is, how easy it is for SMEs to find people who give credit (lenders) and the accompanying credit information.

Anderson (1999) Clarde Jesus and Cuevas (1998) defined access to credit as approval from a lender’s perspective whereby access is determined by lenders rules.

Mayanja D (1999) defined credit accessibility as the right to use finance in form of a loan, lease and asset management in return for a promise to pay for the services and products rendered in form of fees/interests.

According to Biryabarema (1998), small and medium enterprises have small means, they are not characterized by large financial and capital outlays, small and medium enterprises therefore require special attention of lending institutions if they are uplift their status, develop and progress and improve their access to micro-credit facilities from the available lending institutions. Access to microcredit facilities will also enhance the growth of small enterprises and eventually graduate them into large business enterprises.

Therefore in his view, Biryabarema also contended that there was a great need in so far as access to micro credit facilities for the growth of small enterprises is concerned, he went ahead to say that every business whether small or big needs some form of financial help at some point especially when the business is growing rapidly. This is in agreement with Njuki (1998) who also asserts that credit is a big ingredient in the development formula.

Cook 2002 and MacMahon 2001 assert that financial credit is the most important form of external support required for SMEs growth especially in developing countries while according to levy (1993), restricted access to financial services slows down the growth of SMEs. Therefore credit facility is a developmental tool that enhances growth of all business enterprises. Credit extended to SMEs enhances its performance in terms of growth, profitability sales turn over as well as an enterprises market share. Inaccessibility such credit facilities lead to business failure as asserted by Bitekyerezo (1993).

Small enterprises owners have continually constituted a bigger percentage of the clients that fail to access credit facilities from the lending institutions. The major challenges relate to interest rates lending rates offered by lending institutions, collateral requirements to ascertain loan recovery to lenders as well as information dissemination of the borrowers (SMEs) as discussed below;

This refers to the premium received by the lender after a stated period of time. To the borrower, interest rate charge is the cost of capital at the time of obtaining a loan. According to Cottarch et al (1995) interest rates charged by financial institutions are determined by numerous factors including, inflation rates, exchange rates, discount rates and the risk profile on the loan.

This refers to the tangible asset that lenders ask for as a guarantee for the recovery of the loan in case of default Dutoit (1997) states that although security places the customer's assets under encumbrance, it enables the customer to invariably negotiate better interest rates for the credit facility.

Although some financial institutions have been providing uncollateralized loans to SMEs (FINCA hand book, 2008), requirements for security still pose a bigger challenge among SMEs seeking credit facilities especially from traditional lending institutions.

According to levtskey 1990, lending to small enterprises was perceived as being risky. They are characterized by high mortality rate, susceptibility to market changes, insufficient collateral and intensely affected by economic fluctuations making financial institutions reluctant to deal with these clients. This undermines their sustainable growth.

Scholtens et al, 1999 reveals that access to capital is not only attributable to size but also as a result of problems associated with inefficient information through which projects can be evaluated. Existing literature reveals that availability of relevant financial information accelerates the process of credit accessibility among SMEs.

According to Peterson and Rajan (1994), a relationship with an institutional lender increases the availability of financing of small business and a lesser degree that those relationships reduce the cost of borrowing.

Furthermore, Cole (1998) argued that lenders are more likely to extend credit if they have a preexisting relationship with the borrower.

International discussion in Vienna (2000) on challenges of SMEs Financing noted that the size and nature of financing gaps is not known due to poor record keeping and reporting by financial institutions, SMEs owners intending to access micro credit facilities should therefore keep proper books of accounts which show their willingness to develop relationship with the lenders to close the information gap and enhance sustainable growth.

SMEs have widely been described by various researchers, according to Burns (1996) an SME is defined as an enterprise that employs one to ten and is managed by its owners or part owners in a personalized way and not through medium of a formalized management structure.

In support of the above view, Balunywa (1998) says that SMEs are usually sole proprietors legally owned by one person who controls the business and they normally have unlimited liability where it's difficult to separate ownership from the enterprise. The major beneficiaries of credit facilities from micro-credit institutions are these

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small and medium scale entrepreneurs in both urban and pre-urban centers.

The threshold of SMEs is also defined in terms of sales figure (average annual turnover) as an enterprise with less than fifty million (50,000,000) shillings annually sales turnover also threshold for value added tax (VAT). However, a clear understanding of the purpose for which the definition of an SME is to use should decide any decision of definition.

Growth and financial value creation may not be the only objectives further management of the firm but this has often been the case especially for small enterprises in developing countries (Mouritsen 1998). Sustainable growth is considered as a success indicator for business enterprises (O'Goeman, 2001) and is also a viable measure of business performance while reflecting on it as a long term business objective.

Performance among small enterprises can also be measured by their profitability, increased sales, customers or even increased number of employees. However, growth remains an outstanding success variable due to numerous reasons including;

Firstly, growth is one of the most significant components of economic strategies for new job and wealth creation (Carson et al, 1995) Hodgelts and Kuratko, 1995). This therefore has got multiplier effect.

Secondly, most small and medium entrepreneurs use growth related measures for example growth for sales and growth of customer volume in attaining business strategic goals more reliably than profit related measures (Hudson et al, 2001).

According to small Borre et al (1995), one important characteristic that distinguishes the best performing firms from other firms is their commitment to growth. However growth among business enterprises is also a complex process in that most enterprises increasingly grow in their early years but later, the rate declines on an increasing level (Burns, 1994).

Stoner (2001) explains that profitability is the excess of income over expenditure which can be expressed by ratios for example, gross profit margin and net profit margin ratios, profitability of an enterprise has greatly been relied on as an indicator of growth among SMEs (Lucey 2000) through some studies still indicate that it's an ambiguous measure since it can be looked at differently by different people.

Accountants for instance have got a divergent view of profits from economists view (Pandey, 1999). Nevertheless profitability measures the firms financial strength which provides a competitive edge and accelerates sustainable growth of SMEs.

This is the total amount of goods sold within a specified period of time often expressed in monetary terms (Pens, 2000). Increasing sales revenue puts the firm to a better position in terms of its sustainability as well as growth and majority of small business owners at least use the growth of sales as

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reliable indicator of their firm's growth (Penn et al, 1998).

The existing literature as per the research conducted by numerous scientists reveals that there is a correlation between access to micro-credit and growth of SMEs.

Previous studies also reveal that sustainable financial and operational growth of enterprises is more entrenched in their ability to find credit facilities and put them to best use. Some small enterprises however limit their issuance of outside equity so as to maintain control of their firms (Fox, 1990).

Financial credit is the most important form of external support required for SMEs growth especially in developing countries, (Cook, 2002) and (Mac Mahon 2001). According to Levy (1993), restricted access to financial services slows down the growth of SMEs. Therefore credit facility is a developmental tool that enhances growth of all business enterprises regardless of their sizes.

Previous studies also reveal the challenges encountered by SMEs in accessing outside borrowing like collateral, interest rate and inadequate financial information and this adversely affects growth of enterprises.

Methodology

In this study, the researcher used longitudinal research design to establish the performance of enterprises before and after accessing credit facilities. Quantitative methods were adopted to analyze the rate of growth in sales volume, number of employees, as well as profitability of the enterprises overtime. The study was conducted in Kampala more especially in industrial area regions. This area of study was selected due to the fact that Kampala has got various micro-credit institutions and at the same time the industrial area is characterized with numerous SMEs. A sample size of 50 (fifty) respondents was selected from the survey population. There are a variety of sampling methods in use however, in this study the researcher focused on a few of which included; Stratified sampling, Purposive sampling

Findings and Discussion

Study Findings on the relationships between access to micro-credit and the growth of small, medium enterprises

response	**X**	**Y**	**R_X**	**R_Y**	**$D=R_X-R_Y$**	**D^2**
strongly agree	16	20	2	1	1	1
agree	28	16	1	2	-1	1
not sure	4	12	3	3	0	0

disagree	2	0	4	5	-1	1
strongly disagree	0	2	5	4	1	1
						$Ed^{2=}4$

Source: primary data

From the expression

$R=1-[(6Ed^2)/n\ (n^2-1)]$

$R=1-[(6*4)/5(5^2-1)]$

$R=1-24/120$

$R=1-0.2$

$R=0.8$

The result above shows that there is a high positive correlation of R= 0.8 between access to micro-credit and the growth of small and medium enterprises. This implies that there is high relationship and access to micro credit can be the best way through which small and medium enterprises can be transformed from the rampant collapse.

Empirical evidence from this and other literature cited in the fixit suggests that where as SMES have potentially substantial contributions in the economy, attainment of other optimal performance is constrained by their limited ability to access micro credit facilities.

Results from this study also revealed that failure to access credit, credit by SMEs is an account of several factors, principal of which include; inadequate financial/ managerial skills possessed by a higher percentage of SMEs owner, inadequate collateral to guarantees loan recovery to lenders, non negotiable lending rates(interest rates) as well as ineffective information dissemination. These findings can confidently be inferred to generally apply through out the country.

The study findings revealed that increase in growth dimensions of various SMEs depends on their access to micro credit facilities. Most SMEs that have easy access to micro credit facilities have high productivity, growth in sales revenue, and their customer volumes' increase over time. Credit is therefore big ingredient in the development formula for most SMEs.

Results from the study revealed that access to micro credit and the growth of SMEs are positively related as shown by the rank correlation co-efficient of 0.8 this means that as access 10 micro credit among SMEs increase, their growth rates increase too. The results are consistent with the study by ferry, (1998) who emphasize that restricted access to financial services to SMES slows down their growth.

The findings, the researcher has found out that in order to enhance small scale business productivity, the limiting factors entrenched in accessing micro credit facilities that relate to interest rates, collateral requirements need to be exhaustively examined and relevant policy initiatives under taken.

This will increase access to micro credit facilities and overall. Financial accessibility for growth of business enterprises

Findings from the study showed that growth of SMES in terms of increase in sales volume, number of employees, as well as productivity is driven by SMEs access to credit facilities. The study also revealed that most SMES acquire some or whole of their start up (initial) investment capital from lending institutions. Therefore growth of SMEs to a large extent depends on the amount of credit accused.

To accelerate their growth, SMEs owner should utilize all avenues available to secure credit facilities. This will also make it possible or the existing and future SMEs to fill the "missing bank" currently evident in the country's business performance strata.

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