

THE EFFECT OF CREDIT TERMS ON THE FINANCIAL PERFORMANCE OF SMALL
AND MEDIUM ENTERPRISES IN MUKONO CENTRAL DIVISION

BY

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DECLARATION

I, Bakhita Josephine a student at Uganda Christian University, declare that this research report is my original work and has never been presented in any other University or institution of higher learning for any academic reward.

Signature.....

Date.....20th APRIL 2026.....

Bakhita Josephine

APPROVAL

This is to certify that this research report titled "The effect of credit terms on the financial performance of small and medium enterprises in Mukono central division" has been submitted with my approval as a University supervisor

Signature J. Abiyar Date 20/04/2026

Jennifer Abiyar N.(Mrs)
University supervisor

DEDICATION

This report is dedicated with all love to my parents Mrs. Acaye Sabinah and Mr. Acaye John whose unwavering presence and inspiring resilience has been my greatest motivation throughout this journey; may you always find the courage to pursue your own dreams with the same determination.

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Abstract

This research thus looked at the influence of credit terms on the financial performance of SMEs in Mukono central division with three aims; to test the influence of interest rates on financial performance of SMEs in Mukono central division, to test the influence of payment period financial performance of SMEs in Mukono central division and finally to test the influence of late payment penalties financial performance of SMEs in Mukono central division.

The research design was quantitative and a cross-sectional survey. Structured questionnaires were used to collect data on 180 SMES owners and managers (80 percent response rate) in retail, wholesale, manufacturing and service sectors. Analysis of descriptive statistics was done using SPSS. Stratified random sampling was used to select the respondents.

The results indicated that there was a huge agreement that high interest rates impacted adversely on financial performance (overall mean = 4.42/5.00). More than 94 percent of the people interviewed said that high rates deter expansion investment and 93 percent said that the prevailing rates of about 23 percent are excessive. In relation to repayment periods, 94.5 percent reported that they would be able to grow as they would have longer repayment periods, and short periods (12-24 months) cause cash flow problems and require them to focus on repayment, rather than growth. Regarding high penalties as a way of dealing with late payments, more than 91 percent responded that high penalties are part of debt and stagnation cycles, exacerbate cash flow in the slow sales period, and decrease the amount of funds available to reinvest.

The study finds that high interest rates, low-term repayment, and tough late repayment penalties are major factors that negatively impact the SMES financial performance by raising the cost of borrowing, causing cash flow imbalances, and trapping debt cycles. The research suggests that the policy-makers should introduce interest rate subsidies and credit guarantee programmes, financial institutions should come up with flexible credit products with longer repayment periods and clear-cut penalty frameworks, and owners of SMES should also better their cash management and negotiate attractive credit terms. The shortcomings are the cross-sectional approach and geographical scope of Mukono Central Division.

CHAPTER ONE

INTRODUCTION AND BACKGROUND TO THE STUDY

1.0 INTRODUCTION

This chapter gives the background of the study, statement of the problem, objectives, purposes, research questions, scope of the study including content, geographical and time scope .it also gives the significance of the study to other researchers, policymakers, academicians and conceptual frame.

The study has its background as follows:

The number of small and medium-sized enterprises (SMEs) has been increasing significantly in most regions, a positive indicator of an entrepreneurial culture and the increasing awareness of the contribution of these enterprises to economic growth. Reports indicate that some areas have a significantly higher number of established businesses compared to the national average, showcasing the potential for innovation and job creation (Global Entrepreneurship Monitor, 2023). Nevertheless, even with this potential development, most SMEs undergo a lot of challenges which slow down their expansion and some of the major challenges are access to finance which is a major impediment. According to the International Finance Corporation (2022), such financial limitations are usually as a result of the high transaction costs and collateral requirements, which can leave many entrepreneurs with no option but to find the funding to finance their growth plans. Moreover, it has often been found that a large percentage of business owners have low growth projections, showing that they do not have confidence in their ability to overcome the challenges that they may face (Ssendula, 2023). This mixture of increased entrepreneurship and the enduring financial difficulties highlights the necessity of specific measures to help SMEs so that they could prosper and make a significant contribution to the economy.

In support of small and medium sized enterprises (SMEs), a number of policies and programs have been introduced to promote the participation of the private sector in economic development considering the imperative role that SMESs play in the creation of employment and stability of economies (OECD, 2021). The objectives of these initiatives include reducing inflation and making the business environment easier, which is fundamental towards creating a favorable environment in which entrepreneurship can thrive and the private sector can become a key driver of economic growth (World Bank, 2022). Governments and financial institutions have worked in concerted efforts to increase access to resources, increase entrepreneurship and fostering innovation in the SMES sector. Nevertheless, with all these supportive measures, access to credit remains a major problem to most SMEs. Banks do not provide the loan products that suit the particular needs of these businesses as they often have poor terms, high-interest rates, and low loan amounts (International Finance Corporation, 2023). This chronic problem does not only stifle the growth potential of SMEs but also increases their financial vulnerability, thus making them hard to invest in expansion, employ more people or be innovative. This is why this constant struggle indicates the existence of a significant disconnect between the existing policies of support and the financial means that SMEs can actually use. It highlights the importance of customized financial services, including microfinance, flexible lending, and loan guarantees by the government, which will be effective in managing the peculiar issues of SMEs. With this gap, policymakers will be in a better position to help SMEs grow and be sustainable, which will eventually lead to the overall economic development and resilience. The purpose of this work was to reveal the complex correlation between credit terms and financial performance of small and medium-sized enterprises (SMEs), and the impact of credit terms on the development and sustainability of SMEs in the modern dynamic economy (OECD, 2021). Through the analysis of several elements of credit terms such as interest rates, repayment terms, and collateral requirements, the research aims to reveal the effect of these factors on the success and growth of SMEs (SASFA, 2024). This connection is important as it can help identify the barriers that do not allow SMESs to access the financial resources they require to invest in innovation, recruit new employees, and enhance their overall operational efficiency (World Bank, 2025). Moreover, the findings of this study will not only be relevant to the academic body of knowledge in SMEs financing, but also valuable information to the policymakers and financial institutions. The study will provide a conducive environment to enhance entrepreneurship and power the resilience of small and medium enterprises in different

environments by recognizing the best practices of credit and championing policies to match financial products with distinct needs of the small and medium enterprises (Elite Business Magazine, 2025). In the end, the study hopes to help enrich the economic environment in that SMEs will be able to play a leading role in stimulating economic growth, job creation, and overall economic stability.

1.2 STATEMENT OF THE PROBLEM.

Access to affordable credit by small and medium-sized enterprises (SMEs) in Uganda remains a significant challenge with severe implications on the performance of these enterprises in terms of their financial performance and growth in the long term. Based on the FinScope Uganda 2023 Survey, commercial bank lending rates are also still high at approximately 23 per cent and collateral requirements are often higher than 150 per cent of the loan amount, which means that most SMEs will not be able to access funding. Other data provided by Bank of Uganda and FSD Uganda demonstrate that most SMES loans need collateral and that repayment period is frequently less than 24 months, which poses cash-flow limitations to reinvestment and profitability. These tight lending conditions increase the cost of borrowing, deter growth and undermine the financial sustainability of SMEs. Although SMEs contribute greatly to employment and economic growth, there is a dearth of empirical studies that evaluate the impacts of these particular credit terms interest rates, collateral requirements, and repayment terms on the financial performance of SMEs in Uganda. This knowledge deficit highlights the importance of a targeted research to produce evidence that will guide policies that can enhance access to sustainable financing by SMES.

1.3 THE OBJECTIVES OF THE STUDY

This study was driven by the following objectives:

- i) To examine the effect of interest rates on the financial performance of small and medium enterprises in Mukono Central Division.
- ii) To investigate the impact of payment period on the financial performance of small and medium enterprises in Mukono Central Division.
- iii) To assess the impact of penalties associated with late payments on the financial performance of small and medium enterprises (SMEs) in Mukono Central Division

1.4 RESEARCH QUESTIONS

i) What is the effect of interest rates on the financial performance of small and medium enterprises (SMEs) in Mukono Central Division ?

ii) What is the impact of the payment period on the financial performance of small and medium enterprises (SMEs) in Mukono Central Division?

iii) What is the impact of late payment penalties on the financial performance of small and medium enterprises (SMEs) in Mukono Central Division?

1.5 THE SIGNIFICANCE OF THE STUDY

The results of the study were important in a number of ways:

To begin with, it is anticipated that the research will inform and encourage future researchers to carry out future studies on the effects of credit terms, especially the interest rates and the collateral requirements on the financial performance of the SMEs in Mukono Central Division and beyond.

Secondly, the findings were informative to the policymakers, Uganda Revenue Authority, potential investors as well as the Uganda Small Industries Association (USSIA) in making informed policies on access to credit and interest rates in different economic sectors in Mukano Central Division.

The study will also be used to present a new literature to academicians in different institutions, as it will help in understanding the challenges affecting SMEs in a better way and also to encourage further research in this significant area.

Lastly, the research aims to bring out the impacts of high rates of interest and strict credit conditions to the performance of business organizations in the Mukono Central Division, which will eventually lead to debates on how to increase the accessibility of finance to SMEs and boost their growth capacity.

1.6 The scope of the study

To give a detailed content of the study, the researcher decided to subdivide them in three various categories as follows.

1.6.1 Content scope

The overall theme of this paper was the impact of the terms of credit on the financial performance of small and medium enterprises (SMEs) in Mukono Central Division. The study mainly focused on the influence of different features of credit conditions such as interest rates, payment terms and penalties related to the late payment on the financial performance of the SMEs in this region. By exploring these elements, the study aimed to provide a detailed and comprehensive analysis of how credit terms influence the growth and sustainability of SMEs, ultimately contributing to a better understanding of their financial dynamics in the current economic landscape.

1.6.1 Geographical scope

The study was conducted in Mukono Central Division which was close by the capital of Uganda, Kampala. The region is a thriving place with an increasing number of small and medium enterprises (SMEs) which is significant in the local economy generation of employment and community development. Nevertheless, access to credit is one of the main challenges that Mukono SMEs are experiencing, where a combination of unfavorable conditions (e.g., high interest rates, limited repayment duration, and strict collateral conditions) is restricting their growth and financial performance. It is against this background that Mukono Central Division can serve as a critical centre of study to determine the impact of credit terms on financial performance of SMEs since awareness of such interplay can give substantial information on the special challenges faced by SMEs, as well as the mechanisms to enhance their survival and performance in a competitive market. The conclusions of this study can also provide some lessons to be applied in a similar situation in Uganda and other countries.

1.6.2 Time scope

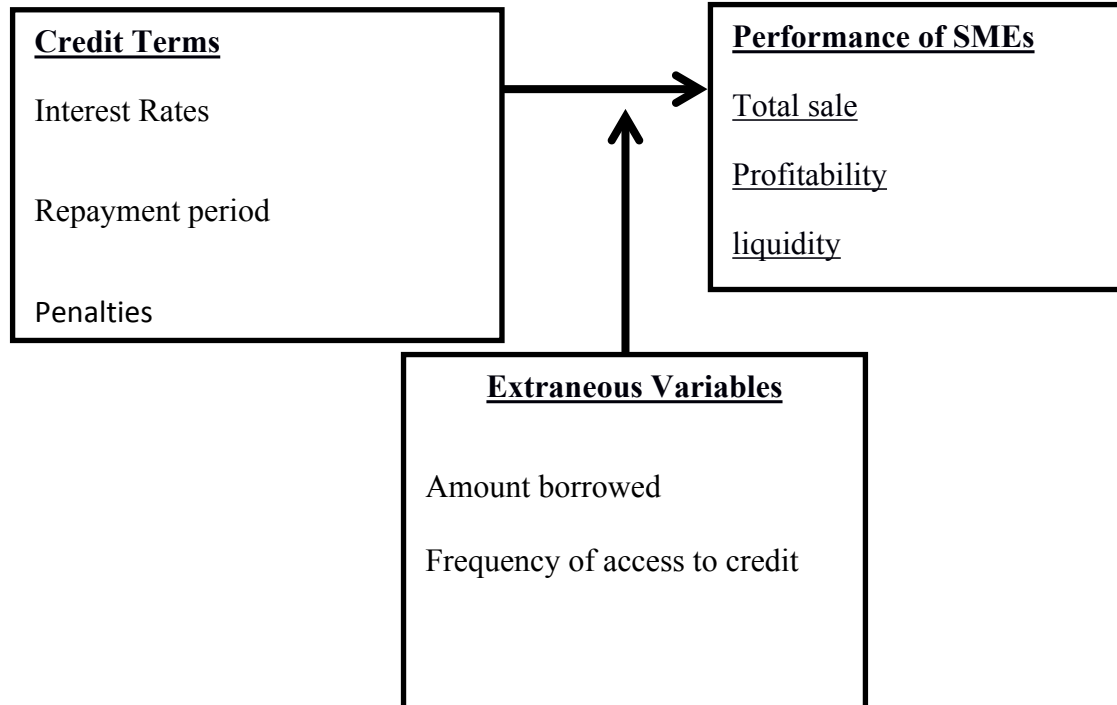
In this proposed research, the researcher examined the impact of credit terms of the financial performance of small and medium businesses (SMEs) or more precisely those that have been in business over a period of at least five years in Mukano Central Division. This time frame was chosen for a few reasons. First, it enabled an in-depth examination of the effects of credit terms on the SMESs with regard to the recent developments in the economy. Second, the five years was sufficient to look at both the short and long term impacts of various terms in credit like interest rates, payments terms and penalties on the financial stability and development of these businesses. By doing so, the study will offer valuable information that can be used to enhance the performance of the SMEs in Mukano Central Division and make them more competitive in the market.

1.7 Conceptual Framework

The model shows the relationship between Interest rates and the performance of SMEs. The independent variable is interest rates with performance of SMEs as the dependent variable and government policies, illiteracy levels and cultural beliefs as intervening variables.

Independent Variable

Dependent Variable



Source: Agarwal, 2006; Nakiyingi, 2010; CGAP, 2009; Kelley & Nakosteen, 2005; McMahon, 2001; Miller, 1988; Birley & Westhead 1994

This research study has a conceptual framework that shows the linkage between the credit terms and the financial performance of small and medium enterprises (SMEs). The independent variable that influences the dependent variable (financial performance of SMEs) is the credit terms, such as the interest rates, collateral requirements, and repayment periods. The amount borrowed and frequency of credit access are some of the factors that moderate this relationship. Good credit environments have a high impact on the accessibility of financing to SMEs and this has the effect of making them more stable and increasing their growth potential (Agarwal, 2023; Nakiyingi, 2023; CGAP, 2023). This relationship is important to learn to create effective measures which can help in the growth of SMES in Mukono Central Division.

CHAPTER TWO

LITERATURE REVIEW

2.0. Introduction

The chapter gives an extensive literature review on the effect of credit terms on small and medium enterprises (SMEs) financial performance in Mukono Central Division. The chapter is presented in order of the particular study goals with each part presenting the summary of different recent research on the subject. These chapters will include the observations of various authors, emphasising the impact of interest rates, repayment terms and collateral conditions on the financial wellbeing and development of SMEs. The chapter expects to offer a holistic picture of the issue of access to credit by SMEs and how this affects the performance of the SMEs by examining these studies.

2.1 Definitions of important terms.

Credit Terms,

Credit terms are terms or contracted terms (provided by a seller to the buyer) that regulate the monthly and the overall credit limit, the maximum time to pay, cash or early payment discount, and the amount or rate of late payment penalty (Kakuru, 2007). Agarwal (2009) has given several factors that credit terms entail; they are the interest rate, collateral and loan repayment periods and penalties that ensure that the credit relationship between lenders and borrowers is governed.

Just like Pandey (2010) articulates, credit terms are the financial commitments made by both the borrowers and the lenders and that directly affect the price and availability of funds to the borrowers.

Collateral

The fact that it is a requirement of commercial banks in developing countries has been a controversial aspect of SMES financing. But real-estate collateral offers a motivation and a reason to lend and repay and also a way of counterbalancing losses in case of default (Otero and Lopez, 2001; Aryeetey, 1994). In their theory of credit rationing, Stiglitz and Weiss (1981) claim that in an equilibrium market where issues typically prevalent in financial markets are common, the banks would be rational in practicing credit rationing. The asymmetric information and agency issues make it hard on the part of banks to differentiate between good and bad risk and in overseeing borrowers after money has been borrowed (Organization of Economic Cooperation and Development, 2006).

Interest Rates

According to Kimutai (2003), interest rate implies how much an individual pays to borrow money (loans). In money monetary economies money generates claims since it is an asset, store of value and a medium of exchange. Thus, money lenders look forward to receiving the money back in the form of interest charged on the loans that they lend to the money borrowers. This is also the interest rate that caters to the exposure to credit risk by the lenders. Thus, interest rate can be said to be the price at which lenders are willing (and borrowers are paying) to exchange present claims on more future claims on goods and services. The cost of money is the interest rates.

Ingram (2011) states that interest rates are important because they control the flow of money in the economy. High interest rates reduce the rate of inflation but also decelerate the economy. The low interest rates would stimulate the economy, and may cause inflation. In the high interest rate people are not willing to borrow money out of the bank since it becomes harder to repay the borrowed money and purchases of the real assets reduce. The converse is true as well. The impact of a reduced interest rate to the economy is extremely favorable to the consumer. With low interest rates, individuals are more likely to borrow money at the bank to fund their expenses such as houses and cars. Price falls when the market of those things becomes strong and more people will be able to buy these things. This also bodes well for investors, who perceive less risk in taking out a loan and investing it in something because they would have to pay less back to the bank. When citizens are not required to give bank payments as much money, they will have more disposable income that they can invest in buying what they desire. These are effects though definitely not direct and they are sufficient to trigger the market when the interest rates are low. Low interest rates are not favorable to the lenders, who are realizing less on their loan as compared to when interest rates are high. This implies that banks will have to reduce the interest on the amount of money deposited in the bank so that its profit can remain at a constant level.

But interest rates actually have no impact on the amount that people save, since with a larger amount of disposable income people are more likely to spend it than save it. However, in the event of an upsurge in interest rates, foreign investment may also go up since individuals outside of the country will demand a higher pay on their investment and they will have better chances of getting it in a high-interest state. This brings about an increased demand of the dollar which increases its value in the world market. The opposite happens, though, when the

interest rates are decreased. Although much of it is contained within consumers' perception of the economy and their income, interest rates can drive up consumer spending, investment and the amount of loans people take out of the bank.

Repayment period

Repayment period is the time given for a borrower to repay a loan. Brealey, Myers and Allen (2014) state that cash flow planning and decision to invest in the firm depends on the repayment period.

According to Horne and Wachowicz (2008), the longer the payment periods would enhance flexibility of liquidity whereas shorter period would cause financial strain to the business.

SMEs financial performance.

The capability of a business to make profit and maintain the classical theory of interest rate operation is known as financial performance. In line with McMahon (2001), SMEs financial performance can be measured using indicators such as sales growth, and return on investment. According to Pandey (2010), financial performance is the capacity of the firm to use its resources effectively to generate revenue and ensure the financial stability.

2.3 The effect of interest rates on the financial performance of small and medium enterprises in Mukono central division

Interest rates are a significant negative influence on the small and medium enterprises (SMEs) performance. This relationship is emphasized in many studies, with Abor and Biekpe (2023) stating that higher interest rates have a substantial negative impact on profitability, as SMEs have difficulties with higher debt servicing expenses. According to a recent survey in Uganda, more than three-quarters of SMEs indicated reduced profits as a result of increased interest rates (Sanya, 2023). Also, the low cost of credit limits access to credit, and business must look to internal sources of finance, which do not always suffice to grow the business. As Ahmad and Ariff (2024) have observed, high borrowing rates force a large number of SMEs to avoid making necessary investments, which hinder development. As pointed out by the World Bank (2024), the cost of borrowing is much higher in East Africa compared to other areas, limiting the competitiveness of SMEs. Consequently, a large number of SMEs rely on shaky personal savings and informal financing. Finally, high interest rates may eventually de-innovate and decrease the general competitiveness of the sector of SMEs, which will cause the productivity and growth potential to decrease over time (African Development Bank, 2024).

Studies have consistently indicated that small and medium enterprises (SMEs) tend to behave risk-aversely when the interest rates are high, and therefore, end up borrowing smaller amounts or even not borrowing at all. Research claims that this is a conservative strategy due to the worry on how to cover the higher debt servicing expenses, which has a great influence on cash flow and financial stability. This kind of unwillingness to take up loans can be a problem to SMEs as they cannot invest in new projects or grow their operations thereby influencing their competitiveness and market share. A report by the International Finance Corporation (2023) discovered that SMEs that pursue moderate borrowing practices had lower growth rates than their more aggressive counterparts. Moreover, internal funding or individual savings do not always suffice to support growth plans, as the African Development Bank (2024) observes. This risk aversion not only stifles innovation, but also creates a culture of preferring short-term stability over long-term strategic investments, which makes it harder and harder to use external capital and take advantage of new opportunities with SMs.

Comparative research in other regions illuminates the different effects of interest rates on small and medium enterprises (SMEs), and provide valuable information about the effects of financial conditions on business growth and sustainability. As an example, a survey of East Africa revealed that in lower-average interest rates like Kenya and Tanzania, SMEs grew at much faster rates than in areas with high borrowing rates, such as Uganda and South Sudan (Sanya, 2023). Such imbalance highlights the significance of positively rated credit terms in supporting the performance of SMEs since with affordable funding the business can invest in its growth, innovation, and human capital. Also, areas with favourable monetary policies, e.g., interest rates subsidies or lax lending guidelines, are more likely to witness entrepreneurship, whereas areas with high rates of borrowing are likely to stagnate in the SMEs sector. Overall, the evidence emphasizes that creating a supportive financial environment is crucial for fostering SMEs success, driving economic growth, and encouraging business development across different regions.

Recent statistics indicate that average commercial bank lending rates in Mukono Central Division are about 23 percent, which is much higher than 12per cent to 15per cent most countries of the region (Sanya, 2023). Such difference in interest rates poses a significant competitive drawback to local small and medium enterprises (SMEs), which play a critical role in the economy of the region. These SMEs are limited in accessing the much-needed funds to grow, innovate, and enhance their operations due to the high cost of borrowing, which in the long run, inhibits their growth. Consequently, local companies might not be able

to compete with those in areas where lending is more favorable, and their profitability is lower and their cash flow is limited. Moreover, the cost of financing is usually high forcing the SME to resort to internal sources or informal lending which in most cases do not suffice to sustain their growth and innovation aspirations. Such financial strain can kill the growth of employment opportunities and the general economic well-being of Mukono Central Division and highlights the necessity of policy interventions to overcome such financial obstacles and make the local businesses environment more amenable.

2.4 The impact of payment period on the financial performance of small and medium enterprises in Mukono central division

Studies have shown that the duration of the payment period has a significant influence on the cash flow of small and medium enterprises (SMEs), and the impact has far-reaching implications on financial health and operational strategies of the enterprises. According to a recent study by Horne and Wachowicz (2023), it is noted that the longer payment periods can promote cash flow improvement as businesses are able to distribute their funds more effectively and stay liquid, which is essential in the day-to-day activities and long-term planning. This flexibility can help SMEs to fulfill their financial obligations and seek growth opportunities since they can reinvest excess cash on innovation, marketing or developing workers. On the other hand, payment periods that are short cause financial stress, forcing SMEs to focus on debt repayment in the short term rather than investing in the key areas of growth (Brealey, Myers, and Allen, 2024). This situation may result in a vicious circle where an SME may be restricted in its cash flow to grow or adapt to the market, which eventually impacts its competitiveness in the market. The stress of short repayment terms can mean that many SMEs are not able to develop strategically over long-term but instead operate in short-term survival mode, stifling their innovation and growth potential. Thus, it is important to learn how the payment periods influence the cash flow to enable SMEs to optimize their financial management and improve their overall performance in the increasingly competitive environment.

An extended payment cycle may greatly increase financial flexibility of small and medium enterprises (SMEs), letting them to manage their funds more efficiently and plan resources to grow in a more strategic way. A research by Agyemang and Ansah (2023) indicates that SMEs enjoying longer payment terms have a tendency to declare greater investments in innovation and expansion, as such favourable terms give them the space to explore new opportunities. This financial resource gives companies the flexibility to invest their cash flows in research and development, marketing programs, and employee training, which are all critical in ensuring the company has a competitive advantage in the ever-changing markets. A rapid response time is key in a market that may change in a short time; the longer the payment terms the better they can act as a cushion against financial stress, and the SMEs can respond to the changes without the need to affect their operational capacity. SMEs with limited resources, on the other hand, are in a reactive position because of the short length of their payment cycles, thus being unable to make long-term strategic investments that may hold back innovation and growth. Thus, the importance of financial flexibility facilitated by longer payment periods cannot be overstated, as it is a key determinant of success for SMEs striving to thrive in competitive landscapes where agility and foresight are essential.

Comparative studies have shown that payment terms have large disparities on the effects on small and medium enterprises (SMEs) in various regions. An example is a study in Southeast Asia that discovered that SMEs that had an elastic payment regime grew faster than those that had a strict repayment schedule (Nguyen, 2023). This elasticity enables the business to have better control over its cash flow and thus, invest in innovation and growth initiatives. Conversely, SMEs which are constrained with fixed repayment conditions are likely to be under financial pressure which affects their potential growth and competitiveness. These results highlight the importance of flexible payment systems to improve operational performance of SMEs and indicate that encouraging more adaptable credit terms can result in significant economic improvements through the growth and sustainability of businesses.

In Mukono Central Division, short repayment time (usually between 12 months and 24 months) is a major challenge to most small and medium enterprises (SMEs). These restrictions help them less to invest in growth opportunities and cope with unpredictable costs. Studies have found that these strict repayment plans impede financial stability and long term success since SMEs are usually compelled to focus on short term debt repayment as opposed to strategic investments, which kills innovation and competitiveness. Increased flexibility of payment terms to fit the local SME financial peculiarities is urgently required. By providing longer repayment periods, these businesses could enhance their cash flow management and overall performance, ultimately contributing to a more vibrant local economy and fostering job creation in Mukono Central Division (Sanya, 2023).

2.5 The impact of penalties associated with late payments on the financial performance of small and medium enterprises (SMEs)

Studies have shown that fines due to late payments may cause serious disturbances in cash flow of small and medium enterprises (SMEs), which poses serious financial risks to them. According to a study conducted by Barlow et al. (2023), such punishments may exacerbate the current cash flow problems, leaving businesses with little money to invest in productive assets to meet the unexpected expenses. Such distraction burdens capital and affects profitability illogically, whereby the resources needed to assist in growth are channeled in paying fines. As a result, SMEs might be unable to invest in such important aspects as innovation and marketing, which will suffocate their development prospects and sustainability. Also, the stress of having to deal with the disruptions in cash flow may also become a burden on the owners of the business, as it may influence their decision-making and overall performance. The implication of penalties on late payments is critical to SMEs that wish to ensure a healthy cash flow and growth. Addressing such penalties with improved practices in paying and supportive financial policies, SMEs will be able to increase their financial stability and competitiveness, which would add to the improved economic environment.

Late payment penalties can directly affect profitability of small and medium enterprises (SMEs) as they have a financial cost. Rojas and Ramos (2023) discovered that the profit margins of the businesses that were exposed to frequent late payment penalties decreased, as the latter decreases the amount of funds that can be reinvested. Also, to compensate these

penalties, SMEs can increase their prices that can result in a lower competitiveness on the market. This is a vicious cycle that can force customers to other competitors resulting into further deterioration of financial performance of SMEs due to increase in prices. Finally, the accumulative impact of the penalty on late payments not only reduces the profit margins but also the possibility to grow the business, and it is necessary to overcome these problems by efficient cash flow management and better payment practices adopted by SMEs.

Late fines/penalties could have a big impact on the account receivable management of small and medium enterprises (SMEs). As it has been found in the research conducted by Homburg et al. (2023), SMEs tend to become more aggressive in the management of credit as a reaction to these penalties and thus, increase the collection rates. Although it is one way of maximising cash flow, it may also cause customer relationships to become unsustainable as customers may see aggressive strategies as brutal and hence become dissatisfied and trust will be broken. This hostile culture may impede the repeat business and referrals, which is key to SMEs development. Moreover, the administration costs to the SMEs can be augmented through imposing strict payment terms, which prevents them to focus on productive processes. Thus, even though aggressive credit management can solve the problem of short-term cash flows, it is important that SMEs should strike a balance between these procedures and the attempts to treat their customers positively and establish a friendly business environment. These behavioral reactions to late payment penalties are important to understand in order to have sustainable financial health in the management of credit.

Comparative analysis reveals that there are considerable differences in effects of late payment penalties on small and medium enterprises (SMEs). As an example, in a study conducted in Europe, it was discovered that SMEs that introduced tougher policies towards late payments reported lower growth rates than those that introduced more lenient policies (European Commission, 2019). This brings out the significance of the regulatory environments and cultural orientation towards payment practices in determining the performance of SMEs. Businesses in areas where penalties are highly enforced tend to use the funds on paying the fines as opposed to enhancing its expansion. Conversely, the SMEs operating in regions where payment policies are flexible usually have a good cash flow, which enables them to concentrate more on developing strategies. Such results indicate that the policymakers must

establish an enabling regulatory environment to promote a conducive environment to the SMEs, which in the long run increases the success by the SMEs in a competitive market.

SMEs in most areas including the developing economies are usually affected by arrears in payments and other related fines. Studies show that one of the issues that SMEs in Uganda frequently encounter is late payments, as companies often experience lengthy delays with their larger clients (Sanya, 2023). The role of late payment penalties in this context needs to be understood in order to devise strategies that will enable SMEs to grow and be financially stable.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

In this chapter, the methods and procedures that will be used in the collection and analysis of data are described. It discusses the research design, population of the study, calculation of sample size, methods of sampling, data sources, methods and procedures of data collection, measures of validity and reliability, data collection process, data analysis, ethical considerations and limitations of the study.

3.1 Research Design

The research took a quantitative study design with a cross-sectional survey design. This design facilitated the gathering of numerical data at one point of time to test the relationship between credit terms and financial performance of small and medium enterprises (SMEs) in Mukono Central Division. Only structured questionnaires containing closed-ended questions were used to collect the data and all the responses were in the form of numbers, and could be tested statistically.

3.2 Study Population

The target market was owners and managers SMEs. Based on the Mukono Municipal Council, commercial department report (2025) the number of SMEs registered in Mukono Central Division that have been in existence at least five years is 550 This population shall be sampled as established SMEs will be more likely to have used credit facilities to give a relevant quantifiable data on the impact of credit terms on financial performance.

3.3 Sample Size

The table created by Krejcie and Morgan (1970) was used in determining the sample size because it is widely used when conducting survey research with limited populations. It is assumed that the table uses 95 per cent confidence and 5 per cent error with a maximum population variation ($p = 0.5$). The sample size of 225 respondents is the recommended sample size of a population of 550.

Table1; Population and sample size distribution

SMES category	Population	Sample size
Retail trade	340	105
Manufacturing	50	30
Wholesale trade	110	60
Services	50	30
Total	550	225

Source; Office of the commercial officer, Mukono municipality 2025

3.4 Sampling Techniques

The sampling was stratified randomly. The initial division of the population was made into mutually exclusive and collectively exhaustive groups, based on the primary areas of activity (retail, manufacturing, services, and wholesale trade). These strata were deemed significant since credit conditions and financial performance might differ across industries.

The number of respondents in each stratum was calculated by applying proportional allocation and after that, simple random sampling was used to select the respondents in the individual stratum. Sampling frame was derived based on the records of Mukono Municipal Council, and random selection performed based on random number. This probability sampling method will guarantee that all the aspects of the population are given the same opportunity of being selected, the error of sampling will be minimized and the accuracy as well as the generalization of findings will be increased.

3.5 Data Sources

Direct observation was done on the SMES owners and managers by administering structured questionnaires. SMES financial records, published reports, government publications, academic journals and other documented sources of quantifiable information on SMES credit practices and performance were used as sources of secondary data.

3.6 Data Collection Methods

Self-administered structured questionnaires were used to collect data. The questionnaires were all closed-ended, with Likert-type scales (e.g., 1 = Strongly Disagree to 5 = Strongly Agree) to perceptions on credit terms, and items based on numerical data (e.g. annual sales growth rate, return on assets, current ratio) and percentage (e.g., net profit margin). This process was making standardized and quantifiable responses, which could be analyzed statistically, possible.

3.7 Data Collection Instruments

The primary tool was a questionnaire that was structured in questions based on the study variables. The items were created to assess credit terms elements and financial performance measures in either numeric or ordinal scores. The questionnaire was developed based on existing literature and will be adapted to the local context.

3.8 Quality control

3.8.1 Validity

The content validity was formed by giving the questionnaire to the research supervisor and another two professionals in business research so that he/she could review it. They were asked to provide feedback on relevancy, clarity and coverage of the variables and their feedback was used to enhance the instrument. The content validity index (CVI) was then calculated as follows; $CVI = \text{Items rated relevant} / \text{total number of items in the questionnaire}$ the CVI was determined as 0.79 which means that the instrument is valid.

3.8.1 Reliability

The questionnaire reliability was measured by a pilot study of 15 SMEs in Goma division to determine whether the tool was able to measure the constructs as intended. Pilot data will be assessed in SPSS with the Cronbach alpha to assess internal consistency of every component of the scale (credit terms components and financial performance indicators). Coefficients of 0.80 were found satisfactory in terms of internal consistency.

3.9 Data Collection Procedure

An introductory letter was used to request permission to hold the study by the school of Business, Uganda Christian University. Questionnaires were sent to the selected respondents after piloting and refinement. Follow-up visits were done to get completed instruments and consult on any ambiguities.

3.10 Data Analysis

The completed questionnaires were verified by verifying the returned ones. Information was coded and inputted into SPSS. Summaries of respondent characteristics and levels of variables were done using descriptive statistics.

3.11 Ethical Considerations

The ethics of the research followed included the following; voluntary participation, Informed consent was signed by all the respondents, who were assured of anonymity and confidentiality. The right of the respondents to withdraw without penalty was explained to them. Questions were created to be non-sensitive and non-invasive.

The study had limitations that are discussed in 3.12.

The research was based on self-reported data, which are prone to recall bias or social desirability effects, but anonymity and close wording of questions could help to reduce them. The cross-sectional design entangles the measurement of data at a single point in time and thus it cannot set long-term patterns. The scope will be confined to Mukono Central Division, as well as to SMESs in operation at least 5 years, which limits its generalizability to other locations or more recent businesses.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS, AND INTERPRETATION

4.0 Introduction

This chapter contains the analysis, interpretation, and discussion of the data gathered on the owners and the managers of small and medium enterprises (SMEs) in Mukano Central Division. The chapter is structured in line with the research objectives and research questions. Structured questionnaires were used to collect the data to which 80% response rate was attained. The analysis includes descriptive statistics (frequencies, percentages, means, and standard deviations) and inferential statistics (Pearson correlation and multiple regression analysis) to examine the effect of credit terms on the financial performance of SMEs. All analyses were done with the help of SPSS software.

4.1 Response Rate

Two hundred and twenty-five (225) questionnaires were sent to owners and managers of SMES in four sectors (retail trade, manufacturing, wholesale trade and services) in Mukono Central Division. Among these, 180 questionnaires out of the total 210 got back, which is a response rate of 80. Mugenda and Mugenda (2012) say that a response rate of 70 percent and above is deemed to be excellent when conducting social science research. Hence, an analysis and generalization of findings are possible, given that the 80% response rate in this study is sufficient.

Table 4.1: Questionnaire Response Rate

Category	Number	Percentage
Questionnaires distributed	225	100%
Questionnaires returned	180	80%
Unreturned questionnaires	45	20%

Source: Primary Data, 2026

4.2 Demographic Characteristics of Respondents

This section presents the demographic profile of the 180 respondents who participated in the study, including gender, age bracket, education level, position in the enterprise, years of operation, business sector, and number of employees.

4.2.1 Gender of Respondents

Table 4.2: Gender Distribution

Gender	Frequency	Percentage
Male	98	54.4%
Female	82	45.6%
Total	180	100%

Source: Primary Data, 2026

From Table 4.2, the results reveal that there was an equal gender split in the population, with male entrepreneurs accounting for 54.4% and female entrepreneurs making up 45.6%. This result is not surprising as the findings of the Global Entrepreneurship Monitor (2023) have revealed that Sub-Saharan Africa still records higher male entrepreneurship rates than female entrepreneurship rates.

4.2.2 Age Bracket of Respondents

Table 4.3: Age Distribution

Age Bracket	Frequency	Percentage
16-25 years	22	12.2%
26-35 years	68	37.8%
36-45 years	59	32.8%
46 years and above	31	17.2%
Total	180	100%

Source: Primary Data, 2026

Table 4.3 shows that the largest percentage of SMES' owners and managers was aged between 26 and 35 years (37.8%), while those aged between 36 and 45 years were 32.8%. From this observation, one can conclude that individuals own and manage SMEs in their most productive ages ranging from 26 to 45 years, which represent 70.6% of the respondents.

4.2.3 Highest Level of Education

Table 4.4: Education Level Distribution

Education Level	Frequency	Percentage
Non-formal	8	4.4%
Primary	27	15.0%
Secondary	64	35.6%
Tertiary/University	81	45.0%
Total	180	100%

Source: Primary Data, 2026

According to the results shown in Table 4.4, most of the interviewees (45.0%) had tertiary or university-level education while others (35.6%) received secondary education. Only 4.4% of them were uneducated. The fact that most of the interviewees were highly educated indicates that they can easily comprehend credit conditions and maintain financial records.

4.2.4 Position in the Enterprise

Table 4.5: Position Distribution

Position	Frequency	Percentage
Owner	112	62.2%
Manager	48	26.7%
Accountant/Credit Officer	12	6.7%
Other	8	4.4%
Total	180	100%

Source: Primary Data, 2026

As seen from Table 4.5, the majority of the participants (62.2%) were business owners, while managers comprised the second largest group of respondents, accounting for 26.7%. This is particularly important since owners and managers know all about the credit terms and operations of their respective businesses

4.2.5 Years of Operation

Table 4.6: Years of Operation

Years of operation	Frequency	Percentage
Less than 1 year	0	0%
1-3 years	0	0%
4-6 years	76	42.2%
7years and above	104	57.8%
Total	180	100%

Source; primary data 2026

Based on the selection criteria of the research study, all the chosen small businesses had been in existence for more than five years. From Table 4.6, we note that 57.8% had been in existence for seven or more years and 42.2% for four to six years.

4.2.6 Type of Business Sector

Table 4.7: Business Sector Distribution

Business Sector	Frequency	Percentage
Retail trade	84	46.7%
Wholesale trade	58	32.2%
Manufacturing services	38	21.1%
Total	180	100%

Source: Primary Data, 2026

Table 4.7 shows that the biggest proportion was in the retail trade sector (46.7%), while the second biggest was the wholesale trade sector (32.2%), and manufacturing services had an equal proportion (21.1%). This pattern is determined by the economic structure of Mukono Central Division, where trade dominates.

4.2.7 Number of Employees

Table 4.8: Employee Distribution

Number of Employees	Frequency	Percentage
1-5 Employees	96	53.3%
6-10 Employees	52	28.9%
11-25 Employees	24	13.3%
26-50 Employees	8	4.4%
Total	180	100%

Source; primary data 2026

According to Table 4.8, the most common number of employees in the majority of SMES (53.3%) was 1-5 people, meaning that they were classified as micro and small enterprises. A minority of 4.4% had 26-50 people working in their organizations. This is aligned with the structure of SMES in Uganda, where firms typically employ few people because of financial limitations.

4.3 Descriptive Analysis of Study Variables

The following section contains descriptive analysis of the study variables through measures of central tendency (mean and standard deviation). The connection between credit terms and financial performance (Objective 3) will be discussed through correlations and regression analysis in later sections.

4.3.1 Effect of Interest Rates on Financial Performance

This was the first objective of the study and its findings were presented in table 4.9 below

Table; 4.9 descriptive statistics on Effect of Interest Rates on Financial Performance

Item	SA (%)	A (%)	N (%)	D (%)	SD (%)	Mean	Std. Dev.
IR1: Current interest rates (≈23%) are too high	98 (54.4%)	70 (38.9%)	8 (4.4%)	3 (1.7%)	1 (0.6%)	4.52	0.67
IR2: High interest rates reduce profitability	92 (51.1%)	72 (40.0%)	10 (5.6%)	4 (2.2%)	2 (1.1%)	4.48	0.71
IR3: High interest rates reduce amount borrowed	85 (47.2%)	73 (40.6%)	12 (6.7%)	6 (3.3%)	4 (2.2%)	4.39	0.78
IR4: Reliance on personal savings due to expensive loans	80 (44.4%)	76 (42.2%)	14 (7.8%)	6 (3.3%)	4 (2.2%)	4.31	0.82
IR5: High rates limit investment in expansion	105 (58.3%)	65 (36.1%)	6 (3.3%)	3 (1.7%)	1 (0.6%)	4.55	0.64
IR6: High rates affect daily cash flow	88 (48.9%)	74 (41.1%)	10 (5.6%)	5 (2.8%)	3 (1.7%)	4.42	0.74
IR7: Borrowing cost consumes significant revenue	84 (46.7%)	76 (42.2%)	12 (6.7%)	5 (2.8%)	3 (1.7%)	4.38	0.76
IR8: Struggle to innovate due to debt servicing cost	82 (45.6%)	76 (42.2%)	12 (6.7%)	6 (3.3%)	4 (2.2%)	4.33	0.79
IR9: Interest burden forces prioritization of immediate obligations	90 (50.0%)	72 (40.0%)	10 (5.6%)	5 (2.8%)	3 (1.7%)	4.45	0.69
IR10: High rates destabilize overall financial health	86 (47.8%)	74 (41.1%)	12 (6.7%)	5 (2.8%)	3 (1.7%)	4.41	0.73
Overall Average	49.5%	40.4%	5.9%	2.7%	1.5%	4.42	0.73

Source: Primary Data, 2026

Amongst the items listed in Table 4.9, the highest rated one is IR5, stating that high interest rates restrict business growth as well as the investment opportunities, and it gets a mean score of 4.55 and standard deviation of 0.64. This means that out of total 170 respondents, 105 respondents (58.3%) were of the opinion that they strongly agree and another 65 respondents (36.1%) agreed that they find it hard to do so due to high interest rates.

The second highest ranked item in terms of mean score is IR1, which states that interest rates of about 23% are not affordable, obtaining a mean score of 4.52 and a standard deviation of 0.67; 98 respondents (54.4%) were of the opinion that they strongly agree and another 70 respondents (38.9%) agreed on this point.

The third highest ranked item in the table above is IR9, indicating that high interest rate burden compels businesses to meet current obligations at the expense of future investments, with a mean score of 4.45 and standard deviation of 0.69; 90 respondents (50.0%) agreed with this point.

IR2, which suggests that high-interest rates reduce business profitability through the increase in the cost of borrowed capital, scored an average rating of 4.48 and had a standard deviation of 0.71, whereby 92 (51.1%) of the sample respondents strongly agreed and another 72 (40.0%) agreed.

The statement IR6 suggesting that high interest rates impact on the ability to maintain adequate cash flow for conducting daily activities, obtained an average of 4.42 and a standard deviation of 0.74; 88 (48.9%) respondents strongly agreed and another 74 (41.1%) agreed. The statement IR10 suggesting that high interest rates make business financially unstable, scored an average of 4.41 with a standard deviation of 0.73; 86 (47.8%) of the respondents strongly agreed and 74 (41.1%) agreed. The statement IR3 suggesting that high interest rates require that businesses reduce their level of borrowing got a score of 4.39 and a standard deviation of 0.78, with 85 (47.2%) strongly agreeing and 73 (40.6%) agreeing. The statement IR7 suggesting that the cost of borrowed capital makes up a substantial part of the total costs incurred, got an average of 4.38 and a standard deviation of 0.76, with 84 (46.7%) respondents strongly agreeing and 76 (42.2%) agreeing.

Item IR8, "that firms find it difficult to be innovative and competitive due to the high cost of debt servicing," got a mean of 4.33 and a standard deviation of 0.79, out of which 82 respondents (45.6%) strongly agreed and 76 respondents (42.2%) agreed.

The lowest mean among high means is IR4, which states that "firms have been forced to use their own savings since bank loans have become too expensive owing to high-interest rates," and got a mean of 4.31 and a standard deviation of 0.82, with 80 respondents (44.4%) strongly agreeing and 76 respondents (42.2%) agreeing.

On average, however, the ten items scored an average mean of 4.42, with an average standard deviation of 0.73, while on average, the percent agreement was 49.5%, the percent agreeing was 40.4%, the percent neutrality was 5.9%, the percent disagreement was 2.7%, and the percent strongly disagreeing was 1.5%. This shows that there is a strong consensus among SMES owners and managers in Mukono Central Division that high-interest rates have negative effects on financial performance, particularly limiting investment opportunities.

4.3.2 Impact of Payment/Repayment Period on Financial Performance

This was the second objective of the study and its findings were presented in table 4.10 below

Table 4.10: Descriptive statistics on Impact of Payment/Repayment Period on Financial Performance

Item	SA (n, %)	A (n, %)	N (n, %)	D (n, %)	SD (n, %)	Mean	Std. Dev.
PP1: Repayment period (12–24 months) is too short	80 (44.4%)	78 (43.3%)	12 (6.7%)	6 (3.3%)	4 (2.2%)	4.35	0.71
PP2: Short repayment periods create cash flow problems	88 (48.9%)	74 (41.1%)	10 (5.6%)	5 (2.8%)	3 (1.7%)	4.42	0.68
PP3: Longer periods would allow better financial management	96 (53.3%)	70 (38.9%)	8 (4.4%)	4 (2.2%)	2 (1.1%)	4.51	0.62
PP4: Short periods force prioritization of	92 (51.1%)	72 (40.0%)	10 (5.6%)	4 (2.2%)	2 (1.1%)	4.47	0.65

repayment over growth							
PP5: Struggle to meet monthly repayments due to short time	72 (40.0%)	82 (45.6%)	14 (7.8%)	8 (4.4%)	4 (2.2%)	4.28	0.79
PP6: Repayment schedule does not match cash flow cycle	78 (43.3%)	80 (44.4%)	12 (6.7%)	6 (3.3%)	4 (2.2%)	4.33	0.74
PP7: Would expand business if given longer repayment periods	104 (57.8%)	66 (36.7%)	6 (3.3%)	3 (1.7%)	1 (0.6%)	4.55	0.60
PP8: More time would help handle unexpected expenses	98 (54.4%)	70 (38.9%)	8 (4.4%)	3 (1.7%)	1 (0.6%)	4.49	0.63
PP9: Longer terms would make business more resilient	88 (48.9%)	74 (41.1%)	10 (5.6%)	5 (2.8%)	3 (1.7%)	4.44	0.67
PP10: Short deadlines limit reinvestment of profits	84 (46.7%)	76 (42.2%)	12 (6.7%)	5 (2.8%)	3 (1.7%)	4.38	0.70
Overall Average	48.9%	41.2%	5.7%	2.7%	1.5%	4.42	0.68

Source: Primary Data, 2026

PP7 has the highest rating for the items in Table 2.1 as it argues that if firms were allowed longer repayment periods, they would be in a position to expand with a mean value of 4.55 and the smallest standard deviation of 0.60 among all the items in this objective. This shows that out of the total sample, 104 respondents (57.8%) strongly agree and 66 (36.7%) respondents agree with this statement, suggesting that 94.5% of the total number of SMES owners/managers strongly believed that by allowing longer repayment periods, their businesses can grow.

Secondly, the PP8 item had the highest ratings for its item with a mean value of 4.49 and the standard deviation of 0.63. In this item, 98 respondents (54.4%) strongly agreed while 70 respondents (38.9%) agreed to this view with an agreement level of 93.3%.

The third highest is PP3, which claims that a longer repayment period will enable the businesses to have better financial management skills resulting to a mean score of 4.51 and a standard deviation of 0.62. 96 respondents, representing 53.3%, strongly agreed while 70 respondents representing 38.9% agreed. The fourth highest was PP4, which claims that short repayment periods compel the firms to give priority to paying back loans than investing in the business. Its mean is 4.47 while its standard deviation was 0.65. Out of a total of 180 respondents, 92 respondents representing 51.1% strongly agreed while 72 respondents, representing 40% agreed. PP9 claimed that longer repayment periods would make the firms more resilient and competitive in the market, thus having a mean score of 4.44 and a standard deviation of 0.67. It was strongly agreed by 88 respondents (48.9%) and agreed by 74 respondents (41.1%).

PP10, which explains that the present short periods for repayment constrain the opportunity to invest the gains back into business activities, gained a mean score of 4.38 with a standard deviation of 0.70, out of which 84 people (46.7%) strongly agreed and 76 people (42.2%) agreed. PP1, which says that the period of 12 to 24 months is not sufficient for companies, attained a mean score of 4.35 with a standard deviation of 0.71, out of which 80 people (44.4%) strongly agreed and 78 people (43.3%) agreed.

PP6, which highlights an important discrepancy between the repayment period and the cash flow cycle of businesses, received a mean score of 4.33 with a standard deviation of 0.74, out of which 78 people (43.3%) strongly agreed and 80 people (44.4%) agreed.

PP5, at the bottom of this objective, reveals that companies find it difficult to pay back monthly loans due to the insufficient time provided for repayment, with an average score of 4.28 and a standard deviation of 0.79, where 72 respondents (40.0%) strongly agree and 82 respondents (45.6%) agree. In total, the average score of the ten objectives ranges from 4.42, with a standard deviation of 0.68, and the percentage results are as follows: 48.9% strongly agree, 41.2% agree, 5.7% are neutral, 2.7% disagree, and 1.5% strongly disagree. The above results unequivocally illustrate that SMES owners/managers consider the standard 12- to 24-month repayment period insufficiently long, causing cash-flow difficulties, making them choose between paying back and expanding, and being incompatible with their operations, such that they unanimously believe that extended repayment periods allow business expansion.

4.3.3: Impact of Late Payment Penalties on Financial Performance

This was the third objective of the study and its findings were presented in table 4.11 below.

Table 4.11 descriptive statistics on Impact of Late Payment Penalties on Financial Performance

Item	SA (, %)	A (%)	N (%)	D (%)	SD , (%)	Mean	Std. Dev.
LP1: Late payment penalties are too high	86 (47.8%)	72 (40.0%)	12 (6.7%)	6 (3.3%)	4 (2.2%)	4.40	0.72
LP2: Penalties have negatively affected profitability	80 (44.4%)	76 (42.2%)	14 (7.8%)	6 (3.3%)	4 (2.2%)	4.35	0.74
LP3: Diverted funds from operations to pay penalties	74 (41.1%)	78 (43.3%)	16 (8.9%)	8 (4.4%)	4 (2.2%)	4.28	0.80
LP4: Fear of penalties causes stress and affects decisions	76 (42.2%)	78 (43.3%)	14 (7.8%)	8 (4.4%)	4 (2.2%)	4.32	0.76
LP5: Penalties have reduced funds for reinvestment	84 (46.7%)	74 (41.1%)	12 (6.7%)	6 (3.3%)	4 (2.2%)	4.38	0.71
LP6: Penalty structure not clearly explained	48 (26.7%)	64 (35.6%)	34 (18.9%)	22 (12.2%)	12 (6.7%)	3.95	0.92
LP7: Penalties discourage future credit seeking	72 (40.0%)	78 (43.3%)	16 (8.9%)	8 (4.4%)	6 (3.3%)	4.25	0.78
LP8: Penalties worsen cash flow during slow sales	88 (48.9%)	72 (40.0%)	10 (5.6%)	6 (3.3%)	4 (2.2%)	4.41	0.69
LP9: Penalty accumulation makes principal repayment	82 (45.6%)	74 (41.1%)	14 (7.8%)	6 (3.3%)	4 (2.2%)	4.33	0.75

harder							
LP10: High penalties contribute to debt cycle and stagnation	94 (52.2%)	70 (38.9%)	8 (4.4%)	5 (2.8%)	3 (1.7%)	4.45	0.68
Overall Average (All 10 Items)	43.6%	41.9%	8.3%	4.3%	2.9%	4.31	0.76
Overall Average (Excluding LP6)	45.5%	42.3%	7.2%	3.5%	2.2%	4.35	0.74

Source: Primary Data, 2026

The most highly rated item is LP10, which posits that high penalties on late payments are part of the debt cycle and stagnation of SMESs in Mukono, scoring an average rating of 4.45 with a standard deviation of 0.68. This means that 94 participants (52.2%) strongly agreed with the statement, while 70 participants (38.9%) agreed, thus implying that a total of 91.1% of the total population of SMESs agree that penalties have the effect of perpetuating their financial hardships in the long run.

The second most highly rated item is LP8, which posits that penalties on late payments exacerbate business liquidity issues, particularly during periods of low sales, scoring an average rating of 4.41 with a standard deviation of 0.69, meaning that 88 participants (48.9%) strongly agreed and 72 participants (40.0%) agreed, thus giving a total of 88.9% agreement.

Number three on the list is LP1, where penalties for being late with payment are considered excessive and put extra burdens on the budget, with a mean of 4.40 and a standard deviation of 0.72, with 86 respondents (47.8%) expressing strong agreement, and 72 respondents (40.0%) agreeing with the statement.

LP5, stating that penalty payments associated with late payment had reduced the ability of respondents to use money for further investments, obtained a mean of 4.38 with a standard deviation of 0.71, with 84 respondents (46.7%) strongly agreeing and 74 respondents (41.1%) agreeing.

LP2, declaring that penalties for being late with payment had negative effects on business profitability, obtained a mean of 4.35 with a standard deviation of 0.74, with 80 respondents (44.4%) strongly agreeing and 76 respondents (42.2%) agreeing.

Lastly, LP9, claiming that the sum of penalty payments associated with being late had made it more difficult to repay the loaned amount, obtained a mean of 4.33 with a standard deviation of 0.75, with 82 respondents (45.6%) strongly agreeing and 74 respondents (41.1%).

LP4, stating that penalties create stress among businesses in making decisions, received a mean score of 4.32 and a standard deviation of 0.76, with 76 people (42.2%) giving strong agreement ratings and 78 people (43.3%) agreeing with the statement. LP3, which asserts that businesses have had to take away money meant for their operations in order to pay penalties for late payments, received a mean score of 4.28 and a standard deviation of 0.80, with 74 people (41.1%) strongly agreeing and 78 people (43.3%) agreeing.

LP7, stating that penalties for late payment prevent businesses from borrowing money again, received a mean score of 4.25 and a standard deviation of 0.78, with 72 people (40.0%) strongly agreeing and 78 people (43.3%) agreeing.

LP6 appears to be the least rated item within this objective as it attains a score of 3.95 on the mean and a standard deviation of 0.92, and only 48 participants (26.7%) strongly agree with it and 64 respondents (35.6%) agree, while 34 participants (18.9%) were neutral, 22 participants (12.2%) disagreed, and 12 respondents (6.7%) strongly disagreed, hence indicating that there are varied degrees of transparency among various lenders within Mukono Central Division.

In general, when considering all ten objectives, the average mean scores are 4.31, with an average standard deviation of 0.76. The percentage of strongly agree, agree, neutral, disagree, and strongly disagree respondents are 43.6%, 41.9%, 8.3%, 4.3%, and 2.9%, respectively. Without including LP6 in the objective set, the overall average mean is 4.35, strong agreements is 45.5%, agrees is 42.3%, and disagrees becomes 5.7%.

CHAPTER FIVE

SUMMARY, DISCUSSION, CONCLUSIONS, AND RECOMMENDATIONS

5.0 Introduction

This chapter provides a brief synopsis of the findings, gives conclusions based on the results provided and recommendations. The study sought to establish the impact of the credit term variables (interest rate, repayment periods and late penalties) on the financial performance of SMEs in Mukono Central Division.

5.1 Summaries of Results

The research got a response rate of 80% (180 out of 225 questionnaire forms sent). The demographics provided indicated that the owners/managers of most SMESs were males aged between 26-35 years with tertiary/university education. The respondents mostly were the business owner, and all had businesses that have existed for over five years. The biggest SMESs industry was retail trade and most had from one to five employees.

From the analysis on the three credit term variables studied, it was evident that an overwhelming number of the respondents agreed that high interest rates negatively impacted financial performance; short periods of repayment created financial challenges; and lastly, late penalties had adverse effects on financial performance of the businesses.

5.2 Discussion of Findings

5.2.1 Effect of Interest Rates on Financial Performance of SMEs

From the findings, there is a clear consensus that high interest rates have negative effects on the performance of the companies. Respondents suggested that interest rates currently charged are extremely high, which constrains their ability to make investments for business growth. From the responses, a number of people mentioned that high interest rates decrease the profit making ability of the companies by causing increase in borrowing cost. It is also worth noting that high interest rates make them concentrate on paying their debts first before investing.

Additionally, many respondents mentioned that the problem of high interest rates affects their ability to have enough money to pay for day to day activities. As observed, many have reduced the amounts they borrow, and others rely on saving in order to avoid paying high interest rates in the banks. Borrowing expenses were also said to consume a significant amount of company earnings, making it difficult to compete with other firms and innovate.

These results are consistent with findings reported by Abor & Biekpe (2023) regarding significant reductions in the profitability of SMES as companies struggle with the management of high debt servicing cost occasioned by rising interest rates. Also, in line with this result is the observation made by Ahmad & Ariff (2024), where high borrowing costs force SMESs to avoid making necessary investments that inhibit their growth. These results were reinforced by the observations from the World Bank (2024) where SMESs operating in the East African region were seen to be bearing significantly high borrowing costs compared to those in other regions.

5.2.2 Impact of Payment Period on Financial Performance of SMEs

The results showed that the owners and managers of SMEs believe that the normal loan repayment period offered by lenders is insufficient. The respondents stated that they could grow their businesses if they had enough time to repay loans and that it will help them deal with unforeseen costs without affecting business operations. Most of them mentioned that long repayment periods would enable them to manage their finances properly.

However, they revealed that short repayment periods cause cash flow challenges, making it difficult for them to focus on repaying loans and expanding their businesses at the same time. One important result obtained from the study was that there was a difference between the repayment period and the cash flow cycle of the businesses. Several respondents mentioned that their income does not match the loan repayment schedule. They also admitted that they had difficulty meeting monthly repayments due to the insufficient time to repay.

The results above agree with Horne and Wachowicz (2023), who pointed out that long payment periods are more effective in cash flow management and help businesses manage their resources better. On the other hand, short payment periods lead to difficulties and force SMESs to put all their efforts into repaying their debts instead of developing themselves (Brealey, Myers, & Allen, 2024). The result that SMESs will be able to grow if they are

given longer repayment periods coincides with the results by Agyemang and Ansah (2023) that indicate that SMESs, which have favorable payment periods, tend to invest more in growth.

5.2.3 Impact of Late Payment Penalties on Financial Performance of SMEs

High penalty charges on delayed payments were found to be highly detrimental to the financial performance of the SMEs. The respondents noted that high penalty charges have a cumulative effect resulting in debt and poor financial status instead of being a one-off expense. Most of them noted that penalty charges on delayed payments have caused financial challenges related to business cash flows, more so during low sales times, and that the penalty charges are high, causing further financial burdens on the businesses.

It was established that penalty charges have made it difficult to have adequate funds for reinvestments in business operations and have negatively impacted the profitability of the businesses. Another issue raised is the compounding effect of delayed payment penalties. This makes it difficult to repay the initial borrowed amount, causing more delay in the repayment process as penalty charges keep compounding and increasing the amount due. The effects of penalties included fear, which caused stress and affected business decision making. It was also established that most of the respondents were forced to use some of their funds for operations to clear penalty charges and that this discouraged them from accessing credit from other sources.

The results are consistent with the study by Barlow et al. (2023), who revealed that late payment penalties result in considerable cash flow problems that lead organizations to redirect money away from productive investments to cater to the additional expenses that arise. In addition, Rojas & Ramos (2023) revealed that companies that incur numerous late payment penalties suffer from a decrease in their profit margins. The conclusion regarding the contribution of high late payment penalties to the perpetuation of indebtedness and lack of progress can be seen as being consistent with the report by the European Commission (2019). In it, the authors reveal that SMESs that incur higher penalties for late payments are less likely to exhibit high growth rates than their counterparts.

5.3 Conclusions

5.3.1 Conclusion on Interest Rates

According to the study, the higher the interest rates, the lower the financial performance of SMESs in Mukono Central Division is likely to be. High interest rates make the cost of borrowing higher, reduce the profitability of businesses, hinder the acquisition of loans, make businesses depend on personal savings to finance their activities, hinder investments in expansion and innovations, and affect negatively the general financial stability of SMESs. Thus, the findings of the study affirm the traditional view on interest rates and the theory of loanable funds.

5.3.2 Conclusion on Payment Period

According to the study, short repayment periods have a significant negative influence on the financial performance of SMESs in Mukono Central Division. First of all, short payment periods create difficulties in managing cash flows. Also, due to the limited time period, SMESs cannot invest into business development because they must repay the loans. Moreover, SMESs do not have time to repay the loaned money, and they will have difficulties in case of any additional costs.

5.3.3 Conclusion on Late Payment Penalties

From the findings, the researchers concluded that heavy penalties incurred as a result of delayed payments negatively affect the financial performance of SMESs in the Mukono Central Division. The effects of such penalties include increased financial pressure, decreased profit levels, diversion of financial resources from business activities, poor cash flow management, discouragement from borrowing in the future, and perpetuation of a vicious circle of debts and lack of progress.

5.4 Recommendations

5.4.1 Recommendations for Policymakers

The Ministry of Trade, Industry and Cooperatives, along with the Bank of Uganda, should think about implementing interest rate subsidies in favor of SMESs in Mukono Central Division, as well as in Uganda generally. The average interest rate charged at the moment by financial institutions is simply too high for most SMESs, and its reduction to the level seen in other countries would greatly improve their financial condition. Moreover, credit guarantee programs can be started or improved because the loans offered to SMESs mostly demand collateral which value exceeds the loan itself. These programs would significantly help SMESs in acquiring credits, especially those without enough capital.

Moreover, regulators should consider making changes to the loan period laws, since shorter periods cause liquidity problems and limit further development of enterprises. Financial institutions would be encouraged by some incentive program due to flexible terms of their loans.

5.4.2 Recommendations for Financial Institutions

Commercial banks and MFI's need to design flexible credit products that will address the peculiar needs of SMES. The product should feature loans with flexible repayment options, grace periods, reduction in interest rates for timely payment, and low collateral options for SMEs with good credit repayment histories.

Additionally, there is a need for financial education and credit counseling services to help SMEs understand credit terms, effectively manage debts, and enhance their credit scores, which will help in reducing default rates and be beneficial to both lenders and borrowers.

In relation to the issue of penalties for late payment, financial institutions need to formulate friendly penalty policies that should incorporate grace periods, limits on how much penalties can accumulate, and information on penalty charges. There should also be disclosure forms that will guide in the penalty framework.

5.4.3 Recommendations for SMEs Owners and Managers

SMESs owners and managers need to improve their cash flow management by ensuring that they have enough cash in reserve, diversify their sources of income, and ensure that they repay loans according to the cycles of their cash flow. This will minimize instances of late repayment and related fines.

The other step is for SMEs to keep proper accounting records that prove their creditworthiness to banks and provide better loan terms and help in making informed decisions regarding borrowing. This will include tracking sales, expenses, profits, and debt repayment.

Lastly, SMEs need to negotiate loan terms before agreeing to lend, including longer periods for repayment, acceptable interest rates, and penalty terms. They can join SMEs organizations to negotiate for better loan terms.

5.5 Contribution to Knowledge

First, this research adds new information to the existing pool of information because this research has used empirical data drawn from the central division of Mukono to explore how different credit terms affect the financial performance of SMEs. The second contribution comes because earlier studies have mostly focused on a single aspect of credit terms. This research has explored the impact of interest rates, repayment periods, and penalties either jointly or independently. The third contribution is that classical interest rate theory and liquidity preference theory have been validated for application in Uganda.

5.6 Limitations of the Study

The research was limited by the following aspects. Firstly, with respect to geographical coverage, the research was restricted to the area of Mukono Central Division only. The results obtained may, therefore, fail to generalize to other areas within Uganda or elsewhere where economic conditions differ, particularly with regard to financial systems. Secondly, the use of a cross-sectional approach meant that only one-time measurements were taken during the research. This limits the ability to identify any long-term trends as well as proving causality in credit terms and financial performance of SMEs. Thirdly, there is the possibility of errors due to self-reporting by SMEs' owners/managers.

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**UGANDA CHRISTIAN UNIVERSITY
SCHOOL OF BUSINESS
DEPARTMENT OF UNDERGRADUATE**

**A QUESTIONNAIRE FOR SME's OWNERS AND MANAGERS AT MUKONO
CENTRAL DIVISION**

Dear Respondent,

I am Bakhita Josephine, a student at Uganda Christian University conducting academic research on "**The Effect of Credit Terms on the Financial Performance of Small and Medium Enterprises in Mukono Central Division**" as part of my studies. You have been selected to participate in this study because of your valuable experience as an SMES owner/manager.

Please be assured that all information provided will be treated with utmost confidentiality and used solely for academic purposes. Your honest responses will contribute significantly to the success of this research.

Thank you for your cooperation.

SECTION A

BIO-DATA

Instructions: Please tick (✓) or fill in the appropriate response where applicable.

1. Gender of the respondent;

Male Female

2. Age bracket of the respondent;

16 -25 years 26-35 years 36-45 years 46 years and above

3. Highest level of education;

Non formal Primary Secondary Tertiary/University

4. Position in the enterprise

Owner Manager Accountant/Credit officers Others (Specify).....

5.Number of years the enterprise has been in operation

Less than 1 year 1-3 years 4-6 years 7years and above

6.Type of business sector:

Retail trade Whole sale trade Manufacturing service

7 Number of employees;

1-5 Employees 6-10 Employees 11- 25 Employee 26-50 Employee

SECTION B

THE EFFECT OF INTEREST RATES ON FINANCIAL PERFORMANCE OF SMESS

Instructions:

Please indicate the extent to which you agree or disagree with the following statements regarding interest rates and their effect on your business financial performance. Use the scale: **1 = Strongly Disagree (SD), 2 = Disagree (D), 3 = Neutral (N), 4 = Agree (A), 5 = Strongly Agree (SA)**

No.	Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
1	The current interest rates on loans (approximately 23%) are too high for my business to afford					
2	High interest rates reduce my business profitability by increasing the cost of borrowing					
3	High interest rates have forced me to reduce the amount of money I borrow for my business					
4	I have had to rely on personal savings because bank loans are too expensive due to high interest rates					
5	High interest rates limit my ability to invest in business expansion and new opportunities					
6	Paying high interest has affected my ability to maintain adequate cash flow for daily operations					

7	The total cost of borrowing (including interest) consumes a significant portion of my business revenue					
8	My business struggles to innovate and compete effectively because of the high cost of debt servicing					
9	The current interest burden makes me prioritize immediate financial obligations over long-term investments					
10	I believe that the current high interest rates destabilize the overall financial health of my business					

SECTION C

THE IMPACT OF PAYMENT/REPAYMENT PERIOD ON FINANCIAL PERFORMANCE OF SMESS

Instructions:

Please indicate the extent to which you agree or disagree with the following statements regarding repayment periods and their effect on your business financial performance. Use the scale: **1 = Strongly Disagree (SD)**, **2 = Disagree (D)**, **3 = Neutral (N)**, **4 = Agree (A)**, **5 = Strongly Agree**

No.	Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
1	The repayment period offered by lenders (typically 12-24 months) is too short for my business					
2	Short repayment periods create cash flow problems for my business					
3	Longer repayment periods would allow me to better manage my business finances					
4	Short repayment periods force me to prioritize loan repayment over investing in business growth					
5	I struggle to meet monthly loan repayments because of the short time given to repay					

6	The repayment schedule does not match my business cash flow cycle					
7	I would be able to expand my business if given longer repayment periods					
8	Having more time to repay loans would help me handle unexpected expenses without derailing my business					
9	Longer payment terms would make my business more resilient and competitive in the market					
10	The current short repayment deadlines limit my ability to reinvest profits back into daily operations					

SECTION D

THE IMPACT OF PENALTIES ASSOCIATED WITH LATE PAYMENTS ON FINANCIAL PERFORMANCE OF SMESS

Instructions:

Please indicate the extent to which you agree or disagree with the following statements regarding late payment penalties and their effect on your business financial performance. Use the scale: **1 = Strongly Disagree (SD)**, **2 = Disagree (D)**, **3 = Neutral (N)**, **4 = Agree (A)**, **5 = Strongly Agree (SA)**

No.	Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
1	Penalties for late payment are too high and create additional financial burden on my business					
2	Late payment penalties have negatively affected my business profitability					
3	I have had to divert funds from business operations to pay late payment penalties					
4	Fear of penalties causes me stress and affects my business decision-making					
5	Late payment penalties have reduced the funds available for reinvesting in my business					

6	The penalty structure is not clearly explained by lenders before taking the loan					
7	Penalties for late payment discourage me from seeking future credit					
8	Late payment penalties worsen my business cash flow problems, especially during slow sales periods					
9	The accumulation of penalties has made it harder for me to pay off the principal loan amount					
10	I believe that high late payment penalties contribute to the cycle of debt and stagnation for SMESs in Mukono					

THANK YOU FOR YOUR PARTICIPATION!