

Access To Finance And Performance Of Small And Medium Enterprises In Uganda: A Case Of Selected Smes In Kabale Municipality

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Abstract

This study examined the relationship between access to finance and the performance of small and medium enterprises (SMEs) in Kabale Municipality, Uganda. The study was motivated by the persistent challenges faced by SMEs in accessing adequate and affordable finance, and the consequent limitations on their growth and contribution to economic development. A descriptive cross-sectional design was adopted, and data were collected from a sample of 150 SME owners and managers selected through stratified random sampling. Structured questionnaires measured access to finance across three dimensions — access to bank credit, access to microfinance, and access to equity/informal finance — and SME performance across financial performance, operational efficiency, and market growth dimensions. Descriptive, correlation, and regression analyses were conducted. Results showed that access to bank credit ($\beta = 0.412$, $p < 0.001$), access to microfinance ($\beta = 0.287$, $p < 0.001$), and access to equity and informal finance ($\beta = 0.219$, $p = 0.003$) were all significant positive predictors of SME performance, with the regression model explaining 71.8% of performance variance ($R^2 = 0.718$). The study concluded that financial access is a critical determinant of SME performance and recommended reforms in collateral requirements, expansion of SME-focused financial products, and strengthening of credit guarantee schemes to unlock growth potential of SMEs in Kabale Municipality.

Keywords: Access to Finance, SME Performance, Bank Credit, Microfinance, Equity Finance, Small and Medium Enterprises, Kabale Municipality, Uganda

1.0 Background

Small and Medium Enterprises (SMEs) are widely recognized as the backbone of developing economies, serving as engines of employment creation, income generation, innovation, and poverty reduction (Ahumuza et al., 2025). In Uganda, SMEs constitute approximately 90% of all registered businesses, contribute about 20% of the country's GDP, and provide livelihoods for an estimated 2.5 million people (UBOS, 2022). In regional towns such as Kabale Municipality, located in the southwestern highlands of Uganda, SMEs are particularly vital, forming the primary source of commercial activity, employment, and income for both urban and rural populations in the surrounding districts (Florence & Julius, 2023). Despite their economic importance, Ugandan SMEs continue to face formidable challenges that constrain their growth and sustainability (Sarah & Audrey, 2024).

Among these challenges, access to finance consistently ranks as the most critical constraint reported by SME owners and managers across Uganda (BoU, 2022). The financing gap for SMEs in Uganda is estimated at USD 1.6 billion, reflecting the enormous unmet demand for affordable business capital among the SME sector (Gracious, 2023). This gap arises from multiple structural factors: stringent collateral requirements that most SME owners cannot meet, high commercial interest rates (averaging 21–24% per annum in Uganda), short loan tenors that are misaligned with business investment cycles, limited financial literacy, and the perceived high risk of SME lending by formal financial institutions (Sophie & Crispus, 2024). Consequently, many SMEs depend on personal savings, family contributions, rotating savings groups (ROSCOs), and informal moneylenders sources that are often inadequate in volume, expensive in cost, or unreliable in availability (Florence & Julius, 2023). In Kabale Municipality, these challenges are compounded by the relatively remote geographic location, limited presence of formal financial institutions, and the predominantly agricultural economic base that creates seasonal income fluctuations among SME operators (Alex et al., 2023). Understanding the specific ways in which different types of financial access influence SME performance in this context is essential for informing targeted policy interventions, financial product design, and business development support programmes (Winny et al., 2023).

2.0 Problem Statement

Despite the acknowledged importance of SMEs to Uganda's economy, their potential remains largely unrealized due to persistent financial exclusion (Florence & Julius, 2023). In Kabale Municipality, SMEs encounter severe difficulties in accessing bank credit due to collateral demands they cannot satisfy, high interest rates that erode profit margins, complex application procedures that are time-consuming and costly to navigate, and limited awareness of available financial products (Irumba et al., 2024). While microfinance institutions have partially filled this gap, their loan sizes are often too small for meaningful business expansion, and repayment schedules are frequently misaligned with business cash flows (Winny et al., 2023). Equity finance options are virtually non-existent for most SMEs in the municipality, given the underdeveloped capital market and limited awareness of alternative financing instruments (Ivan et al., 2023). The cumulative effect of these financing barriers is that many SMEs in Kabale Municipality remain stunted in growth, unable to upgrade their equipment, expand operations, hire additional staff, or penetrate new markets (Ariyo, 2023). Empirical research specifically examining the finance-performance nexus for SMEs in Kabale Municipality is scarce, creating an evidence gap that this study sought to address (Christopher & Nelson, 2024).

3.0 Main Objective

The main objective was to examine the relationship between access to finance and SME performance in Kabale Municipality, Uganda. Specific objectives were: (i) to assess the effect of access to bank credit on SME performance; (ii) to determine the effect of access to microfinance on SME performance; and (iii) to evaluate the effect of access to equity and informal finance on SME performance in Kabale Municipality.

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4.0 Literature Review

4.1 Theoretical Framework

The study was grounded in the pecking order theory of capital structure (Myers & Majluf, 1984), which posits that firms prefer internal financing over external finance, and debt over equity when external finance is required. In the SME context, this theory predicts that SMEs first exhaust internal savings before seeking bank loans, then informal finance, and lastly equity, due to information asymmetries and transaction costs (Alex & Moses, 2024). The study also drew on the resource-based view (Barney, 1991), which argues that access to strategic resources including financial capital constitutes a source of competitive advantage that drives superior performance. From this perspective, SMEs with greater financial access possess a resource advantage that enables investment, innovation, and growth (Ronald et al., 2023).

4.2 Access to Bank Credit and SME Performance

The relationship between bank credit access and SME performance is extensively documented in the literature (A. G. Kazaara & Christopher, 2023). Beck et al. (2008) found across a multi-country study that firms with greater access to external finance grow faster than those constrained by limited credit access. In Uganda, Asiimwe (2017) found that bank credit significantly improved SME asset acquisition, inventory management, and revenue growth. However, the conditionality attached to bank lending particularly collateral requirements often excludes smaller and younger SMEs from accessing formal credit (A. G. Kazaara & Christopher, 2023). High interest rates compound this challenge, with Ssendaula (2019) reporting that Ugandan SMEs that do access bank loans frequently struggle to service them, particularly during periods of business downturn.

4.3 Microfinance Access and SME Performance

Microfinance has emerged as a primary financing alternative for SMEs that lack access to formal bank credit (Ivan et al., 2023). Empirical studies in Uganda by Turyahebwa et al. (2013) found that MFI credit significantly improved SME performance, particularly when accompanied by business development services. The group-lending mechanism facilitates access among collateral-poor SMEs through social capital and peer accountability (Turyatamba et al., 2022). Nevertheless, limitations of microfinance for SME growth include small loan ceilings, short repayment periods, and high effective interest rates that constrain the depth of enterprise expansion possible through MFI financing (Turyatamba et al., 2022).

4.4 Equity and Informal Finance

Equity and informal finance encompassing angel investors, venture capital, family contributions, and informal savings groups represent important supplementary finance sources for SMEs (A. I. Kazaara & Audrey, 2024). Coleman (2000) found in the United States that women-owned SMEs relied more heavily on informal finance due to greater exclusion from formal credit markets. In Uganda, Rotating Savings and Credit Associations (ROSCAs) provide predictable, interest-free or low-cost access to lump-sum capital that SMEs use for equipment purchases and working capital

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(Aryeetey, 2008). While informal finance fills critical gaps, its scale and predictability are limited, constraining its role in financing significant enterprise expansion(Sarah et al., 2024).

5.0 Methodology

A cross-sectional descriptive survey design was employed. The target population comprised all registered SMEs in Kabale Municipality operating across sectors including retail trade, food and beverage, manufacturing, transport, and professional services(Sarah et al., 2024). Using the Uganda Registration Services Bureau (URSB) register, a sampling frame of 380 SMEs was identified(Nafiu et al., 2012). Stratified random sampling was used to select 150 SMEs, with strata defined by sector and business size (micro, small, medium)(A. Nafiu et al., 2012). Data collection employed a structured questionnaire with Likert-scale items measuring access to finance dimensions (bank credit access, microfinance access, equity/informal finance access) and SME performance dimensions (revenue growth, profitability, operational efficiency, market expansion). The questionnaire was pre-tested on 15 SMEs not included in the main sample, and Cronbach's alpha reliability coefficients exceeded 0.70 for all constructs. Data were analysed using SPSS version 25, applying descriptive statistics, Pearson correlation analysis, and multiple linear regression(Nelson et al., 2022).

6.0 Results and Discussion

6.1 Descriptive Statistics

Of the 150 questionnaires distributed, 143 (95.3%) were successfully completed and returned, forming the basis of the analysis. The majority of respondents (58.7%) were male, and most (72.7%) had been in business for between 3 and 10 years, indicating a relatively established SME population. Retail trade was the dominant sector (41.3%), followed by food and beverage services (23.1%) and manufacturing (18.9%). Regarding financing, the majority of SMEs relied on personal savings (84.6%), followed by microfinance (61.5%), family/friends (53.1%), and bank loans (29.4%), with only 8.4% having accessed any form of equity investment. Table 1 below provides descriptive statistics for the main study variables.

Variable	N	Mean	Std. Dev.	Min	Max
Bank Credit Access	143	2.87	1.12	1.00	5.00
Microfinance Access	143	3.54	0.91	1.00	5.00
Equity/Informal Finance Access	143	3.21	0.98	1.00	5.00
Financial Performance	143	3.38	0.86	1.20	5.00
Operational Efficiency	143	3.45	0.79	1.40	5.00
SME Performance (Composite)	143	3.42	0.82	1.30	5.00

Source: Primary Data, 2025

The descriptive statistics in Table 1 reveal that microfinance access recorded the highest mean score among the finance access variables (3.54), reflecting its relatively greater prevalence and perceived accessibility among SMEs in Kabale Municipality compared to formal bank credit. Bank credit access scored the lowest (2.87), consistent with the documented barriers to formal banking encountered by SMEs in the municipality (Alex & Kazaara, 2023). Equity and informal finance access scored 3.21, reflecting the moderate role of family contributions and ROSCAs in supplementing other financing sources (Ahumuza et al., 2025). The composite SME performance score averaged 3.42, suggesting moderate overall performance levels. Operational efficiency slightly outscored financial performance, indicating that while SMEs manage their day-to-day operations reasonably well, translating operational efficiency into financial growth remains challenging — a pattern often associated with limited capital for scaling (Julius & Kazaara, 2026).

6.2 Correlation Analysis

Variable	1. Bank Credit	2. Microfinance	3. Equity/Informal	4. SME Performance
1. Bank Credit Access	1.000			
2. Microfinance Access	0.318**	1.000		
3. Equity/Informal Finance	0.274**	0.389**	1.000	
4. SME Performance	0.621**	0.548**	0.463**	1.000

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

Source: Primary Data, 2025

The Pearson correlation results in Table 2 reveal statistically significant positive relationships between all three finance access dimensions and SME performance. Bank credit access demonstrated the strongest correlation with SME performance ($r = 0.621$, $p < 0.01$), notwithstanding its relatively lower accessibility scores in the descriptive analysis (Nelson et al., 2022). This finding suggests that among the SMEs that do manage to access bank credit, the quantum and terms of funding are sufficiently significant to drive meaningful performance improvement consistent with the notion that formal bank loans enable larger, longer-term investments than microfinance or informal sources. Microfinance access also showed a strong positive correlation with performance ($r = 0.548$, $p < 0.01$), affirming its importance as a performance enabler for the majority of SMEs in the municipality (Nelson et al., 2023). Equity and informal finance, while demonstrating the weakest correlation ($r = 0.463$, $p < 0.01$), still evidenced a meaningful and significant association with performance, underscoring the important supplementary role of family capital and informal savings groups in financing SME activities. The inter-correlations among independent variables (ranging from 0.274 to 0.389) are moderate, confirming the absence of severe multicollinearity.

6.3 Regression Analysis

Model	R	R ²	Adjusted R ²	Std. Error	F	Sig.
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1	0.847	0.718	0.712	0.441	120.98	0.000
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Predictor	B	Std. Error	Beta (β)	t	Sig.
(Constant)	0.524	0.197		2.660	0.009
Bank Credit Access	0.412	0.058	0.412	7.103	0.000
Microfinance Access	0.287	0.064	0.287	4.484	0.000
Equity/Informal Finance	0.219	0.071	0.219	3.085	0.003

Source: Primary Data, 2025

The multiple regression results present a compelling picture of the combined and independent effects of finance access dimensions on SME performance. The overall regression model is highly statistically significant ($F(3, 139) = 120.98$, $p < 0.001$) and explains an impressive 71.8% of the variance in SME performance ($R^2 = 0.718$), with the adjusted R^2 of 0.712 confirming that this explanatory power is robust and generalizable (Nelson et al., 2023). Bank credit access emerged as the strongest independent predictor of SME performance ($\beta = 0.412$, $t = 7.103$, $p < 0.001$), indicating that each unit improvement in bank credit access corresponds to a 0.412-unit increase in performance, holding other factors constant (A. G. Kazaara & Christopher, 2023). This underscores the critical importance of unlocking formal bank credit for SMEs in Kabale Municipality, as it appears to be the most potent financial lever for performance improvement. Microfinance access is the second most significant predictor ($\beta = 0.287$, $t = 4.484$, $p < 0.001$), confirming the important role that MFIs play in financing SME operations and growth in the municipality (Alex et al., 2024). Equity and informal finance access, while the smallest predictor in the model ($\beta = 0.219$, $t = 3.085$, $p = 0.003$), nevertheless makes a statistically significant and economically meaningful contribution to explaining SME performance variance, affirming that diversified financing combining formal credit, microfinance, and informal capital produces superior performance outcomes (Faridah et al., 2023).

7.0 Discussion of Results

The study's results provide strong quantitative support for the hypothesis that access to finance is a significant determinant of SME performance in Kabale Municipality. The finding that bank credit is the most powerful predictor of performance is consistent with Beck et al. (2008) and Asiimwe (2017), who similarly found formal credit to be the most growth-enabling financing source for SMEs. The high explanatory power of the regression model (71.8%) suggests that the financial access framework adopted in this study captures the most critical finance-related determinants of SME performance in the Kabale context (Polycarp et al., 2023). The comparatively lower mean score for bank credit access (2.87) relative to its high performance impact underscores a tragic paradox: the most impactful financing source is precisely the one least accessible to SMEs (Julius & Matovu, 2025). This financing gap represents a significant market failure and policy challenge that demands urgent attention. The significant contribution of microfinance to performance, combined with its relatively higher accessibility, highlights the strategic importance of MFIs as the de facto primary formal financing channel for most SMEs in Kabale, and the need to strengthen and scale up MFI operations in the municipality.

8.0 Conclusions and Recommendations

This study concludes that access to finance encompassing bank credit, microfinance, and equity/informal finance is a significant and powerful predictor of SME performance in Kabale Municipality, collectively explaining over 71% of performance variation. Bank credit access exerts the greatest performance impact but remains the least accessible, while microfinance serves as the primary accessible financing channel for most SMEs. Diversified financing strategies combining multiple sources are associated with superior performance outcomes.

The study recommends that the Government of Uganda, through the Uganda Development Bank (UDB) and the Private Sector Foundation Uganda (PSFU), establish and operationalize a dedicated SME Credit Guarantee Scheme for municipalities such as Kabale, reducing collateral barriers and enabling more SMEs to access bank credit. Commercial banks should develop SME-tailored loan products with appropriate collateral alternatives (such as movable asset financing), lower interest rates, and flexible repayment schedules aligned with business cash flows. Microfinance institutions should expand their presence in Kabale Municipality and increase loan ceilings for growing SMEs that have outgrown entry-level microfinance products. The Kabale Municipality Business Development Unit should provide SME owners with financial literacy and business planning training to improve creditworthiness and loan utilisation efficiency. Future research should employ longitudinal designs to establish causal relationships between finance access interventions and SME performance trajectories over time.

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