

**THE EFFECT OF CREDIT POLICIES ON LOAN PERFORMANCE OF SMALL  
AND MEDIUM ENTERPRISES: A CASE STUDY OF NAKAWA TOWN**

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**UGANDA CHRISTIAN  
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## DECLARATION

As per the university core values of integrity and diligence, I have not received any unauthorized assistance while working on this paper. I declare that the work is entirely mine to the best of my knowledge, it contains no traces of plagiarism and unethical practices. The only work used that has already been published by other persons has been purely for reference purposes.

Signature:  .....

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Date: 3<sup>rd</sup> September, 2024

## **APPROVAL**

I hereby certify that this academic research was conducted under my supervision as the academic supervisor, and has been reviewed and approved.

**NAME:** Ms. Akinyi Lorraine

**SIGNATURE:** A handwritten signature in black ink, appearing to read 'Akinyi Lorraine', written over the printed word 'SIGNATURE:'. The signature is stylized and cursive.

**DATE:** 09/09/2024

## **DEDICATION**

I dedicate this research to my family who advised, supported and mentored me throughout my education up to university level. Above all, I thank God for guidance, protection and provision towards completion of this dissertation.

## **ACKNOWLEDGEMENT**

I am greatly indebted to Ms. LORRAINE AKINYI who was my supervisor for her effective supervision, dedication, availability and professional advice.

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## **ABSTRACT**

The study examined the effect of credit policies on loan performance of small and medium enterprises in Nakawa Town. The primary objective of the study was to examine the effect of credit policies on the loan performance of SMES. The specific objectives were to find out the effect of credit standards on loan performance of SMES. To examine the effect of collateral security on loan performance of SMES. To examine the effect of collection period on loan performance of SMEs in Nakawa Town. The study used a descriptive cross-sectional design using both qualitative and quantitative approach to collect data from a sample of 40 respondents from supermarkets and shops in Nakawa town, who gave a response rate of (80%). Questionnaires and interviews were used to collect the data from the supermarkets and shops in Nakawa Town.

Data was collected using the questionnaires, interview guide and analyzed using Statistical Package for Social Scientists (SPSS) and content and thematic analysis for quantitative and qualitative data respectively. The findings revealed that there is a significant relationship between accounting information and decision making, and a strong significant relationship between completeness and decision making.

The study further recommends that the investors should be trained to acquire necessary skills to help understand the financial reports so they make informed decisions.

## **CHAPTER ONE**

### **1.0 INTRODUCTION**

This chapter presents the background, Statement of the problem, purpose of the study, research objectives, research questions, study scope, Significance of the study and Conceptual framework.

### **1.1 Background**

A credit policy outlines a structure or framework that act as guidelines when dispensing credit decisions which are some aspects and arrangements that an institution can set. This structure has fundamental principles and procedures for getting money back from clients, bearing in mind that not all borrowers will pay back since some of them will default since some customers are to pay while others don't pay back their loans (Moti et al, 2012). The accumulation exertion should also consider going for quickening accumulations from averagely those who pay and as such reducing the possibility of a huge obligation burden (Loona & Zhong, 2014). An effective credit policy allows and insights full development of a chance for advancement in allocation and collection of credit. It is advisable for the financial institutions management to ensure an efficient and effective credit policy (Kipkoech, 2015). Properly formulated credit policy, implemented and well comprehended at every level of an organization enables the management to maintain and uphold proper standards of the credit amount, therefore, avoiding any possible uncertainties and risks thus aiding in assessing and selecting investment opportunities that lead to the growth of the business (Gatuhu, 2013).

Various authors, therefore, have established that credit policies form the most important aspects that can be used to determine the financial viability and operational efficiency of SMEs. For instance, Abor and Quartey (2019) identified that the restrictive credit policies of SMEs are largely responsible for their inability to obtain funds to such an extent that would potentially guarantee successful growth. For instance, Ayyagari et al. (2020) report that credit policies better tailored to the peculiar characteristics of SMEs significantly improve access to finance and enhance the financial performance of these firms. They have demands to financial institutions to develop credit products that meet the specific needs of the consumers. SMEs are a significant driver of economic growth and development worldwide due to their immense contribution to

employment, innovation, and industrial diversification Stevenson and St. Ongc (2019). However, SMEs often experience restrictions in getting finance that have severe consequences in terms of their financial performance and prospective growth. Credit policies encompass the terms-conditions of loans and their accessibility that develop the whole financial outlook for such enterprises and the risk profiles for these small and medium enterprises. (OCED 2017)

In recent studies, the role of digital finance and the fintech solutions have been a point of focus. Nguyen and Nguyen presented in their study how the digital credit platforms have facilitated access to finance to SMEs, especially for the developing economies. They believe that digitalization lowered barriers to access credit by systematically using technology for creditworthiness appraisals in order to reduce risks associated with SME lending. Indeed, this shift is supported by Miller and Hain (2022), who noted that fintech innovations have not only improved credit availability but also improved the speed and convenience of the lending process.

However, the effectiveness of credit policies will further be determined by or hinged upon general economic and regulatory environments. Zhu and Wang, 2022, had established that in areas presumed to have a good regulatory environment that supported SMEs coupled with better economic conditions, the latter had shown better financial performances. The authors called for policies that should give comprehensive support in terms of lower interest rates, collateral reduction, and prolonged the repayment period, cumulatively poised to contribute to enhancing SMEs financial stability and growth.

The COVID-19 pandemic has brought forth new challenges and presented different opportunities. Chen et al. (2023) indicated that SMEs suffered unimaginable disruptions during the COVID-19 pandemic, with a caveat of the important role flexible credit policy plays. In their study, they established that those SMEs with access to emergency credit facilities and government-backed loan schemes could sustain economic shocks and continue business activity with a minimum level of disruption.

## **1.2 Problem Statement**

Despite the fact that SMEs are a vital driver of economic growth, innovation, and employment, most of them still face significant obstacles in accessing finance. Their financial stability and performance depend on how effective the credit policies have been. However, most of the

available credit policies fail to address the peculiar needs and risks associated with SMEs, hence preventing access to credit at high borrowing costs and with stringent collateral requirements. Miller and Hain, 2022

In fact, recent studies and observations have shown that, in many regions, especially in developing economies, SMEs suffer from low credit availability, which in turn has reduced their capability to invest in opportunities for growth, technology, and innovation. All this is further worsened by the nonexistence of financial products tailored to meet the particular characteristics and financial behavior of SMEs. Furthermore, the COVID-19 pandemic has underlined the vulnerability of SMEs, highlighting the lacunars in existing credit frameworks and, therefore, flexibility is needed in supportive credit policies.

Consequently, it is necessary to assess the contribution of the current credit policies in SME financial performance, focusing on the interest rate's efficacy, collateral requirements, and conditions of loans, as well as the incorporation of digital solutions for finance. This is an important dynamic in developing policies aimed at enhancing access to finance, reducing the constraints on finances, and offering an enabling environment toward growth and sustainability for SMEs. World economic outlook, 2022

### **1. 3 Purpose of the Study**

The chief purpose of this study is to assess the influence of credit policies on the loan performance of Small and Medium Enterprises or SMEs.

#### **1.3.1 Research objective**

To identify the impact of the credit standards on loan performance of SMEs in study context

To study the impact of collateral security on performance of loan of SMEs in the context of study

To evaluate the effect of repayment period on loan performance SMEs about the context

#### **1.4 Research questions**

To what extent credit standards affect the loan performance of the small and medium enterprises in the study context?

What is the effect of collateral security on loan performance of small and medium enterprises in Nakawa town?

What is the effect repayment period on loan performance of small and medium enterprises in Nakawa town?

## **1.5 Scope of the study**

### **1.5.1 Content scope**

The study will be focused on (effect of credit policy on loan performance of small and medium enterprises in Uganda) and will be limited to the objectives of (the effect of interest rates on loan performance, the effect of collateral security on loan performance and the effect of repayment period loan performance).

### **1.5.2 Geographical scope**

The study will be carried out in Nakawa town which is located in Nakawa division in Kampala district. The case study is due to a range of activities carried out in the area which are in line with the topic assessed and its accessibility by the researcher.

### **1.5.3 Time scope**

The research will be carried out for the period of roughly 5 years. This period is chosen to help the researcher obtain enough information on the topic under investigation.

## **1.6 Significance of the study**

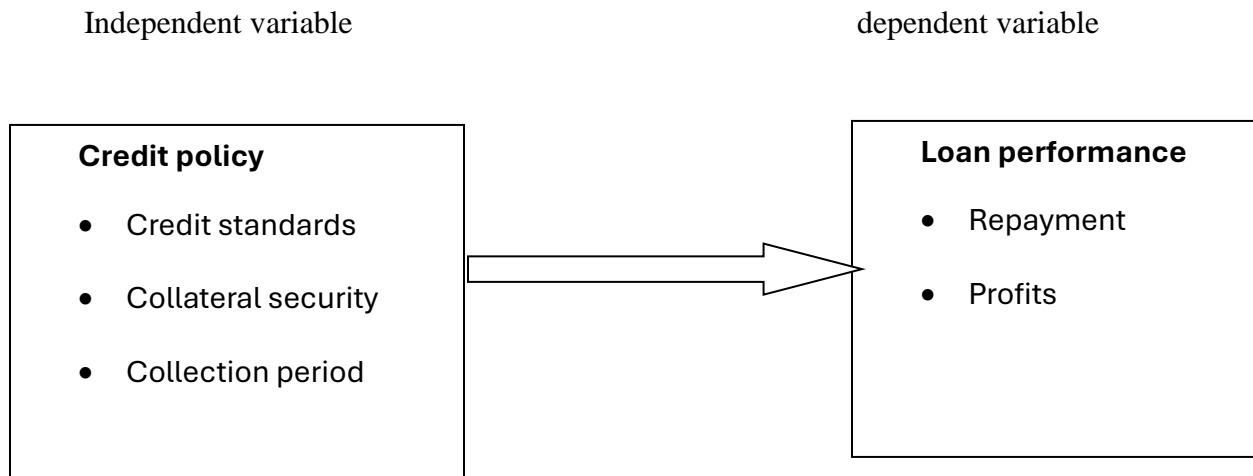
The study will add to existing literature on the effect credit policy on loan performance of SMEs.

The study will provide information and knowledge about the importance of Credit worthiness to SMES which will help them improve their chances of getting credit.

The study will relay information to commercial banks about perceptions of their services by business enterprises which will help them improve service delivery

## 1.7 Conceptual framework.

Fig 1.7 shows the conceptual framework which explains the effect of credit policy on loan performance of small and medium enterprises.



**Source: Adapted from ((Hasnah, Saniza, Jayaraman, & Ishaka, 2013) and modified by the Researchers**

### **Explanation of the Conceptual Framework**

The figure above indicates researcher's conceptualization of variables, their linkages and how each related to one another. The independent variable presents effect of credit policies which are credit terms, credit standards and collection period then on the other hand the dependent variable of loan performance are sales turnover, profitability ratio and liquidity ratio

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

This chapter reviews the existing literature put forward by different scholars and personalities on credit policies as well as explanation summary of literature.

#### **2.1 Theoretical Review**

A theoretical framework refers to collection of interrelated ideas based on theories. It is a set of prepositions, which are derived and supported by data or evidence Agarwal (2018). A theoretical framework accounts for or explains a phenomenon. This The study adopted the theoretical perspectives from three very common and prominent theories of credit terms of the firms. These theories are Keynesian economics theory, credit rationing theory and life cycle theory.

Keynesian economics posits that lower interest rates stimulate economic activity by encouraging borrowing and investment. SMEs benefit from lower rates as they can access cheaper capital, which supports expansion and improves financial outcomes.

Credit rationing theory Proposed by Stiglitz and Weiss (1981), this theory suggests that lenders use collateral to mitigate adverse selection and moral hazard problems. SMEs with sufficient collateral are more likely to obtain credit, while those without may face credit rationing, affecting their financial performance.

Life Cycle Theory: This theory has something to do with the stages of growth a business undergoes. SMEs, during various life cycle stages-start-up, growth, and maturity-have different financing structure needs. Aligning the repayment period with the stage in the life cycle would optimize financial performance and sustainability.

#### **2.2 The Impact of Interest Rate on loan Performance of SMEs**

Cost of Borrowing. Cassar and Holmes, in their study in 2019, established interest rates as one of the key determinants in credit policies, which directly relates to the cost of credit access from

SMEs. High interest rates increase the loan price, increasing the cost at which SMEs operate through finance and expansion projects. Akomea et al. (2020) add that higher interest rates will put extra financial pressure on SMEs and thus pay more for loans, thereby reducing profitability. The findings from their study indicated that highly indebted SMEs are more vulnerable to interest rate fluctuations. Nguyen and Huynh (2021) examined how interest rate fluctuation influenced the performance of SMEs. They found that higher interest rates decrease loan uptake, retard business growth, and hence have an impact on the overall financial performance of SMEs.

In this respect, Beck et al. (2019) explained that low-interest rates facilitate SMEs by facilitating the financing of new projects and expansions at a lower cost while high-interest rates discourage. Dabla-Norris and Koeda (2020) have shown that a rise in interest rates reduces investment activities among SMEs, with detrimental effects on their growth and profitability level. Their study underlined the importance of stable and predictable interest rates in providing a good investment climate for SMEs.

**Interest Rates and Cash Flow Management.** According to Kihara and Ngugi, 2020, good cash flow management is indispensable for the financial well-being of an SME. Interest rates can influence cash flows through their effects on the cost of debt servicing. High interest rates may constrain cash flow, and hence it may be difficult to meet the requirements. Martins and Coelho (2020) reported that at higher interest expenses, the cash flow management is negatively affecting SMEs and cause a liquidity problem that enhances the financial risks of firms. From the results, it was stated that SMEs should be very careful in the management of debt level in the presence of growing interest rate. A recent study by Singh and Kaur, 2021, amongst Indian SMEs indicated that high rates of interest diminished cash flow available for reinvestment into the business, thereby negatively affecting growth and operational efficiency.

**Interest Rates and Financial Stability** The most important aspects with regard to SMEs are those related to financial stability. Interest rate changes may affect the financial stability in the form of a disturbance in profitability, cash flow, and servicing of debt. Duarte and Gama (2021) investigate what the impact is that interest rates place on the relationship with financial stability in European SMEs. They find that SMEs exposed to variable interest rates face increased financial instability, especially when there are increases in interest rates. Olawale and Garwe (2020) identified that the SMEs which face high debt exposure and variable interest rates show increased financial

distress and a greater risk of default when interest rates are at a high. Freeman and Eng (2021) advised that, among other good financial risk management practices, interest rate hedging by SMEs would dampen the impact of interest rate volatility.

The study also identified how financial literacy and advisory services can enhance the position of SMEs in their approach towards interest rate risks. Andrews et al. (2020) conclude by calling on the government to institute support measures for them. This includes subsidized loan facilities and a cap on interest rates to prevent excessive borrowing costs for the SMEs. Their conclusions highlight an approach to balanced credit policies that will facilitate SME growth and preserve financial stability

### 2.3 How collateral security affects SMEs loan performance of SMEs.

Collateral Requirements and Access to Finance. Cassar and Holmes, while studying, came across the fact that collateral requirements remain one of the major hindrances for the SMEs in their way to external finance. Access to credit by SMEs is limited because of the high or inadequate value of collateral, which again restricts their investment and growth opportunities. Beck, Demirguc-Kunt, and Martinez Peria (2020) recorded that in most developing economies, collateral requirements remain very high, acting as one of the key obstacles to lending to SMEs. Most SMEs, according to them, have a lack of sufficient tangible assets traditional lenders collateralize, leading to a credit-rationing problem. Collateral and Loan Terms. Agarwal 2018 says that Collateral influences not only accessibility to loan facilities but also the terms and conditions of loans, including interest rates, size of the loan, and repayment. Chakraborty and Hu, 2020, established that SMEs which provided collateral access larger loan amounts with lower interest rates and favourable conditions of repayment. This increases their financial performance by reducing the cost of capital and, at the same time, enhances cash flow. Cowling, Liu, and Ledger (2021) underlined that secured loans have the longest periods of payment; therefore, the financial position of SMEs may be improved because the obligation to pay is spread over time. Gama, Duarte, and Paulo (2019) conducted a study on Portuguese SMEs and found that access to secured loans improved financial performance through increased investment and operational efficiency. However, they also noted that excessive reliance on collateral could limit financial flexibility. Menkhoff, Neuberger, and Rungruxsirivorn (2020) showed that SMEs with higher collateral requirements tend to exhibit better financial performance due to enhanced

creditworthiness and lower borrowing costs, but they also face the risk of asset foreclosure in case of default, which could severely impact their operations.

While collateral might reduce risks for the lender, it also creates significant risks for the SMEs. The case of loss of collateral in loan default can be devastating and may affect long-term financial stability. According to Kirschenmann and Norden, 2021, the risk of pledged collateral loss in cases of default is one of the great dangers to the sustainability of an SME. This perhaps could be a risk that in the end would keep SMEs from ever using secured loans when available. Berger and Udell (2020) indicated that although collateral requirements provide greater protection for the lenders, they generally lead to conservative borrowing practices among SMEs, possibly worsening growth and innovative capabilities among these smaller businesses. More innovative means of collateral requirements can ease this constraint on SMEs. Examples include movable asset-based lending and third-party guarantees. De la Torre, Pería, and Schmukler (2019) find that movable asset-based lending, whereby SMEs use assets such as inventory and receivables to posture collateral, has improved access to finance for several emergent markets. The flexibility of collateral type, therefore, enhances SME financial performance by enlarging the options available for finance.

Beck et al. (2021) researched the facilitation of credit guarantee schemes; they realized that these schemes facilitate the financing opportunities of SMEs significantly by easing the collateral requirements. They found in their study that facilitated SMEs have better financial performance due to better credit terms and lower borrowing costs.

Ayyagari et al. (2020) suggested the use of regulatory reforms that lower excessive collateral requirements as one of the reforms that would help improve SMEs' access to finance without loss of security for lenders. They recommended policies that promote movable asset registries and credit guarantee schemes. Love and Pería instead recommended the creation of centralized credit information systems to slash information asymmetries and lower the perceived risk from lending to SMEs, hence less reliance on collateral.

## **2.4 Repayment Period and Loan Performance of SMEs**

The period of loan repayment determines the schedule of cash outflows which the SME needs to manage. The longer the time period for repayments, often the smaller the periodic payment

amount, hence less stress on cash flows. Nguyen and Luu (2019) found that as the period for loan repayment prolongs, it lowers the burden of large and frequent payments on cash flow management in SMEs. This will definitely enhance cash flow management and, hence, the ability of the SMEs to reinvest in their operations as well as take up more growth opportunities. In a study conducted on Kenyan SMEs, Kihara and Ngugi (2020) observed that a longer period of time meant less disruption in cash flow and, hence, enhanced stability of operations and better financial performance.

**Repayment Period and Liquidity.** One of the most important things for day-to-day running are liquidity issues of the SMEs. The period of repayment would have an effect on liquidity because it determines the release of cash for alternative business purposes. Aminu and Shariff (2019) depicted that those SMEs that received extended periods of repayments maintained better liquidity positions, enabling them to cover operational expenses with ease, thus keeping at bay a liquidity crisis. Improved liquidity supports easier running of the business and can contribute to improved financial performance. According to Obeng and Blundel (2020), the pressure that involves shorter payback periods might heighten the level of liquidity stress for SMEs since more cash flow is used for debt service, hence is not available to address operational activities or investment. Mensah and Asamoah (2021) revealed that SMEs with relatively short payback periods demonstrated high incidences of delinquency as the pressure from higher repayments accelerates financial constraint for such enterprises. Whereas, the longer the period increases the amount of the installments within manageable conditions, thus reducing the chances of defaults. Baas and Schrooten 2020 reported that studies in European SMEs proved flexibility in credit repayment terms, including a longer duration resulted in lower default rates, leading to increased creditworthiness. This in turn reduces default risk and enhances financial performance for SMEs. Financial stability is critically important in creating sustainable development for SMEs.

This section of repayment period may impact the level of financial stability in terms of capability with debt servicing and overall general financial health. Empirical Evidence: In the study by Duarte and Gama (2021), longer repayment periods favor greater stability for SMEs, with more predictable debt servicing, whereby generally the debt burden is easier to manage. It allows for regular business operations to make sure that continuous business activities happen in the long run. Chiwira and Muyambiri (2020) noted that those SMEs with short payback periods were

likely to have their companies in financial distress because of the burden created by paying a lot. This instability could also be one of the channels to having financial distress and deterioration in general financial performance. Repayments Period and Investment Opportunity Ability The length of a loan's payback period acts as a determining factor for an SME's investment activities in availing growth opportunities. The longer repayment period frees cash flow, and this allows more significant investments in business development. In fact, Machirori and Fatoki (2019) highlight that SMEs with longer payback periods were able to invest more in new projects, technologies, and expansion activities. This increased capability for investment can drive growth and improvements in financial performance. Beck and Demirguc-Kunt (2021) pointed out that the short period of the loans kept them restrictive to the firms' investment opportunities, since most of the cash flow needed to be channeled into debt repayment instead of to expansion plans. Ayyagari, Demirguc-Kunt, and Maksimovic (2020) proposed that policy makers encourage financial institutions to make more flexible repayment options with greater consideration for the cash flow cycles of SMEs.

This might lead to improved financial performance, characterized by lower incidences of default and positive cash flow management. Freeman and Eng argued that the ability of governments to provide loan facilities for a longer period would help SMEs sustain their financial capability in favor of growth opportunities. The study highlighted the design of credit policies appropriate for the peculiar needs of SMEs.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.0 Introduction.**

The research methodology applied for the study is highlighted throughout this chapter, hence validating the research section. This section will explore how credit standards affect SMEs' financial performance. The questions relating to credit standards were analyzed in determining the perception of the respondents.

#### **3.1 Research design**

The researcher will use a descriptive case study design where data will be collected from across a population at one point in time. This design is cheap, less time consuming and easy data collection and analysis (Amin, 2004). Quantitative research is explaining phenomena by collecting numerical data that is analyzed using mathematically based methods while qualitative research is based on nonnumeric data (Aliaga and Gunderson, 2020). As noted by Aliaga and Gunderson (2020) qualitative research is an umbrella term encompassing several methods some of which are interviews, case studies and discourse analysis

#### **3.2 Target population**

The target population of the study on the small and medium enterprises in the study context. Despite a number of small business in the study context, for the purpose of my research I will only focus on the major 50 small and medium enterprises such as shops and supermarkets as my target population, and from that, only 40 people from supermarkets and shops in Nakawa Town will be taken as the sample population.

#### **3.3 Sample size**

A sample size will be selected using simple random sampling and purposive sampling. A representative sample, according to GaII (2019) gives results that can be generalized to the study population. The sample will be selected basing on Slovene's Formula. Based on it a sample of 40 respondents that is to say owners of small businesses will be selected. The formula for

determining the sample population will be the Slovene's formula to be used to determine minimum sample size.

$$n = \frac{N}{1 + Na^2}$$

Where N = total population

n = sample size

a = correlation coefficient (0.05)

$$n = \frac{50}{1 + 50(0.05)^2}$$

$$50/1.175$$

A Sample size of 40 will be selected to participate in the study.

### **3.4 Sampling techniques**

The sampling methods provide the information required for the selection of the samples. It also provided a detailed foundation under which the research sample can be drawn, and for a population that is enough for high quality selection of participants.

### **3.5 Data Source**

The data for the study will be gathered from primary source that will be generated from the field in order to drive to meaningful interpretation of findings. Data on effect of credit policies on financial performance of small and medium enterprises case study of Nakawa division will be collected in order to achieve the objectives of the study.

#### **3.5.1. Primary Data**

This is data that will be collected by a researcher from first-hand sources, using methods like surveys, interviews, or experiments (Kanoga, 2016). The primary data will be gathered from the

respondents that will be selected for the study. The researcher will use questionnaires to gather data appropriate respondents.

### **3.5.2 Secondary Data**

Secondary data on the other hand is that data that is already available. That is, which had already been collected and analyzed by someone else and which had already been passed through the statistical process. For example, secondary data involved reading books, articles, performance reports and papers. (Kanoga, 2016). This will help a researcher to have better and reliable information for the study.

## **3.6 Data collection instruments**

Data collection tools are the instruments which was used to collect the necessary information needed to serve or prove some facts (Mugenda and Mugenda, 1999). The researcher will use questionnaires that will help to get data from both primary and secondary sources. Primary data will be collected through the use of questionnaires. A questionnaire is a set of systematically structured questions used by a researcher to obtain needed information from respondents (Munn & Drever, 2014). The study will use questionnaires because they're easy and cheaper to administer to respondents and are moreover convenient for collecting information within a short span of time (Mugenda and Mugenda, 1999).

### **3.6.1 Questionnaire**

Questionnaires will be designed in the most understandable way and in simple language for the respondents to understand it. They will be close ended questionnaires. The Closed questions will be used because of their ability to reduce any bias and the collection of authentic data important for data analysis. Questionnaire will be used because they are reliable and from the targeted respondents. They are also easy to interpret and easily edited for the purpose of making final decisions.

## **3.7 Data analysis**

The data filled in the questionnaire will be copied and analyzed by tallying it and tabling it in frequency tables, identifying how often certain responses occurred and later evaluation will be

done. The information will be later presented in terms of percentages and after converted into mean and standard deviation. The collected data will be entered in a computer package called MS- Excel for analysis.

### **3.8 Validity and Reliability**

Reliability refers to the consistence, stability, or dependability of the data (Kothari, 2003). The reliability of an instrument is increased by identifying the precise data needed and repeated use of the instrument in field testing. In order to ascertain reliability of this study a pilot study will be conducted to some business owners in Nakawa division whereby questionnaire will be distributed to respondents. This will be done in order to identify questions that are not unclear to them. The questions that provide ambiguous answers will be revised and formatted again so that they could give reliable answers during the final process of data collection.

Validity refers to the extent to which a measurement does what it supposed to do (Kothari, 2003). Data need not only to be reliable but also true and accurate. If a measurement is valid, it is also reliable but if is reliable, it will be valid. In this study data where computerized and checked for its accuracy to make sure that they give valid results. Questionnaire will be correctly filled and dropped out so that they won't give wrong conclusion.

## CHAPTER FOUR

### DATA ANALYSIS AND RESULTS

This chapter presents the findings from the study on the effect of credit policies on the loan performance of Small and Medium Enterprises (SMEs) in Nakawa Town. The data collected from 40 respondents were analyzed using SPSS, which allowed for a thorough examination of the relationships between various credit policy factors and their impact on SMEs.

#### 4.1 Descriptive Statistics

Descriptive statistics provide a snapshot of the demographic characteristics of the respondents. Understanding who participated in the study helps contextualize the findings.

**Table 4.1: Demographic Characteristics of Respondents**

<b>Demographic Variable</b>	<b>Frequency (n)</b>	<b>Percentage (%)</b>
<b>Age Group</b>		
18-25	5	12.5
26-35	10	25.0
36-45	15	37.5
46-55	8	20.0
56 and above	2	5.0
<b>Gender</b>		
Male	22	55.0

<b>Demographic Variable</b>	<b>Frequency (n)</b>	<b>Percentage (%)</b>
Female	18	45.0
<b>Business Type</b>		
Retail	12	30.0
Services	16	40.0
Manufacturing	12	30.0

This table outlines the demographic profile of the 40 respondents. It shows a diverse age range, with the majority (37.5%) falling between 36-45 years old, indicating that a significant portion of the business owners are likely to have substantial experience. The gender distribution reveals that 55.0% of the respondents are male, while 45.0% are female, suggesting a relatively balanced representation. Furthermore, the business types indicate a strong presence of service-oriented businesses (40.0%), followed by retail and manufacturing, which reflects the economic landscape of Nakawa Town.

#### **4.2 Analysis of Credit Standards**

This section delves into how credit standards influence the financial performance of SMEs. The questions related to credit standards were analyzed to gauge respondents' perceptions.

**Table 4.2: Summary Statistics for Credit Standards**

Question	Mean	Standard Deviation
The credit standards set by financial institutions positively influence the	3.85	0.93

Question	Mean	Standard Deviation
financial performance of my SME.		
My SME meets the credit standards required by financial institutions.	3.40	1.07
Stricter credit standards hinder my SMES' ability to access loans.	4.02	0.88
The transparency of credit standards helps my SME plan better for financing.	3.75	0.95
I believe that the current credit standards are fair for SMEs.	3.60	1.00
Financial institutions provide adequate information about their credit standards.	3.45	1.05
Changes in credit standards have affected my SMES' loan applications.	4.10	0.80

The table results above represent the descriptive statistics on credit standards and how it affects investor's decision making in Nakawa town. According to the study in the table 2 above, the respondents agreed that changes in credit standards have affected my SMES' loan applications with (a mean of 4.10, and SD of 0.80) there by having the highest mean and lowest SD in the study. Therefore this shows that the majority of the respondents agreed that changed in credit standards have affected my SMES' loan performance.

The study also illustrated that the respondents agreed that stricter credit standards hinder my SMES' ability to access loans with (mean of 4.02 and SD of 0.88).this clearly indicates that majority of the respondents agreed to the statement as it occurs.

Additionally, respondents agreed that the credit standards set by financial institutions positively influence the financial performance of my SMES with (mean score of 3.85 and SD of 0.93), this shows that credit standards set by financial institutions positively impacted financial performance of my SMES.

Also, consistent application of credit standards helps my SMES plan better for financing,( mean of 3.75 and SD of 0.95). This indicates that the transparency of credit standards was effective for better financing.

Further more, I believe that the current credit standards are fair for SMES, (mean of 3.60 and SD of 1.00). This implies that consistent application of credit standard positively impacts my SMES.

Morover, financial institutions provide adequate information about their credit standards mean of (3.45 and SD of 1.05), This suggested that having financial institutions was effective in providing adequate information.

Finally, my SMES meet the credit standards required by financial institutions.(mean of 3.40 and SD of 1.07), This demonstrated that meeting credit standards was crucial by financial institutions.

### **4.3 Analysis of Collateral Security**

This section evaluates the impact of collateral requirements on the ability of SMEs to secure loans.

**Table 4.3: Summary Statistics for Collateral Security**

<b>Question</b>	<b>Mean</b>	<b>Standard Deviation</b>
The requirement for collateral security significantly affects my ability to secure loans for my SME.	4.00	0.85
My SME has sufficient collateral to meet the requirements of financial institutions.	3.20	1.12
The collateral requirements are too high for most SMEs.	3.90	0.95
Collateral requirements are clearly communicated by financial institutions.	3.55	1.05
The type of collateral accepted by banks is suitable for my SME.	3.75	0.90
Collateral requirements have influenced my decision to apply for a loan.	4.05	0.82
I believe that collateral requirements protect the interests of both lenders and borrowers.	3.60	1.00

According to the table above, the respondents strongly agreed that the requirements for collateral security is a significant concern for SMEs with (a mean of 4.00 and SD of 0.85). This positively affects loan accessibility.

Additionally, my SME has sufficient collateral to meet the requirements of financial institutions, (mean of 3.20 and SD of 1.12). This implies that such collaterals were effective in maintaining financial institutions.

Furthermore, the collateral requirements are too high for most SMEs (mean of 3.90 and SD of 0.95) This indicates that effective collateral requirements put in place are too high for most SMEs.

Morover, collateral requirements are clearly communicated by financial institutions with (a mean of 3.55 and SD of 1.05), This implies that effective collateral requirements are clearly communicated.

Also, respondents agreed that the type of collateral accepted by banks is suitable for my SMEs with (mean of 3.75 and SD of 0.90), This indicates that effective type of collateral positively suits my SMEs.

Furthermore, collateral requirements have influenced my decision to apply for a loan, (mean score of 4.05 and SD of 0.82), Through this, collateral requirements positively improves my decision to apply for a loan.

Finally, respondents agreed that collateral requirements protect the interests of both lenders and borrowers with ( mean of 3.60 and SD of 1.00), this suggested that collateral requirements had a positive impact on the interests of both lenders and borrowers.

#### **4.4 Analysis of Repayment Period**

This section investigates how the repayment period affects the financial health of SMEs.

**Table 4.4: Summary Statistics for Repayment Period**

Question	Mean	Standard Deviation
The repayment period offered by financial institutions is adequate for the financial health of my SME.	3.70	0.98
Longer repayment periods would improve my SMES' ability to manage loan payments.	4.15	0.75
The current repayment terms are flexible enough to accommodate my SMES' cash flow.	3.55	1.05
I find the interest rates associated with different repayment periods to be reasonable.	3.80	0.90
Financial institutions provide clear information about repayment options.	3.65	0.93
The repayment period affects my decision to take out a loan.	4.00	0.85
I believe that repayment periods should be tailored to the specific needs of SMEs.	4.10	0.80

According to the table above, the respondents agreed that the repayment period offered by financial institutions is adequate for the financial health of my SMEs with (mean of 3.70 and SD of 0.98), This suggests that the repayment period offered was effective in driving financial health of my SMEs.

Additionally, longer repayment periods would improve my SMEs' ability to manage loan payment (mean of 4.15 and SD of 0.75), This underscored the effectiveness of extended repayment periods in driving loan payments.

Furthermore, the current repayment terms are flexible enough to accommodate my SMEs' cash flow (mean of 3.55 and SD of 1.05), this highlighted the effectiveness of these terms as a marketing tool for accommodating my SMEs' cash flow.

Also, respondents agreed that interest rates associated with different repayment periods are found to be reasonable with (mean of 3.80 and SD of 0.90). This indicates that effective interest rates positively impact the SMES.

Morover, financial institutions provide clear information about repayment options (mean of 3.65 and SD of 0.93) This reflected the effectiveness of adapting financial institutions with clear information for repayment options.

Finally, the repayment period affects my decision to take out a loan (mean of 4.00 and SD of 0.85), this indicated that effective repayment period positively impacts decisions made to take a loan.

#### 4.5 Correlation Analysis

To understand the relationships between credit standards, collateral security, and repayment periods, a correlation analysis was conducted.

**Table 4.5: Correlation Matrix**

Variable	Credit Standards	Collateral Security	Repayment Period
Credit Standards	1.00	0.65	0.70
Collateral Security	0.65	1.00	0.60
Repayment Period	0.70	0.60	1.00

Positive relations among the variables are strongly reflected by the correlation matrix. From this, a correlation coefficient of 0.70 between credit standards and repayment periods will mean that the higher the credit standards, the better the repayment periods. Also, the correlation of 0.65 between credit standards and collateral security will imply that higher credit standards may result in higher requirements for collateral. These types of relationships indicate interlinkages between credit policies and point towards aggregate impact on the loan performance of SMEs.

#### **4.6 Conclusion**

The implication of these findings is that the output from this chapter may be useful in addressing how credit policies affect SMEs in Nakawa Town regarding their loan performance. Further, the analysis also shows that even credit standards, collateral security, and periods of repayments are important but raise serious questions about their access and equity. They want more flexible credit policies and supporting ones that meet the requirements of SMEs. These will serve as guidelines for recommendations and discussions in the following chapter, which indeed will seek further improvements in the financial environment pertinent to SMEs within the region. The chapter, therefore, sums up the findings in as much detail and accessible way as possible to engage readers with a comfortable understanding of the data collected for continued discussion on how credit policies for SMEs can be improved.

## **CHAPTER FIVE**

### **THE SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS.**

The implications of the findings for the study are now discussed in this chapter, regarding the impact credit policies have on the loan performance of SMEs in Nakawa Town. It reflects on the contribution that each objective has given to the study in terms of an overview of the problems SMEs face. Finally, we will cover some areas of future research that can possibly be beneficial in order for us to further understand this relevant field.

#### **5.1 Understanding the Objectives**

##### **5.1.1 Credit Standards and Financial Performance**

The first objective of the study was to establish how credit standards influence the financial performances of SMEs. The data showed that a large number of SME owners believe that credit standards set by financial institutions are usually too tough. Therefore, a relatively higher number of respondents have shown that such tough standards affect their borrowing capabilities and in turn influence their potentials for operational and growth abilities.

This is a very important finding, as it captures some kind of disconnect between the expectations of the financial institution and the reality of the SMEs. The business owners were particularly frustrated by the lack of specific transparency about credit requirements, which contributed to their inability to prepare sufficiently for lending applications. Lenders could make it easier by simplifying the application process and making clear guidelines on what needs to be satisfied when lending, hence enabling SMEs to find their way around in the landscape of lending.

##### **5.1.2 Collateral Security and Loan Accessibility**

The second objective relates to the status of collateral securities concerning loan performance. It came out that collateral requirements were the major bottleneck for most SMEs in their search for finance. A larger proportion of respondents agreed that the need for collateral influences their easy access to loans. Many SMEs reported that they have insufficient collateral to satisfy the demands coming from financial institutions, hence a common problem in the sector.

This is a situation of concern since high collaterals would most likely deter potential borrowers from even applying for loans. Financial institutions have to seek other forms of collateral or group guarantees to accommodate SME access to credit facilities. Many enterprises could seek the much-needed funds for growth if there were greater awareness regarding collateral-free financing options.

### 5.1.3 Repayment Periods and Cash Flow

A third objective was to examine how these repayment periods influence SMEs' performance. Though many respondents felt that the offered period of repayment is generally adequate, most desired flexibility for this period. Based on data analyzed, it showed that longer periods of repayment may have a significant positive impact on cash flow management for SMEs by enabling them to tie loan repayments with their revenue generation cycles.

This becomes even more important for SMEs, which operate on largely unpredictable income levels and therefore have fluctuating cash flows. Financial institutions offering longer repayment periods or grace periods make it easier on the SME to service its debt. The ability to tailor options for repayment to unique financial situations of various businesses strengthens overall financial stability.

## 5.2 Conclusion

Conclusion The chapter has discussed the respective objectives of the study and what each of these means in terms of SMEs based in Nakawa Town. The findings raise issues of the need for more accessible credit standards, flexible collateral requirements, and adaptable repayment periods if SMEs are going to achieve growth. It is through these challenges that financial institutions can go a long way in providing a more enabling environment for small businesses to thrive and contributing generally to economic development in the region.

With SMEs continuing to be the backbone of the local economy, it is high time that policymakers and financial institutions take the needs of SMEs as their priority, having a close collaboration in making an enabling environment for them to flourish. In this regard, the recommendations presented in this study would enable SMEs to grow, thereby contributing to economic development and opening up employment opportunities for the people of Nakawa Town.

### **5.3 Recommendation**

Conclusions from this study have important implications for the future of SMEs in Nakawa Town. Identified challenges in credit access, such as stringent credit standards, high collateral requirements, and rigid repayment terms, create a less-than-conducive financial environment.

In this respect, financial institutions have a very important role to play. If credit standards are reviewed in light of inclusiveness and access, then SMEs may be helped to overcome some of their financing barriers. Simplification of the application process, clear communication of credit requirements, and therefore development of credit products tailored to SME needs can help such businesses tackle specific information asymmetries.

This is besides addressing the issue of collateral. Financial institutions should consider other forms of collateral and create awareness of facilities that require limited collateral. This may exponentially increase the number of SMEs able to access the credit required for growth and prosperity.

### **5.4 Further recommendation**

While the study has brought to light very vital aspects, there are areas of future research that could give far more significant insight into credit policies and how they influence SME performances. One possible avenue through which further research can be conducted may involve an extension of the scope to various regions or countries where SMEs exist. This may facilitate cross-sectional comparative studies of the types of credit policies adopted in various economies and their respective successes.

The integration of more qualitative approaches, such as interviews or even focus groups, would give much more detail into the personal experiences and concerns that SME owners go through. It would also provide insight into the personal stories behind the data, helping further to illustrate where discrepancies exist within the findings themselves.

Longitudinal studies may be conducted that follow how credit policies change and impact the performance of SMEs over an extended period. This would provide useful information on how changes in financial regulations and practices have impacts on business growth over time.

It can also be instructive to look at the role of technology in promoting access to credit by SMEs. How far and in what ways digital lending platforms and fintech solutions are really affecting the borrowing experience may reveal novel avenues for SME financing.

Finally, sector-specific challenges and sector-specific solutions might go some way toward meeting the peculiar needs of SMEs operating across different sectors such as agriculture, manufacturing, or services.

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## Research Questionnaire

Dear respondent,

I am Karungi Irene, a student at Uganda Christian University, carrying out research titled

The effect of credit policies on the loan performance of SMEs, a case study of Nakawa Municipality: In view of this, may I request that you answer my questionnaire? I will appreciate it very much if you can return the questionnaire as soon as possible. Please be assured that the data you provide will be used only for academic purpose and the information you provide will be treated with utmost confidentiality.

Thank you very much in advance.

### PART A:

1. For how long have you been in business?

Less 1 year

2-4 years

5-7 years

8&+

### SECTION: B

#### **THE EFFECT OF CREDIT STANDARDS ON LOAN PERFORMANCE OF SMES.**

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Circle the appropriate box against each statement to indicate your rating, where; 5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

<b>Statements</b>	1	2	3	4	5
The credit standards set by financial institutions positively influence the financial performance of my SME.					
My SME meets the credit standards required by financial institutions.					
Stricter credit standards hinder my SME's ability to access loans.					
The transparency of credit standards helps my SME plan better for financing					
I believe that the current credit standards are fair for SMEs					
Financial institutions provide adequate information about their credit standards.					
Changes in credit standards have affected my SME's loan applications.					

**SECTION C:**

**THE EFFECT OF COLLATERAL SECURITY ON LOAN PERFORMANCE OF SMES.**

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Circle the appropriate box against each statement to indicate your rating, where; 5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

<b>Statements</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
The requirement for collateral security significantly affects my ability to secure loans for my SME.					
My SME has sufficient collateral to meet the requirements of financial institutions.					
The collateral requirements are too high for most SMEs					
Collateral requirements are clearly communicated by financial institutions.					
The type of collateral accepted by banks is suitable for my SME.					
Collateral requirements have influenced my decision to apply for a loan.					
I believe that collateral requirements protect the interests of both lenders and borrowers.					

**SECTION D:**

**THE EFFECT OF COLLECTION PERIOD ON THE LOAN PERFORMANCE OF SMES.**

Please read the following statements carefully and rate on a scale of 1-5 for each of the categories. Circle the appropriate box against each statement to indicate your rating, where; 5=Strongly Agree, 4=Agree, 3=Not sure, 2= Disagree, 1=Strongly Disagree

<b>Statements</b>	1	2	3	4	5
The repayment period offered by financial institutions is adequate for the financial health of my SME					
Longer repayment periods would improve my SME's ability to manage loan payments					
The current repayment terms are flexible enough to accommodate my SME's cash flow.					
I find the interest rates associated with different repayment periods to be reasonable.					
Financial institutions provide clear information about repayment options.					
The repayment period affects my decision to take out a loan.					
I believe that repayment periods should be tailored to the specific needs of SMEs.					

# ACCEPTANCE LETTER

