

**THE IMPACT OF CREDIT RATIONING ON THE GROWTH OF SMALL AND
MEDIUM ENTERPRISES IN MUKONO DISTRICT**

ERIC TUMWINE

S23B05/086

**A DISSERTATION SUBMITTED TO THE SCHOOL OF BUSINESS IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF BACHELOR OF
BUSINESS ADMINISTRATION OF UGANDA CHRISTIAN UNIVERSITY**

April, 2026




**UGANDA CHRISTIAN
UNIVERSITY**

A Centre of Excellence in the Heart of Africa

DECLARATION

I, ERIC TUMWINE, hereby truthfully declare to the best of my knowledge that this research work is my original work and has never been published or submitted before for the award of a degree, diploma or for any equivalent academic title in any university or any other academic institution of higher learning.

Signature:  _____ Date: 22nd/04/2026 _____

ERIC TUMWINE

APPROVAL

This is to certify that this study report titled, ' **THE IMPACT OF CREDIT RATIONING ON THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN MUKONO DISTRICT.**' has been carried out by Eric Tumwine under my supervision of madam Jennifer Abiyar N. (Mrs.). It is now ready for submission to the School of Business at Uganda Christian University.

Signature: _____

J Abiyar N

Jennifer Abiyar N. (Mrs.)

Date: _____

22/04/2026

DEDICATION

I would like to dedicate this research study report to my parents/ Guardian. You all believed and invested so much in me even when you owned so little of your own. For what I claim as my achievements, you have achieved much more through your dedication to excellence, resources and the opportunities you provided for me.

ACKNOWLEDGEMENT

I want to express my gratitude to the almighty God for giving me life and for guiding me along my academic journey, it has not always been simple but it has been possible.

My supervisor madam Jennifer Abiyar N. (Mrs.) has my sincere gratitude for all her hard work and knowledge she has provided to me when I was under her supervision.

Last but not least, I would want to express my gratitude to my beloved family for their affection, spiritual support and financial assistance throughout my academic career.

May God bless everyone.

LIST OF ACRONYMS

SMEs – Small and Medium Enterprises

UIA – Uganda Investment Authority

SACCOs – Savings and Credit Cooperative Organizations

UDB – Uganda Development Bank

PDM – Parish Development Model

GDP – Gross Domestic Product

ROA – Return on Assets

ROE – Return on Equity

SPSS – Statistical Package for the Social Sciences

CVI – Content Validity Index

RBV – Resource-Based View

POT – Pecking Order Theory

BDF – Business Development Fund

COVID-19 – Coronavirus Disease 2019

ABSTRACT

This study explored the effects of credit rationing on the growth of SMEs in Mukono District, Uganda. Credit rationing, in terms of loan denial, restricted loans, interest rates, and collateral conditions, is still affecting SMEs adversely in terms of profitability, growth, and sustainability. The objectives of this study were formulated based on three major areas: relationship between credit rationing and SME profitability; alternative methods of financing employed by SMEs to improve growth; and how credit rationing affects investments and growth.

The methodology chosen for the study was a cross-sectional descriptive research design. The population of this study consisted of 300 SME business owners licensed in Goma Division of Mukono Municipality, Uganda, from which 171 respondents were sampled using Yamane's (1967) formula under simple random sampling method. Structured questionnaires were used as an instrument for data collection. The return rate of 164 questionnaires out of 171 distributed translated into 96.1% response rate. SPSS was utilized to analyse collected data using means, standard deviations, Pearson correlations, and regressions.

Correlation findings reveal a negative relationship between credit rationing and SME profitability ($r = -0.685$), as well as between credit rationing and SME expansion ($r = -0.710$). Findings reveal strict collateral policy (mean = 4.50) and high interest rate (mean = 4.35) to be the most significant credit rationing problems. In terms of coping strategies, alternative sources of finance like retained profits (mean = 4.60) and SACCOs (mean = 4.15) are reported. Regression analysis finds that credit rationing accounts for 57.0% of SME growth results ($R^2 = 0.570$, $p < 0.001$).

The study has established credit rationing as one of the significant obstacles to SME profitability, growth, and expansion in Mukono District. The paper therefore recommends adoption of cash flow-based lending models by banks, streamlining of government recovery programs, and investment in financial records by SMEs. These are critical in tapping into growth opportunities of SMEs and their contribution to the country's economy.

TABLE OF CONTENTS

DECLARATION	i
APPROVAL	i
DEDICATION.....	iii
ACKNOWLEDGEMENT.....	iv
LIST OF ACRONYMS.....	v
ABSTRACT.....	vi
TABLE OF CONTENTS	vii
CHAPTER ONE	1
1.1 Introduction	1
1.2 Background of the Study	1
1.3 Statement of the Problem	2
1.4 Purpose of the Study	2
1.5 Objectives of the Study.....	3
1.6 Research Questions	3
1.7 Scope of the Study	3
1.7.1 Content Scope	3
1.7.2 Geographical Scope.....	3
1.7.3 Time Scope.....	4
1.8 Significance of the Study	4
1.9 Conceptual Framework.....	4
CHAPTER TWO	6
LITERATURE REVIEW.....	6
2.1 Introduction	6
2.2 Definitions of key terms	6
2.3 Theoretical review	7
2.4 The relationship between credit rationing and profitability of SMEs	10
2.5 The alternative financing mechanisms used by SMEs to enhance growth	13
2.6 The influence of credit rationing on investment and expansion decisions	16
2.7 Summary of literature and research gaps	18
CHAPTER THREE.....	19
RESEARCH METHODOLOGY	19
3.1 Introduction	19
3.2 Research design.....	19
3.3 Population of the study	19

3.4 Sample size	19
3.5 Sampling procedure	19
3.6 Data sources	20
3.6.1 Primary data.....	20
3.6.2 Secondary data.....	20
3.7 Data collection methods	20
3.8 Data collection instruments.....	20
3.8.1 Questionnaire.....	20
3.9 Data presentation	20
3.10 Reliability and validity	20
3.11 Procedures	21
3.12 Data analysis	21
3.13 Ethical considerations.....	21
3.14 Anticipated limitations.....	22
CHAPTER FOUR.....	23
FINDINGS, ANALYSIS, PRESENTATION AND INTERPRETATION OF RESULTS.....	23
4.1 Introduction	23
4.2 Response rate	23
4.3 Demographic characteristics of respondents	23
4.5 Descriptive statistics on alternative financing mechanisms	25
4.6 Descriptive statistics on investment and expansion decisions.....	26
4.7 Inferential statistical analysis	26
4.7.1 Correlation analysis.....	27
4.7.2 Regression analysis.....	27
CHAPTER FIVE.....	28
SUMMARY OF FINDINGS, DISCUSSION, CONCLUSION AND RECOMMENDATIONS ..	28
5.1 Introduction	28
5.2 Summary of major findings	28
5.3 Discussion of major findings	28
5.3.1 The Relationship Between Credit Rationing and the Profitability of SMEs.....	28
5.3.2 Alternative Financing Mechanisms Used by SMEs to Enhance Growth Faced with persistent rejection from formal banking institutions.....	29
5.3.3 The Influence of Credit Rationing on Investment and Expansion Decisions	29
5.4 Conclusion.....	30
5.5 Recommendations.....	30
5.6 Areas for further study	30

REFERENCES	31
APPENDICES.....	34

CHAPTER ONE

1.1 Introduction

This chapter presents the background, statement of the problem, objectives of the study, research questions, scope, significance, and the conceptual framework.

1.2 Background of the Study

Overall, SMEs constitute around 90% of business organizations and more than 50% of total employment globally (World Bank, 2020). In developing nations like Uganda, SMEs represent the bedrock of industrial production, commerce, and employment generation. Despite their significance, SMEs confront perennial difficulties when seeking financing. Financial institutions regard them as risky borrowers due to inadequate collateral, informal organizational structures, and the lack of documented financial records. Consequently, credit rationing ensues, whereby creditworthy SMEs are either turned away from borrowing or offered credit on disadvantageous terms.

Specifically in Uganda, SMEs are believed to generate close to 80% of GDP and provide jobs to roughly 70% of the workforce (UIA, 2023). They play crucial roles in important sectors such as manufacturing, commerce, service provision, and agriculture. Nonetheless, their access to inexpensive credit remains constrained. Commercial banks tend to favor large corporations capable of securing adequate collateral and documenting financial information. Based on a report by the Bank of Uganda (2023), collateral levels frequently surpass 150% of the loan amount, while interest rates range from 18% to 22%.

As a result, a majority of SMEs have been forced to explore the use of informal financing avenues such as SACCOs, microfinance lenders, and even borrowing from family members. The findings of the Mukono District Business Association (2022) indicated that roughly 63% of SMEs in the district borrowed money from SACCOs for working capital purposes, compared to 27% accessing formal bank loans. While this represents a solution to some extent, the loan amounts are small and are associated with relatively high interest rates.

The current problem is further exacerbated by the impacts of the COVID-19 pandemic. From 2020 to 2022, many SMEs encountered unprecedented disruptions resulting in significant decreases in revenue generation as well as business closures. Government measures taken to

encourage recovery include the establishment of the Uganda Development Bank (UDB) SME Recovery Fund and the Parish Development Model (PDM). However, due to several issues, implementation and reach of these solutions was limited. For instance, only 40% of the intended recipients were able to benefit from the PDM initiative during its first year.

In this regard, the challenges facing credit rationing within Uganda mirror the challenges being faced by other countries within Sub-Saharan Africa. According to the African Development Bank (2022), it has been observed that approximately 40% of the SMEs in the region are financially constrained as a result of not having access to long-term capital. Nevertheless, some nations such as Kenya and Rwanda have taken positive strides to ensure that the problem of credit rationing does not become an impediment to their development.

To conclude, although SMEs have played a crucial role in contributing to the growth and development of the Ugandan economy, their development has been constrained owing to financial exclusion and credit rationing.

1.3 Statement of the Problem

Although many interventions have been adopted by the government and the financial sector to assist SMEs, it is evident that the availability of credit is still difficult. The rationing of credit prevents SMEs from obtaining enough funding for expansion. Research conducted by Ayyagari et al. (2022) and Uganda Investment Authority (2023) shows that many SMEs do not obtain enough funding due to strict collateral demands, high-interest rate demands, and lack of documentation in the financial sector. This makes it difficult for the enterprises to grow and generate profits. Continued existence of such a problem means that there will be limited contribution of the SMEs to the growth of the economy since they cannot provide jobs to individuals. It is vital to investigate the impact of credit rationing on the growth of SMEs.

1.4 Purpose of the Study

The key aim of the study was to establish the impact of credit rationing on the growth of Small and Medium Enterprises in Uganda. Specifically, how inadequate credit impacted on the operations of the enterprises as well as their decision-making process regarding investments and other sources of finance when facing credit rationing.

1.5 Objectives of the Study

General Objective:

To assess the impact of credit rationing on the growth of small and medium enterprises.

Specific Objectives:

- i. To determine the relationship between credit rationing and profitability of small and medium enterprises.
- ii. To evaluate alternative financing mechanisms that small and medium enterprises use to enhance their growth.
- iii. To examine how credit rationing influences investment and expansion decisions among small and medium enterprises.

1.6 Research Questions

What is the relationship between credit rationing and profitability of small and medium enterprises?

What are the alternative financing mechanisms do small and medium enterprises use to enhance their growth?

How does credit rationing influence investment and expansion decisions among small and medium enterprises?

1.7 Scope of the Study

1.7.1 Content Scope

The study examined the relationship between credit rationing and the growth of small and medium enterprises, specifically focusing on profitability, financing mechanisms, and investment decisions.

1.7.2 Geographical Scope

The investigation will concentrate on small and medium-sized businesses that operate in the Mukono municipality in particular the Mukono Central division. Areas such as Buguju, Namuyenje and Ntawo villages will be targeted since they have a higher number of SMEs operating in them. These areas were chosen due to the presence of more SMEs which can easily allow the assessment of credit rationing effects on SMEs.

1.7.3 Time Scope

The study covered the period between 2020 and 2025, capturing the post-COVID-19 recovery phase, which significantly influenced SME access to credit and financing conditions in Uganda.

1.8 Significance of the Study

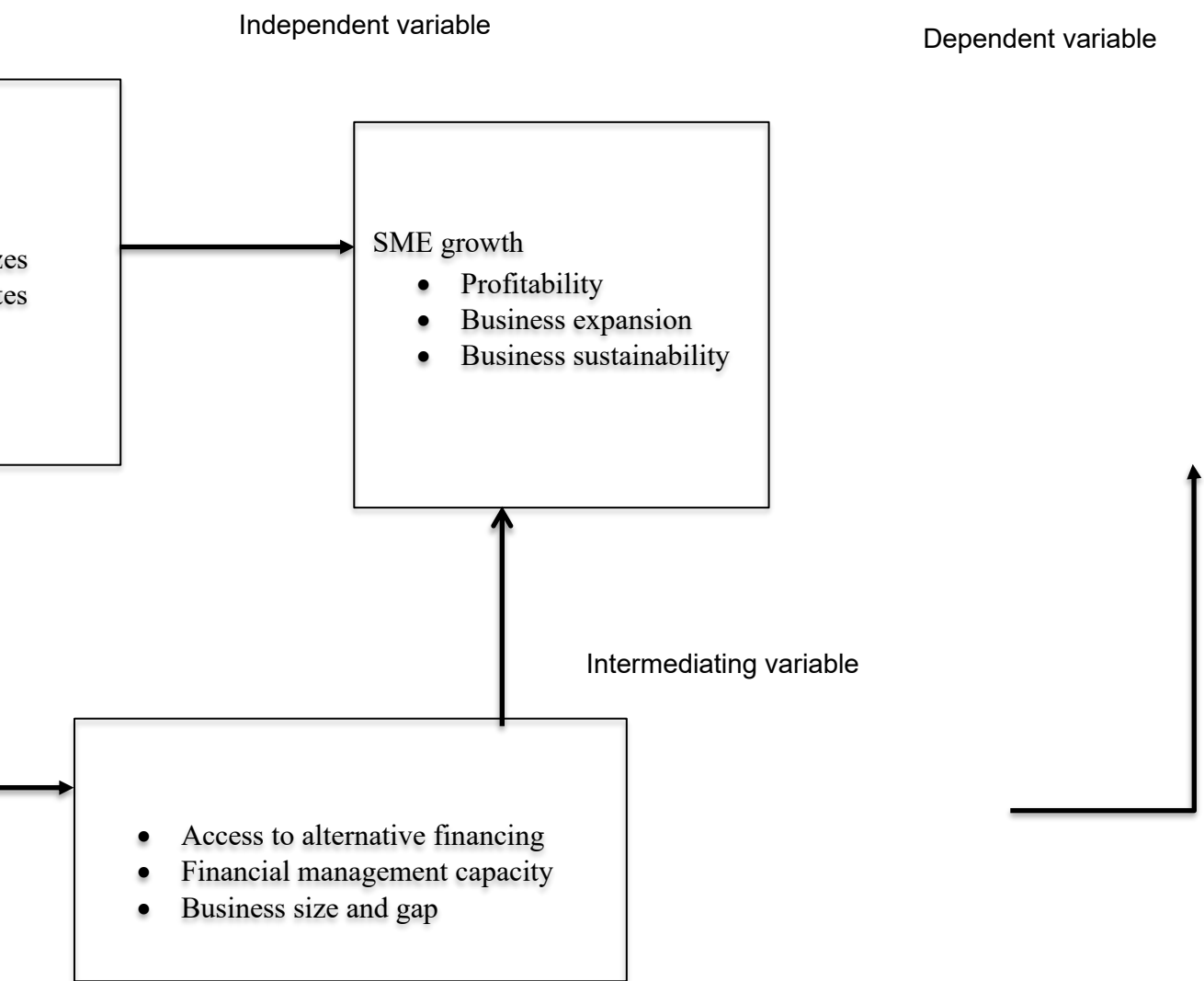
This study was important since it revealed information about one of the toughest obstacles faced by SMEs due to a lack of accessible funding. The study shed light on the effects of credit rationing on profitability, investments, and growth, thereby increasing knowledge about the impact of financial barriers on the entire performance of SMEs in Uganda.

The findings were useful in formulating financial policies and strategies for facilitating credit availability to SMEs in order to ensure growth and development. In addition, the study emphasized the need for researching other sources of finance for SMEs apart from commercial banks.

Some of the sources include SACCOs and microfinance institutions, which can help to improve the financial strength of businesses, making them resilient in order to grow. Furthermore, the study is an important addition to the body of knowledge in SME financing, especially with regard to the correlation between credit rationing and business growth in Uganda.

1.9 Conceptual Framework

The conceptual framework illustrates the relationship between credit rationing (independent variable), intermediating variables, and SME growth (dependent variable).



Source: Stiglitz, J.E. & Weiss, A. (1981). Credit rationing in Markets with Imperfect Information. *The American Economic Review*, 71(3), 393 – 410.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a comprehensive review of existing literature related to the impact of credit rationing on the growth of small and medium enterprises (SMEs).

2.2 Definitions of key terms

Credit rationing

Credit rationing refers to a scenario whereby lenders cut back on the amount of credit available to borrowers who are ready to pay high-interest rates because of issues of adverse selection and moral hazard due to information asymmetry.

Jaffee and Russell (1976) argue that credit rationing refers to a restriction of credit availability even though some borrowers are ready to accept high-interest rates or provide more collaterals, noting that some borrowers are excluded.

Keasey and Watson (1993) refer to credit rationing as an inability to receive credit or provision of less credit than desired by borrowing firms, especially small firms lacking a history of creditworthiness.

According to Bester (1985), credit rationing involves banks using non-interest-rate factors such as collateral demands in screening potential borrowers.

Small and Medium Enterprises (SMEs)

World Bank (2020) defines small and medium enterprises as business firms that have less than 300 workers and revenue not above US\$15 million.

According to the European Commission (2021), SMEs are enterprises that employ less than 250 employees and have an annual turnover of less than €50 million or balance sheet value below €43 million.

As regards the Ugandan scenario, according to UIA (2023) and MSME Policy (2015), SMEs are defined as entities having 5-100 workers and total assets ranging from UGX 10 million to UGX 360 million.

Storey (1994) stresses the qualitative aspects of SMEs, including owner-operated, small market shares, and personalized management.

Profitability

According to Ross et al. (2019), profitability refers to the ability of an organization to earn excess profits above the cost of operations and financing, usually measured using ROA, ROE, and net profit margin.

Penman (2013) regards profitability as the efficient use of assets to earn income.

Ayyagari et al. (2022) consider SME profitability using gross profit margin and reinvestment capability.

Alternative sources of financing

According to Ledgerwood (2013), alternative sources of financing include non-bank financial intermediaries such as microfinance banks, SACCOs, trade credit, leasing, factoring, venture capital, and crowdfunding.

In Beck & Demirgüç-Kunt (2006), alternative sources of financing are inclusive of informal financing (such as money lenders, ROSCAs) and semi-formal funding sources, including cooperatives.

Klapper (2006) singles out supplier financing and online banking as emerging options.

Investment and expansion decisions

According to Beck et al. (2019), investment and expansion decisions are that business strategies aimed at investing in tangible assets, technological innovation, market entry, or increased capacity for production.

Carpenter & Petersen (2002) note that such decisions are very dependent on external sources of finance.

2.3 Theoretical review

Credit rationing theory, introduced by Stiglitz and Weiss (1981), provides an explanation regarding the behavior of financial organizations in restricting credit even when borrowers are ready to offer more interest payments. Two main risks that can be encountered by lenders include adverse selection and moral hazards. The increased interest rate may result in borrowing from risky clients or engaging into risky business activities by the clients themselves that could affect their ability to repay their loans. In order to avoid such situations, banks resort to credit rationing.

This theory is very pertinent to Small and Medium Enterprises (SMEs), where they often have little or no collateral, inadequate financial history, or even poor credit record. In such circumstances, the banks may see such businesses as being too risky and therefore refrain from extending any credit to them. Rationing of credit can take different forms including outright denial, partial approval of the credit, tough requirements on collaterals or strict terms attached to the loan. Financially deserving SMEs may also experience credit rationing because banks maximize on risk rather than market demand.

Generally, the Credit Rationing Theory gives a sound explanation of the financing problems faced by SMEs as well as giving justification for the caution observed by banks when granting credit. It helps to justify that availability of credit does not depend exclusively on interest rate but also on how lenders manage risks.

Pecking Order Theory (POT) was developed by Myers and Majluf (1984). Under this theory, a firm follows certain pecking order in its quest for financing sources. This theory states that companies will prefer internal financing first (retained earnings) then external financing in the form of debt, and use of equity as a final source of finance.

In regard to SMEs, the Pecking Order Theory (POT) holds significant meaning since SMEs generally have restricted external access to capital markets due to reasons such as the non-availability of complete financial accounts and audits, or information asymmetries. As a result, they generally depend greatly on internal sources such as savings from individuals, retained earnings and contribution from family members prior to taking a loan.

Additionally, the use of external equity finance can prove disadvantageous for SMEs since any selling of equity would dilute control while attracting excessive scrutiny from the external financiers. Thus, debt financing proves the most favorable form of outside financing. However, the presence of imperfections in credit markets still makes borrowing tough, thereby helping understand SME financing behaviors. Thus, the theory explains the significance of internal funds in SME liquidity.

The Financial Intermediation Theory sheds light on the importance of financial intermediaries in acting as an intermediary between lenders and borrowers of money. According to Gurley & Shaw (1960), financial institutions act in the way they do since they help overcome transaction costs, information asymmetry and risks, which are difficult for individual agents to undertake.

The various roles played by financial intermediaries include the processes of screening borrowers, monitoring of the usage of borrowed money, assessing of risks involved, collecting and organizing savings, among others. For small businesses to benefit from borrowing, the intermediaries should carry out some of these processes since it will be difficult for small businesses to provide the required collateral, self-discipline, or risk assessment skills.

Nonetheless, the theory goes on to shed more light as to why financial institutions might choose to become conservative and even ration credit for some borrowers. In the case of SMEs, this might be because of the costs associated with screening and the perceived risks involved in the process.

The Resource-Based View (RBV) developed by Barney (1991) asserts that the performance and competitiveness of an organization rely on its resource base. The resources must be valuable, rare, inimitable, and non-substitutable (VRIN). They could be tangible resources (financial resources, capital, technology, physical resources), intangible resources (knowledge, brand identity, intellectual property rights), and organizational resources (processes, systems, culture).

Regarding SMEs, the RBV model emphasizes the significance of financial resources like credit for determining the level of firm performance and growth. With credit facilities, SMEs can make investments in machinery and equipment, technology, inventory, trained labor, and innovations. This would develop their capabilities within and help them develop competitive advantages. In contrast, when SMEs lack credit facilities, it becomes difficult for them to develop such capabilities, resulting in poor performance and market competitiveness.

The RBV model also underscores the significance of managerial capability and entrepreneurial abilities. It states that these capabilities are essential intangible resources. Credit facilities enhance such resources through training, expansion, and strategic planning. Therefore, the RBV theory provides the conceptual framework for the connection between financial resources and SME growth.

2.4 The relationship between credit rationing and profitability of SMEs

There is plenty of evidence from literature proving that profitability is an important determinant for measuring SME success and sustainability, and credit is an important determinant that significantly affects this factor. SMEs are companies operating in a business environment characterized by limited cash reserves, unstable demand, and high risk of operations. With credit, firms can balance out their financial position, improve production cycle management, and make use of any market opportunities. In credit rationing, however, this process is compromised, which results in poor profitability levels.

It is widely acknowledged in literature that the level of profitability among SMEs heavily depends on the availability of external finance since the majority of small businesses do not have enough finances internally to ensure continued business activities. This means that credit rationing makes it difficult for companies to finance activities such as buying raw materials, paying electricity bills, transportation costs, and salaries to employees.

Credit rationing is another factor discussed in the literature which limits the ability of SMEs to benefit from economies of scale. Due to insufficient financial resources, SMEs find it difficult to buy raw materials in bulk quantities or to negotiate terms that would facilitate business operations. It leads to high costs and poor competitiveness in the market. High cost, which cannot be recovered from the consumers as a result of intense competition in the market, negatively affects the bottom line of the business.

Price setting strategies is another important issue in relation to credit rationing discussed in the literature. Due to lack of access to credit facilities, SMEs find it difficult to set competitive prices. They have to sell their products in order to raise cash or they do not invest in marketing activities and advertising that could help them increase prices.

There is empirical evidence that credit rationing prevents SMEs from diversifying their income streams. Product or service diversification usually involves an initial investment in research, training, and equipment. Without the possibility of getting credit, SMEs will continue to rely on limited product varieties, thus being susceptible to changes in market demand. This inability to diversify leads to unstable income streams and lower long-term profitability.

Credit rationing is also associated with financial stress for SMEs. Financially constrained SMEs are constantly in need of cash flow management, and they face late payments to suppliers, fines, and deteriorating business relationships. Negative business relations with suppliers can cause unfavorable trading terms or even loss of supplier trust, which adds to cost and reduces profits. Financial stress also distracts the management team from developing long-term strategies to short-term survival tactics.

Moreover, the literature shows that credit rationing affects SME's ability to invest in human resources. It is known that training workers, hiring competent staff, and making improvements in management processes require financing. In the absence of investments into the above-mentioned aspects, SMEs lack efficiency and productivity. Poor performance results in poor output both in terms of its quality and quantity, thus leading to low profits.

Thus, the existing literature clearly indicates that credit rationing adversely affects the profitability of SMEs. This effect appears due to the adverse influence of credit rationing on working capital, operating costs, diversification options, and productivity of SMEs. Due to the above-mentioned effects, SMEs will find it difficult to achieve good financial performance.

Credit rationing plays an important role in shaping the financial structure and sustainability of SMEs. While profits are generated from sales, there are other considerations such as cost management, asset management, and funding strategies. Credit rationing forces the SME to function under financial stress, leading to poor capital structure decisions. SMEs generally depend on internal funding because there are no equity markets. However, when banks fail to offer credit, SMEs are underfunded. The underfunding will reduce the opportunity for profitable investments, thereby lowering the ROI and profitability of the business.

Credit rationing also impacts production efficiency. If an SME is unable to get enough funding, the firm will reduce its operations to fit the resources available. With low production, the fixed costs remain unchanged while the volume of goods produced lowers. Consequently, the costs per unit produced will increase, shrinking the profit margins. Given that SMEs work in competitive environments, it is difficult to raise the prices of the goods produced without affecting profitability.

A third critical area is how credit rationing influences cash flow sustainability. SMEs normally have little liquidity cushion. If their loan applications get rejected or partly approved, there will be a mismatch between their collections and disbursements. The extended cash conversion cycle may require them to delay payments to suppliers, which may incur penalties and strain their relationship with the latter. Such effects, indirectly, affect profitability negatively.

Stock decisions are also influenced. Inability to access short-term credit options forces SMEs to hold smaller inventories to minimize capital utilization. While this improves liquidity in the short term, it predisposes the company to shortages, which limit sales opportunities. Consistent stock outages lead to customer dissatisfaction and brand disloyalty. Ultimately, the lack of repeat business results in lower revenue and profits.

Credit rationing enhances the use of expensive alternative sources of funds. Informal lenders and digital short-term loans normally charge higher interest rates than banks' traditional financing options. The higher cost of servicing such debts leads to increased interest expenses. Consequently, the companies' net incomes fall, leaving them with little retained earnings. As a result, their ability to finance future expansion becomes constrained.

In terms of literature, it can be noted that profitability is highly associated with innovation and productivity improvements. Firms that are innovative produce new products, adopt innovative processes, and increase the level of value addition. Innovation is costly and implies taking risks. Credit-constrained firms do not spend money on innovations because of their inability to repay debts.

Furthermore, it should be mentioned that credit rationing results in lower investments in quality improvement and branding activities. Quality improvement implies the use of higher-quality raw materials, qualified labour force, and improved machinery. If a firm lacks financial resources, it may reduce the level of quality and lose its clients' trust.

The other aspect of macroeconomic resilience also depends on credit access. In times of inflation, volatility in the foreign currency rate, or problems within the supply chain, those SMEs which have enough credit lines have a choice about the procurement pattern and will keep adequate stocks. Those firms which suffer from credit constraints cannot do this and are, therefore, exposed to such risks.

Thus, as can be seen from all the discussed reasons, profitability becomes an issue in many cases when there is credit rationing due to inefficiencies in production, cost of capital, poor bargaining position, lack of innovation, and resilience.

2.5 The alternative financing mechanisms used by SMEs to enhance growth

It is important to note that the literature acknowledges the existence of several alternative financing techniques used by SMEs to minimize the impact of credit rationing in order to facilitate growth. Growth of SMEs encompasses the expansion of production capacity, market coverage, workforce, and assets, all of which involve financial considerations. In the absence of financial assistance from banks, SMEs opt for alternative forms of funding characterized by flexibility and accessibility.

Internal financing via retained earnings stands out as the most common approach to financing among SMEs. According to literature, internal financing via retained earnings provides firms with the opportunity to remain independent and free from any pressure to repay loans. Retained earnings allow for steady growth through reinvestment into inventory, machine maintenance, and small-scale expansions. Nevertheless, the literature notes that internal financing restricts growth potential and pace.

Trade credit is important in supporting SME growth, especially when financial institutions are restrictive in their dealings with small businesses. The suppliers offer credit based on the principle of mutual trust and existing business relationships; thus, SMEs can use inputs without making payments at once. In the literature review, it has been stated that trade credit increases operational continuity, facilitates better inventory management, and helps sales growth. It further helps develop strong buyer-seller relationships, which are vital for business development over time.

Microfinance institutions and SACCOs are repeatedly mentioned in literature review as important sources of funding for SMEs that are denied access to commercial banks. These financial institutions offer small loans that suit small-scale businesses. Literature points out that through group lending and social collateral, the risks involved in default are mitigated. While the loans are small in amounts, multiple loan cycles enable SMEs to grow and stabilize their finances.

Leasing and hire-purchase schemes are also considered important in helping SMEs grow and develop over time. According to literature, leasing is useful in easing the financial pressure linked to asset purchases, allowing SMEs to upgrade their equipment and boost production capacity. Leasing helps expand businesses while ensuring adequate liquidity.

There has been increasing attention in literature on the importance of digital finance, mobile credits, and peer-to-peer lending. These methods decrease transaction costs, facilitate quicker loan processing, and increase access to finance. The use of alternative data on digital platforms in assessing creditworthiness helps SMEs without formalized financial transactions. Scholars have pointed out that digital finance is essential in promoting growth because it allows SMEs to capitalize on market opportunities.

Another topic discussed in literature as an emerging method of financing is crowdfunding. By raising money from many sources, crowdfunding enables product development, entering new markets, and building a brand. Literature has pointed out that besides financing, crowdfunding improves market visibility and customer engagement, which indirectly promotes growth.

One cannot ignore the importance of informal financing through friends and family members in funding SMEs. Literature recognizes the advantages of informal finance in terms of its availability and flexibility, especially at startup and growth phases. Nevertheless, scholars warn that the excessive dependence on informal financing could be counterproductive in environments where lending is restricted. As such, SMEs adopt various sources of financing to promote growth.

Growth does not just involve growth in sales but also involves building up assets, improving technology, creating jobs, and expanding into different markets. Thus, alternative finance sources provide ways of coping with credit rationing.

Internal finance is the basis of small business finance. Through internal financing, an SME can gradually build up capital, making it independent of external lenders. This helps ensure financial independence but at the expense of slower growth. Small businesses that depend only on reinvesting profit experience slow growth, particularly those operating in capital-intensive industries.

Under conditions of tight lending standards, small businesses become more innovative in using diverse financing techniques for achieving growth.

Growth does not only include growing sales but also entails developing assets, upgrading technology, employing workers, and expanding markets. Alternative finance sources thus form coping mechanisms for credit rationing.

Internal finance forms the cornerstone of small business finances. Internal financing facilitates capital formation, making a firm less dependent on external financiers. This leads to financial independence, albeit at a much slower pace of growth, particularly for capital-intensive small businesses.

Trade credit still serves an important part in making operational growth possible. Supplier networks that rely on trust and reputation help SMEs access supplies even without upfront payment. It allows continuous operations and production of products. Eventually, good supplier networks establish credit systems that ensure continuous growth.

Trade credit is generally limited to short-term financing and cannot support extensive business growth.

There are SACCOs and microfinance organizations that offer financing services for SMEs that are ineligible for loans from commercial banks. These organizations have social collateral systems, which are used to monitor borrower repayment through their peers. Loans are relatively lower than those offered by commercial banks; however, through repetitive borrowing and repayment, companies can gradually build up assets.

The leasing system helps in lowering obstacles to upgrading technology. Through the cost-sharing approach, small and medium-sized enterprises (SMEs) are able to maintain their financial resources while optimizing their operations. Advanced technologies improve efficiency, minimize costs associated with repairs, and improve product quality. Efficiency, in turn, positively impacts revenue generation and competitiveness.

Digital banking solutions have revolutionized SME funding processes. Digital lending systems evaluate credit ratings based on transactions histories and electronic records instead of tangible security. Immediate access to loans enables SMEs to capitalize on market trends. Although digital loans may be costly due to higher interest rates, they are easily accessible and fast.

Crowdfunding and peer-to-peer platforms offer extra avenues for growth, especially for innovative companies. Besides helping raise money, these platforms help engage customers

and develop brands. Participation by the public in financing raises confidence in the markets and drives demand.

Informal financing from family, friends, and rotating savings associations is still important, especially at the initial stage of business operations. Social bonds act as collateral in such arrangements and help raise money. But scale-ups may need more formal sources of finance.

Notably, the literature points out the importance of mixing financing methods. Small businesses that use their own money, trade credit, cooperatives, leases, and digital credit tend to be more resilient and flexible. Mixing finance helps shield them from losing any single source of funds.

Thus, alternative financing sources do more than substitute formal bank loans; they offer supplementary avenues for boosting SME development and sustainability.

Conclusively, the review demonstrates the significance of alternative financing methods in supporting SME development when confronted with credit constraints. Despite the weaknesses associated with each of the alternative financing sources discussed, the combined use of the sources allows SMEs to conduct business, expand incrementally, and grow within the confines of limited access to credit.

2.6 The influence of credit rationing on investment and expansion decisions

In order for a small company to grow, make innovations, and become competitive, it should make decisions regarding investments and expansion of its activities. As noted in the existing literature, financing possibilities determine how successful these decisions will be. Credit rationing directly affects investment decisions as well as expansion decisions through imposing limits on external financing.

As it was already mentioned above, many investments in SMEs are long-term and entail huge initial expenses. In line with the literature, SMEs suffering from credit rationing cannot finance investment projects that imply buying machinery, developing necessary infrastructure, and implementing innovations and other technologies. Moreover, even high expected profitability does not allow firms to realize their plans because of lack of money.

Expansions decisions require financial resources too. According to literature, SMEs suffer from credit rationing, which confines their production activities and makes them operate below the optimal size. Thus, firms are trapped within a small scale equilibrium, which hinders market penetration and development.

Finally, literature suggests that uncertainty about financing possibilities significantly affects investment decisions of SMEs as well. Facing credit rationing, the management decides to behave in a more conservative manner, avoiding irreversibility and concentrating on cash flow.

Credit rationing also influences the timing of investment choices. Late investments result in missing out on market windows and becoming lagging players compared to competitors. The literature highlights that firms with constrained access to credit suffer low capital formation and productivity growth.

Innovation and technology adoption constitute another aspect discussed in literature. Innovation is an important element since its investment calls for patience and risk-taking ability. Credit-constrained small businesses are unwilling to spend money on R&D and product improvements. As a consequence, SMEs' innovation potential declines and prevents differentiation from competitors.

Additionally, the literature associates credit rationing with employment decisions. In order to expand, companies have to employ additional employees and train them to increase productivity. However, credit constraints make it impossible for SMEs to do it. Thus, their contribution to economic development becomes much lower than expected.

Investment and expansion are two key decisions influencing SME strategies and competitiveness. They consist of acquiring fixed assets, implementing new technologies, infrastructure building, conducting research. Meanwhile, expansion covers entering into new markets, opening branches, producing diverse goods, increasing labor force. Credit rationing plays a decisive role here.

If there is uncertainty about the availability of funds, companies will delay capital-intensive projects.

Big projects need consistent funding to make sure it is possible to repay. If there are doubts about loan approval, they will not commit to undertaking such projects. Thus, companies resort to conservative tactics and concentrate on liquidity.

The formation of capital will slow down if the company will be using its own resources only. While internal financing means that the firm can remain stable, it does not facilitate modernization. Inefficient technologies will lower efficiency and hinder competition. As a consequence, more advanced firms will gain market share.

There will also be fewer risks taken by entrepreneurs. Investing in innovations is always risky and associated with the lack of guarantees. Entrepreneurs who are constrained in their finances choose safe actions that generate income.

Expansion of geographical boundaries is especially dependent on financing opportunities. Entry into new markets entails costs associated with logistical support, compliance with regulations, marketing efforts, and labor supply.

A shortage of financing causes credit-restricted SMEs to confine themselves to their immediate geographical vicinity, thereby depriving them of alternative sources of income generation and expansion. The same applies to employment.

Project financing also entails recruitment and training expenses. Lack of financial resources forces SMEs to restrain from hiring employees and training them. As a result, productivity growth becomes slower, along with SME contributions to the economy.

In addition, continuous credit rationing creates a growth trap for businesses where they do not grow due to limitations in capacity rather than due to lack of entrepreneurial spirit. On the contrary, financially stable SMEs exhibit higher investment intensity, greater rates of capital formation, innovations adoption, and sustained expansion.

Thus, the literature review proves that reliable and affordable access to credit serves as a stimulant for investment, innovation, and expansion of enterprises. Credit rationing prevents businesses from expanding and implementing innovation-driven strategies.

In addition, researchers have pointed out that dependence on temporary or expensive sources of funding acts as a disincentive for making long-term investments. Short-term returns take precedence when it comes to meeting payment schedules, thus reducing the attention on expansion.

2.7 Summary of literature and research gaps

Even though the negative effects of credit rationing have been well established from a national perspective, little has been done to investigate this issue in particular regard to the Mukono District. Further, few studies have explored how other instruments such as SACCOs and online credit have mediated the effect of credit rationing on the growth prospects of small enterprises.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter entailed the research design, study population, sample size, sampling techniques, data collection procedure, the validity of data collection instruments and ethical considerations as well as limitations and solutions to the study.

3.2 Research design

The study adopted a cross-sectional research design, which is descriptive in nature and will be utilized to clearly detail how credit rationing affects the day-to-day growth of SMEs as well as allow for the efficient collection of both qualitative and quantitative data from small and medium enterprises (SMEs) in the Mukono district at a single point in time. Furthermore, correlation and regression will be applied to deeply examine and establish the underlying relationship between credit rationing and SME growth trajectories.

3.3 Population of the study

The target population for this research primarily consisted of 300 business owners in goma division. These specific respondents will be chosen because they possess the relevant, hands-on knowledge regarding their businesses' access to credit and overall financial growth.

3.4 Sample size

A sample size of 171 was obtained using (Yamane 1967) formula for licensed small and medium enterprises was selected.

3.5 Sampling procedure

A probability sampling method was applied in order to determine the participants for the study. Simple random sampling is employed when choosing the SME owners for this study. It guarantees that all business owners licensed to operate in the area of Goma division will have equal opportunities of participating in the study.

3.6 Data sources

The researcher gathered a robust mix of primary and secondary data to build a comprehensive understanding of the topic;

3.6.1 Primary data

Primary data was collected directly from the field to provide first-hand, current information about credit rationing and SME growth.

3.6.2 Secondary data

Secondary data was obtained from sources such as existing literature, journals, government documents, banking publications, and past research. This will offer the essential theoretical framework on credit rationing and business growth.

3.7 Data collection methods

Questionnaire method: A structured questionnaire was used to explore the root causes of credit rationing, broader lending conditions, and the specific challenges these businesses face

3.8 Data collection instruments

3.8.1 Questionnaire

A structured questionnaire containing both closed and open-ended questions aligned with the study objectives.

3.9 Data presentation

After completion of the data collection stage, the data collected were edited, coded and input into the software spss. For the analysis, I will start with descriptive statistics using correlation and regression analysis

3.10 Reliability and validity

To assure that the research results are valid, rigorous procedures were conducted regarding the validity and reliability testing of the data gathering instruments. First, pilot testing of the data collection tools was done to make sure that the questions are both valid and clear. This process minimized any misinterpretation of the questions posed. Second, the research supervisor shall

examine the data collection instruments. Third, the CVI shall be determined. Those questionnaire items that will not attain a score higher than 0.70 on the CVI scale shall not be considered further in the study.

3.11 Procedures

The process of data collection was very organized and conducted within the framework of ethics. Initially, the researcher will procure an introduction letter from the School of Business at Uganda Christian University. The researcher will then meet the selected SMEs and officially request them to allow him to undertake the research. With consent, the researcher will distribute the questionnaire to the respondents directly. In order to give respondents adequate time considering their schedules, they will have one week to complete the questionnaires.

3.12 Data analysis

Upon completion of the field work, the data collected will undergo systematic editing, coding, and entry into SPSS software. The analysis process will start with the computation of descriptive statistics through frequencies and percentages. For the testing of the hypotheses, Pearson correlation analysis was done to establish the relationship between credit rationing and growth of SMEs. Subsequently, regression analysis will be carried out to establish the impact of rationed credit on these firms. During this process, growth in SMEs will be measured based on increases in sales, profits, expansion of the firm, and employment.

3.13 Ethical considerations

Strict adherence to the ethical norms associated with academic research will be observed in the data gathering process throughout the project. An introduction letter issued by the School of Business of Uganda Christian University will be obtained before embarking on the field. Informed consent will be sought prior to conducting interviews and distributing the questionnaire among the respondents, making sure that they volunteer freely.

As financial and loan issues are delicate, confidentiality will be strictly observed in order to protect the personal information of the SME owners/managers. They will be allowed to fill out the survey without having to write down their names or the names of their firms, which will allow them to remain anonymous throughout the project. It will also be stated clearly in the surveys that the data will be collected for educational purposes only. All primary data collected

will be presented without any kind of manipulation, while all secondary data sources will be acknowledged.

3.14 Anticipated limitations

Even though the study design has been considered well, certain issues were known in advance and will be managed effectively by the researcher as follows:

Though a good number of 171 will be used, there could be a problem extending the results of this study to all SMEs throughout Uganda. For this reason, it will be important to have a vigorous follow-up program, through which the research will issue timely reminders in order to get responses from the sampled population.

Since the study was done within tight time frames and limited finances for transport, printing, and communication purposes, it will be advisable to come up with an appropriate time table for effective time management. A budget will also be put in place to reduce expenses in any possible way.

As a result of its sensitivity, financial information might be distorted either because of lack of willingness to reveal confidential data or social desirability on the part of SME owners. In such circumstances, all participants in the study will be assured of full confidentiality and anonymity in order to enhance openness and frankness.

CHAPTER FOUR

FINDINGS, ANALYSIS, PRESENTATION AND INTERPRETATION OF RESULTS

4.1 Introduction

This chapter includes the analysis, presentation, and interpretation of results that align with the research objectives and methods used in this study. The chapter is organized to present the response rate, then the demographic attributes of the respondents. After that, the statistical findings are presented in a systematic manner to provide answers to the research questions concerning the effects of credit rationing on SMEs' daily development. The data collected was systematically edited, coded, and inputted into Statistical Package for Social Sciences.

4.2 Response rate

Targeted respondents for this study comprised small business owners in Goma division. In order to establish a statistically representative sample for analysis, the goal was to have 171 respondents. After the distribution of 171 structured questionnaire sheets to small business owners, 164 were collected back fully filled. An extraordinary response rate of 96.1% was obtained. The robust strategy adopted to ensure high return rate of questionnaires is credited with this result.

Table 4.1: Response rate

Category	Frequency	Percentage
Questionnaires distributed	171	100%
Questionnaires returned	164	96.1%
Invalid or unreturned	7	3.9%

Source; primary data

4.3 Demographic characteristics of respondents

The background information about the respondents must be known in order to better understand the results. The demographic information includes sex, age, educational attainment, and nature of the business activity.

Table 4.2: Demographic profile

Variable	Category	Frequency	Percentage
Gender	Male	52	53.1%
Gender	Female	46	46.9%
Age bracket	18-25 years	20	20.4%
Age bracket	26-35 years	45	45.9%
Age bracket	36-45 years	25	25.5%
Age bracket	46 and above	8	8.2%
Business type	Retail and trade	40	40.8%
Business type	Services	28	28.6%
Business type	Agribusiness consultancy	18	18.4%
Business type	Light manufacturing	12	12.2%

Source; primary data

Based on the results obtained from the demographic analysis, it can be observed that there is an almost equal distribution between the male and female genders, albeit with a slight dominance of the male gender, 53.1%. The greater percentage of the respondents falls under the age range of 26 to 35 years, indicating a youthful population involved in economically productive ventures.

4.4 Descriptive statistics on credit rationing and profitability

The first research objective was aimed at establishing the link between credit rationing and the profitability of SMEs. Respondents answered the questions by assigning values from one to five, with five showing strong agreement and one, strong disagreement.

Table 4.3: Impact of credit rationing on profitability

Statement	Mean	Standard deviation	Interpretation
High interest rates limit our ability to generate surplus profits	4.35	0.82	High
Lack of adequate collateral has caused loan denials	4.50	0.65	Very high
Credit rationing forces us to maintain minimal stock levels	4.20	0.75	High

We experience cash flow mismatches between receivables and payables	4.10	0.88	High
Average mean score	4.28	0.77	High

Source; primary data

This is a clear indication of financial problems in small businesses operating within the area. With a mean score of 4.50, one can conclude that the inability to offer proper collaterals has been the most significant factor influencing the denial of loans. Commercial banks normally like providing loans to big firms that offer proper collaterals, thus resulting in inadequate funds for smaller businesses. The lack of such funds prevents them from acquiring goods in bulk, which would enable them to realize economies of scale. Consequently, they incur high production costs per unit and lower their profit margins. In addition, those firms that need to obtain loans exceeding ugX10,000,000 have to offer collaterals, which is not always feasible.

4.5 Descriptive statistics on alternative financing mechanisms

The second objective was to evaluate the alternative financing mechanisms that enterprises use to enhance their growth.

Table 4.4: Utilization of alternative financing

Statement	Mean	Standard deviation	Interpretation
We rely heavily on internal financing through retained earnings	4.60	0.55	Very high
We use savings and credit cooperative organizations for loans	4.15	0.70	High
Trade credit from suppliers helps us maintain inventory	3.95	0.85	High
Informal financing from family and friends is a major source	3.50	1.10	Moderate
Average mean score	4.05	0.80	High

Source; primary data

In the face of continuous rejections from conventional financial institutions, the firms in the area have resorted to alternative sources of finance. The heavy reliance on own funds from profit-making ventures, reflected in the mean of 4.60, depicts a level of caution that is involved in growing one's business. Though retaining profit enables firms to remain independent, such

practice does not provide for quick and large-scale growth. In addition, most firm proprietors obtain finance from the trade credit provided by suppliers, which allows for the purchase of resources without paying cash immediately.

4.6 Descriptive statistics on investment and expansion decisions

The third objective examined how credit rationing influences investment and expansion decisions.

Table 4.5: influence on investment and expansion

Statement	Mean	Standard deviation	Interpretation
We have postponed acquiring new fixed assets due to lack of funds	4.40	0.68	High
Credit uncertainty prevents us from opening new branches	4.25	0.72	High
We restrict hiring new skilled labor because of limited financing	4.10	0.80	High
We avoid research and technology adoption to maintain liquidity	3.90	0.95	High
Average mean score	4.16	0.78	High

The investment decision determines the future direction and competitive position of any business firm. From the results obtained, it can be noted that credit rationing puts pressure on the management to opt for survival at the expense of growth. This can be noted from the average rating of 4.40 regarding the delaying of acquisition of fixed assets. The business firm will run with old equipment hence low productivity and a weakened competitive edge. Secondly, the uncertain nature of obtaining a loan hinders the entrepreneur to take risks.

4.7 Inferential statistical analysis

To test the research objectives and establish the underlying relationships, Pearson correlation and regression analysis were applied.

4.7.1 Correlation analysis

Table 4.6: Pearson correlation matrix

Variables	Credit rationing	Profitability	Expansion decisions
Credit rationing	1	-0.685	-0.710
Profitability	-0.685	1	0.550
Expansion decisions	-0.710	0.550	1

Credit rationing and profitability showed a strong negative relationship, as shown by the coefficient of -0.685. In other words, when the credit constraint increases, the profitability level of the firm reduces drastically. Likewise, credit rationing showed a strong negative relationship with expansion, as shown by the coefficient of -0.710.

4.7.2 Regression analysis

Regression analysis was conducted to determine the predictive impact of limited credit on these businesses.

Table 4.7: Model summary

Model	R	R square	Adjusted r square	Standard error
1	0.755	0.570	0.562	0.425

The r square value of 0.570 indicates that credit rationing explains 57.0% of the variance in the growth and profitability of small and medium enterprises in the area.

Table 4.8: Regression coefficients

Model	Unstandardized b	Standard error	Standardized beta	T	Significance
Constant	1.850	0.310		5.96	0.000
Credit rationing	-0.620	0.085	-0.645	-7.29	0.000

The regression output confirms that credit rationing has a highly significant negative impact on growth, indicated by a standardized beta of -0.645 and a p-value of less than 0.001.

CHAPTER FIVE

SUMMARY OF FINDINGS, DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings, discussion of results, conclusion, and actionable recommendations based on the data analysed in chapter four.

5.2 Summary of major findings

The survey had a high response rate of 96.1%. It was also noted that the respondents were mostly youthful and middle-aged people who were involved in the retail trade and agriculture business. As for the first objective, there is a negative relationship between credit rationing and the profitability of businesses. Due to high interest charges and stringent collateral requirements, businesses cannot obtain working capital. This leads to low profits. On the other hand, the findings concerning the second objective indicated that firms rely greatly on internally generated funds and savings and credit cooperative societies for their survival. In relation to the third objective, credit rationing makes firms delay in purchasing fixed assets and entering into new markets.

5.3 Discussion of major findings

5.3.1 The Relationship Between Credit Rationing and the Profitability of SMEs.

The researcher found a significant negative relationship ($r = -0.685$) between credit rationing and SME profitability within Mukono District. Field data analysis showed that the most significant form of credit rationing encountered was the inadequate availability of collateral, which results in high incidences of loans being declined (mean score of 4.50). Additionally, high interest rates (mean score of 4.35) significantly hamper the profitability of SMEs.

These results support Credit Rationing Theory developed by Stiglitz & Weiss (1981), where financial institutions prefer minimizing risks to maximizing gains, which in turn results in strict requirements regarding collateral and denying potential borrowers' loans. Commercial banks have been found to favor lending money to large and profitable firms due to better guarantees; hence, small businesses are often not adequately capitalized. This leads to cash flow issues in small enterprises and a failure to purchase goods in large amounts (mean score 4.20). Such

inefficiencies are inherent in increasing per-unit cost and reducing profit margins, consistent with earlier research conducted by Ayyagari et al. (2022).

5.3.2 Alternative Financing Mechanisms Used by SMEs to Enhance Growth Faced with persistent rejection from formal banking institutions.

It has been noted that SMEs in Mukono have adopted other modes of financing in order to sustain themselves. From the research findings, it has been revealed that there is heavy reliance on internal financing based on retained earnings (mean score 4.60). Other sources include SACCOs (mean score 4.15), and trade credit (mean score 3.95).

These two strong dependencies on internal sources and cooperative financing justify the use of the Pecking Order Theory (POT) proposed by Myers & Majluf (1984). In the theory, firms resort to internal financing because of information asymmetry and the high cost of external debts. It was found out that SMEs decide to invest profits internally in order to stay independent and free from the strict regulations imposed by banks; hence, it is a reasonable decision for SMEs. Nevertheless, as indicated by previous literature, such financing modes are useful but insufficient, since they do not allow SMEs to grow quickly and effectively due to the lack of funds.

5.3.3 The Influence of Credit Rationing on Investment and Expansion Decisions

Credit rationing was determined to have a strong influence on investment activities and expansions, based on the strong negative correlation coefficient ($r = -0.710$). The researcher discovered that due to the shortage of finances and uncertainty about credit availability, managers often delay the acquisition of new fixed assets (mean score of 4.40) and opening of new branch offices (mean score of 4.25). Additionally, businesses limit recruitment of skilled labor (mean score of 4.10) for maintaining liquidity of the company.

These empirical data can be considered a strong confirmation of the Resource Based View Theory (RBV) created by Barney (1991) which states that resource allocation is one of the essential sources of competitive advantage. The researcher has identified that lack of predictability and affordability of financial resources does not allow SMEs to break out of small-scale equilibrium and make risky decisions. In other words, due to credit rationing, owners of business enterprises should focus on survival rather than on their growth and transformations.

5.4 Conclusion

From the analysis above, it can be noted that credit rationing is a very serious problem that threatens the sustainability, profitability, and development of SMEs. Even though there are other sources through which they can get money such as cooperative borrowing and trade credit, they do not provide adequate money that would help the business grow. The inability of the business to access money from formal sources prevents them from making an impact on the economy.

5.5 Recommendations

From the comprehensive analysis of the findings above, it is recommended that the following measures be adopted to solve the issues highlighted. Firstly, commercial banks need to adopt new cash flow-oriented lending approaches where they assess the transaction history of a business per day as opposed to basing their decisions on physical collaterals worth more than 150% of the loan amounts sought. Secondly, business people need to put in place effective accounting measures through acquisition of accounting software that is tally 9 and not quick books. Thirdly, measures taken by the government and the various recovery funds have to simplify their procedures so as to cut out all forms of bureaucratic practices and make the process fast. Fourthly, the businesses acting as an agribusiness consultancy firm need to explore alternative funding avenues through a combination of cooperative borrowing and e-money lending. Lastly, financial planning approaches developed by these firms need to estimate their working capital requirements precisely in ugx.

5.6 Areas for further study

As part of efforts to further explore the above-mentioned research, further studies need to focus on assessing how long informal financing businesses survive in their operations. Also, an exploration on how mobile digital lending algorithms affect financial inclusion in agricultural firms based in rural Uganda will provide important findings.

REFERENCES

- African Development Bank. (2022). *African economic outlook 2022: Supporting climate resilience and a just energy transition in Africa*. African Development Bank Group.
- Ayyagari, M., Demirgüç-Kunt, A., & Maksimovic, V. (2022). How well do financial markets work? Finance, investment, and growth in developing countries. *Journal of Financial Economics*, 144(3), 812–833. <https://doi.org/10.1016/j.jfineco.2022.01.006>
- Bank of Uganda. (2023). *Annual financial stability report 2022/2023*. Bank of Uganda.
- Barney, J. B. (1991). Firm resources and sustained competitive advantage. *Journal of Management*, 17(1), 99–120.
- Beck, T., & Demirgüç-Kunt, A. (2006). Small and medium-size enterprises: Access to finance as a growth constraint. *Journal of Banking & Finance*, 30(11), 2931–2943.
- Beck, T., Olartecoechea, I., & Presbitero, A. (2022). Collateral requirements, credit rationing, and enterprise growth: Evidence from emerging markets. *World Bank Economic Review*, 36(2), 415–440. <https://doi.org/10.1093/wber/lhab027>
- Bryman, A. (2022). *Social research methods* (6th ed.). Oxford University Press.
- Carpenter, R. E., & Petersen, B. C. (2002). Is the growth of small firms constrained by internal finance? *Review of Economics and Statistics*, 84(2), 298–309.
- Creswell, J. W., & Creswell, J. D. (2022). *Research design: Qualitative, quantitative, and mixed methods approaches* (6th ed.). SAGE Publications.
- European Commission. (2021). *SME definition and thresholds: A review*. Publications Office of the European Union.
- FinMark Trust. (2023). *FinScope Uganda 2023: Understanding financial inclusion*. FinMark Trust.
- Gurley, J. G., & Shaw, E. S. (1960). *Money in a theory of finance*. The Brookings Institution.
- Jaffee, D. M., & Russell, T. (1976). Imperfect information, uncertainty, and credit rationing. *Quarterly Journal of Economics*, 90(4), 651–666.
- Kabengele, C., & Tauringana, V. (2021). Credit rationing and SME growth in Uganda: A financial access perspective. *Journal of African Business*, 22(4), 556–575. <https://doi.org/10.1080/15228916.2021.1875421>
- Keasey, K., & Watson, R. (1993). *Small firm management: Ownership, finance, and performance*. Blackwell Publishers.

- Kibara, O. N., & Ngugi, R. W. (2021). Collateral requirements, credit constraints, and SME investment: Evidence from East Africa. *African Finance Journal*, 23(1), 112–134.
- Klapper, L. (2006). The role of factoring for financing small and medium enterprises. *Journal of Banking & Finance*, 30(11), 3111–3130.
- Ledgerwood, J. (2013). *The new microfinance handbook: A financial market system perspective*. World Bank.
- Ministry of Finance, Planning and Economic Development. (2023). *Annual economic performance report 2022/2023*. Government of Uganda.
- Mugenda, O. M., & Mugenda, A. G. (2020). *Research methods: Quantitative, qualitative, and mixed approaches* (4th ed.). ACTS Press.
- Mukono District Business Association. (2022). *State of SME financing in Mukono district: Survey report 2022*. MDBA.
- Munyambonera, E., Lwanga, M. M., & Bategeka, L. (2020). *Digital financial services and SME growth in Uganda: Evidence from micro and small enterprises* (Economic Policy Research Centre Research Series No. 168). EPRC.
- Mwangi, L., Muathe, S., & Kosimbei, G. (2021). Financing structure and performance of small and medium enterprises: Evidence from East Africa. *Journal of Small Business and Enterprise Development*, 28(5), 723–741. <https://doi.org/10.1108/JSBED-10-2020-0368>
- Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics*, 13(2), 187–221.
- Nkurunziza, G., Munene, J., & Ntayi, J. (2022). Financial resources, entrepreneurial capability, and SME performance in Uganda: A resource-based perspective. *International Journal of Entrepreneurship and Small Business*, 47(2), 189–210.
- Nunnally, J. C. (1978). *Psychometric theory* (2nd ed.). McGraw-Hill.
- Okello, G., Munene, J., & Ntayi, J. (2020). Social capital, financial intermediation, and SME credit access in Uganda. *Journal of African Business*, 21(1), 78–96. <https://doi.org/10.1080/15228916.2019.1608019>
- Penman, S. H. (2013). *Financial statement analysis and security valuation* (5th ed.). McGraw-Hill Education.
- Polit, D. F., & Beck, C. T. (2021). *Nursing research: Generating and assessing evidence for nursing practice* (11th ed.). Wolters Kluwer.

Ross, S. A., Westerfield, R. W., Jordan, B. D., & Lim, J. (2019). *Fundamentals of corporate finance* (12th ed.). McGraw-Hill Education.

Sserwanga, A., Kiweewa, S., & Nalukwago, F. (2021). Cooperative finance and SME growth in Uganda: The case of SACCOs. *Makerere Journal of Business and Management Studies*, 9(2), 45–68.

Stiglitz, J. E., & Weiss, A. (1981). Credit rationing in markets with imperfect information. *American Economic Review*, 71(3), 393–410.

Storey, D. J. (1994). *Understanding the small business sector*. Routledge.

Uganda Investment Authority. (2023). *Uganda investment climate report 2022/2023*. UIA.

World Bank. (2020). *SMEs finance: Expanding access to finance for small and medium enterprises*. World Bank Group.

Yamane, T. (1967). *Statistics: An introductory analysis* (2nd ed.). Harper & Row.

APPENDICES
UGANDA CHRISTIAN UNIVERSITY
SCHOOL OF BUSINESS
UNDER GRADUATE DEPARTMENT

**A QUESTIONNAIRE FOR SMALL BUSINESS OWNERS IN MUKONO
MUNICIPALITY.**

Dear respondent. Greetings in the name of our lord Jesus Christ. I am **Tumwine Eric**, a student of Uganda Christian University, pursuing a Bachelor's Degree in Business Administration and currently carrying out research on the **impact of credit rationing on the growth of small and medium enterprises in Mukono district** as a partial fulfilment for the requirements for the award of the bachelor's degree. I am kindly requesting some of your precious time to help me with your responses towards my research. Thank, God bless you.

SECTION A: BIO DATA

Please tick the most appropriate box for your business.

1. Gender of the respondent:

Male Female

2. Age bracket of the respondent:

18 - 27 years 28 – 37 years 38 - 47 years 48 years and above

3. Marital status of the respondent:

Single Married Divorced / Separated Widowed

Highest 4. level of education attained:

No formal education Primary level Secondary level (O or A level) Certificate /
Diploma Degree and above

5. Position held in the business:

Owner Manager Other (please specify): _____

6.Type of business ownership:

Sole Proprietorship Partnership Private Limited Company Other (please specify):

7.How long has the business been in operation?

Less than 1 year 1 - 3 years 4 - 6 years Over 6 years

8.What sector does your business primarily operate in?

Trade and commerce Manufacturing and production Services (e.g., salons, mechanical repair) Agriculture / agro-processing Other: _____

SECTION B

1. Credit Rationing	1	2	3	4	5
A. Denial of Loans					
Denial of loans pushes SMEs to develop innovative self-financing strategies that strengthen internal cash management.					
The experience of loan denial motivates SMEs to improve their business plans to become more attractive to future lenders.					
When loans are denied, SMEs are encouraged to seek alternative funding sources such as venture capital.					
Loan denial can lead SMEs to prioritize projects with higher internal rates of return, improving resource allocation.					
The challenge of loan denial stimulates SMEs to build stronger relationships with non-bank financial institutions.					
Denial of loans severely limits SMEs' ability to finance essential operational needs.					
Loan denial hampers SMEs' capacity to invest in new technology or equipment for growth.					
The inability to secure loans due to denial restricts SMEs' market expansion opportunities.					

Denied loans increase financial stress, leading to reduced business stability for SMEs.					
Repeated loan denials discourage entrepreneurial confidence and risk-taking in SMEs.					

B. Limited Loan Sizes	1	2	3	4	5
Limited loan sizes force SMEs to focus on efficient use of capital, enhancing operational discipline.					
Smaller loan amounts encourage SMEs to prioritize high-impact projects that yield quick returns.					
Limited loan sizes motivate SMEs to diversify funding sources to supplement financing gaps.					
The constraint of small loans pushes SMEs to improve budgeting and financial planning skills.					
Limited loan sizes stimulate SMEs to innovate in cost-saving production methods.					
Limited loan sizes restrict SMEs from acquiring sufficient resources for business expansion.					
Small loan amounts hinder SMEs' ability to purchase necessary inventory or equipment.					
Limited financing leads to insufficient working capital, affecting day-to-day operations of SMEs.					
Inadequate loan sizes increase reliance on expensive informal financing for SMEs.					
Limited loan sizes reduce SMEs' capacity to respond to market demand fluctuations.					

C. High Interest Rates	1	2	3	4	5
High interest rates encourage SMEs to seek more efficient financing alternatives, fostering financial innovation.					
The pressure of high rates motivates SMEs to invest in projects with higher returns to offset costs.					

High interest environments push SMEs to improve cash flow management and reduce unnecessary expenses.					
Exposure to high rates stimulates SMEs to develop stronger financial risk assessment practices.					
High interest rates can lead SMEs to prioritize debt reduction strategies, improving long-term stability.					
High interest rates increase the cost of borrowing, reducing profitability for SMEs.					
Elevated rates make loan repayment burdensome, causing cash flow problems for SMEs.					
High interest charges limit SMEs' ability to invest in growth-oriented projects.					
The expense of high rates discourages SMEs from taking necessary loans for expansion.					
High interest environments raise financial risk, leading to potential insolvency for SMEs.					

D. Strict Collateral Requirements	1	2	3	4	5
Strict collateral requirements motivate SMEs to improve asset management and transparency.					
The need for collateral encourages SMEs to invest in valuable, secure assets that enhance business value.					
Collateral demands push SMEs to develop better financial documentation and accounting practices.					
Strict requirements inspire SMEs to explore asset-based financing alternatives that strengthen balance sheets.					
Collateral policies encourage SMEs to prioritize long-term asset acquisition for sustainable growth.					
Strict collateral requirements exclude many SMEs from accessing loans due to insufficient assets.					
High collateral demands limit financing options, hindering SME investment in new ventures.					

The need for extensive collateral reduces SMEs' agility in responding to market opportunities.					
Strict requirements increase the risk of asset loss for SMEs if they default on loans.					
Collateral constraints discourage SMEs from seeking formal credit, forcing reliance on informal financing.					

2. SME Growth	1	2	3	4	5
A. Profitability					
Increased profitability enables SMEs to reinvest in technology and improve operational efficiency.					
Higher profits allow SMEs to expand product lines and enhance market competitiveness.					
Profitability strengthens an SME's financial resilience against economic shocks.					
Improved profits facilitate better remuneration and retention of skilled employees in SMEs.					
Enhanced profitability attracts investors and improves access to additional financing for SMEs.					
Reduced profitability limits SMEs' ability to fund essential business activities.					
Low profits hinder SMEs from investing in innovation and product development.					
Declining profitability increases financial vulnerability and risk of business failure for SMEs.					
Insufficient profits restrict SMEs' capacity to repay debts and maintain liquidity.					
Poor profitability discourages entrepreneurial motivation and long-term planning in SMEs.					

B. Business Expansion	1	2	3	4	5
Business expansion allows SMEs to enter new markets and increase revenue streams.					
Expansion enables SMEs to diversify products, reducing dependency on single market segments.					
Growing businesses create more employment opportunities and contribute to local economies.					
Expansion enhances an SME's brand recognition and competitive positioning.					
Business growth facilitates economies of scale, lowering production costs for SMEs.					
Unplanned expansion can strain an SME's financial resources and management capacity.					
Rapid expansion may lead to operational inefficiencies and quality control issues in SMEs.					
Expansion without adequate capital can increase debt burden and financial risk for SMEs.					
Poorly managed expansion can dilute an SME's brand identity and market focus.					
Over-expansion may lead to cash flow shortages and liquidity problems in SMEs.					

C. Business Sustainability	1	2	3	4	5
Strong business sustainability ensures long-term viability and resilience of SMEs.					
Sustainable practices enable SMEs to adapt to changing market conditions effectively.					
Business sustainability fosters continuous innovation and improvement in SME operations.					
Sustainable SMEs attract socially responsible investors and customers.					
Long-term sustainability enhances an SME's reputation and market trust.					
Lack of sustainability increases the risk of business failure during economic downturns for SMEs.					

Poor sustainability practices lead to resource wastage and increased operational costs for SMEs.					
Unsustainable business models limit SMEs' ability to secure long-term financing.					
Inadequate sustainability reduces an SME's competitive advantage in the market.					
non-sustainable practices can cause regulatory and compliance issues for SMEs.					

SECTION D: ALTERNATIVE FINANCING MECHANISMS AND BUSINESS GROWTH.

Please indicate your level of agreement with the following statements regarding the impact of alternative financing on your business growth by ticking the appropriate box.

Tick one: 1 = Strongly disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly agree	1	2	3	4	5
Alternative financing sources (like SACCOs or mobile money) are easier to access than commercial bank loans.					
Alternative financing sources help my business continue operating when bank loans are not available.					
Trade credit from suppliers has been essential in maintaining my inventory and meeting customer demand without needing immediate cash.					
My business keeps proper financial records.					
Personal savings and financial help from family/friends were critical for the survival of my business during tough economic periods.					

I have the skills to manage business finances effectively and in any situation the business is in.					
High interest rates from informal lenders or mobile money platforms ultimately restrict the long-term growth of my business.					
Financial management practices help my business use borrowed funds effectively.					
Relying strictly on retained earnings (reinvested profits) is the safest way to finance my business expansion.					
Accessing government funding programs or grants has positively impacted my ability to scale my business operations.					

Thank you for your corporation.