

**THE EFFECTS OF COSTS OF PRODUCTION ON THE FINANCIAL
PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES: A CASE STUDY OF
KAMOL ENGINEERING SERVICES LTD**

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**UGANDA CHRISTIAN
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DECLARATION

I **Nakigozi Faridah** declare that this work is original and has not been presented to any education institution or even published for any award in any university.

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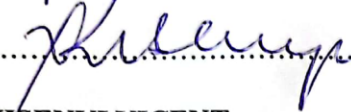
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APPROVAL

This is to certify that the dissertation presented by NAKIGOZI FARIDAH on the impact of costs of production on the financial performance of small and medium enterprises in Mukono was done under my supervision and it is ready for submission.

Date. 5/9/2021.....

Sign.....

MR. KISENYI VICENT

(SUPERVISOR)

DEDICATION

I dedicate this dissertation to my lovely family members for their endless support towards me achieving this level of education.

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First of all, I would like to thank God for his endless protection throughout my academic journey.

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ABSTRACT

The study aimed at examining the impact of costs of production on the financial performance of small and medium enterprises in Mukono. The study had several objectives which included;

To establish the relationship between the costs of production and the financial performance of SMEs in Mukono.

To find out how the costs of production affect the financial performance of small and medium enterprises.

In the study, cross sectional research design was used on the quantitative data obtained from the questionnaire.

Linear regression and correlation analysis were used to find out the relationship between the costs of production and the financial performance of small and medium enterprises.

The study analyzed that there was a moderate negative correlation between costs of production and the establishment of new SMEs.

LIST OF ABBREVIATIONS.

SMEs

Small and Medium Enterprises.

NGOs

Non-Government Organizations

CHAPTER ONE.

1.0 Introduction

Small and medium enterprises are a foundational component of Uganda's economic outlay, employing about five to forty-nine people and having total assets ranging from 10 million Ugandan shillings to 100 million Ugandan shillings. These enterprises are not just statistical figures but they rather embark the livelihoods of countless individuals within the country who seek financial independence and freedom through starting up their own businesses. In Mukono, the rate at which SMEs are introduced is hiking, with many people engaged in various businesses as a means of earning a living. The love of starting up a small or medium enterprise lies in the barriers of entry and these enterprises are most times easier and yet more affordable to establish as compared to larger businesses. This flexibility gives an opportunity to individuals from different backgrounds, plus those with limited finances, to take the risk and focus on their business journeys. Provided in retail, services, or light manufacturing, the reliability to start up a business requires ownership and empowering the local people.

However, despite that SMEs are very many in the amongst the individuals, many small and medium enterprises in Mukono face a number of challenges that reduce on their chances of surviving. There is a trend of a number of these businesses struggling to survive and make it to their first birthday. One of the major causes for this high failure rate is the continuously rising costs of production, which many entrepreneurs find difficult to manage and hence making it difficult for the SMEs to survive. The expenses incurred while running the business can be broken to, a range of factors that include, raw materials, labor, utilities, and transportation costs. For a number of SMEs, especially those that heavily rely on locally produced materials, changes in the market prices can bring about unpredictable financial situations that complicate the budgeting and resource allocation processes. In addition, the competitive nature amongst the business has further challenges, as new businesses most times find themselves struggling for a limited market share with other established firms and SMEs, therefore making it extremely difficult to fund operations in the presence of stiff competition.

Many entrepreneurs lack the access to resources that are critical for business growth and continuity. Limited access to financing is a serious barrier since a number of SMEs struggle to get loans or credit facilities because of the strict lending process put in place by the financial institutions. Due to inadequate funding, entrepreneurs find it very difficult to make investments

in very important tools, technology and staff needed for enhancing productivity and as well as efficiency. Going deeper, the availability of ineffective training and mentoring of individuals in the business field can also hinder their ability to overcome the difficulties of running a business. A number of business people are not well established with the financial management skills, strategies of marketing and as well as operational knowledge required to succeed, this therefore results into poor decision making that can set back these enterprises. The factor of financial limitations and a lack of support system limits the need for the systems that quicken the growth of small and medium enterprises in Mukono.

Overcoming these problems requires an effort from a number of stake holders that include the government and non -government organizations s at large. It is also important to put in place frameworks that aid and help the development and growth of small and medium enterprises. Also providing access to affordable financing services directed to the special requirements of SMEs, as well as offering trainings that equip entrepreneurs with the needed skills of managing their businesses while being assured of their survival. Also, establishing opportunities that bring all entrepreneurs with experience, these can mentor other entrepreneurs in the business while providing guidance and support, helping them overcome the difficulties of the business environment. Creating awareness about the importances of SMEs amongst the local economy can also help get support from both the public and private sectors, creating an approach to ensuring the growth of small and medium enterprises.

1.1 Back ground

Uganda's economy is boosted by the small and medium enterprises (SMEs), which serve as the greatest drivers of growth and development of the business sector. The enterprises cut across a wider range of businesses, including salons, restaurants, retail shops, and very many other services and manufacturing activities. SMEs provide basic goods and services to the local communities and as well as play an important role in creating jobs, helping to eliminate poverty and also improve on the quality of life for all Ugandans. However, despite their significance and advantages, many individuals who are engaged in starting up their own businesses find it difficult to maintain and sustain these businesses and this is always financially. As a result, many of these enterprises fail before they have experienced their first birthday, leading to losses and this discourages other aspiring business owners from starting up their own business.

The challenges faced by SMEs in Uganda are many and mainly originate from many issues. One of the problems is the difficulty in securing enough finances to support business

operations, development and growth. Although the government of Uganda has come up with endless efforts to help SMEs with finances especially through many initiatives and programs, the strategies have most times gone wrong with their intended goals and objectives. Another barrier to accessing financial support is the lack of collateral security that many entrepreneurs face when attempting to get loans. Many small business owners do not have the necessary assets to use as security, which greatly limits their ability to secure funding from the financial institutions that are willing to offer financial assistance. This therefore is particularly common where banks and lending institutions typically require valuable items before approving giving out of loans to small enterprises.

The low levels of profits acquired that are characterized by many SMEs also make it difficult for their financial sustainability. Many small businesses work with small profit margins, which makes it challenging to have enough money for investing in the operations, expanding, or reduce on the financial laggings. This is because of high interest rates on bank loans that can discourage entrepreneurs from acquiring the financial support they need to develop their businesses. The cost of borrowing is always high and this therefore leads to many individuals to not afford the loans. Adding on, the high level of bureaucracy involved in the loan application process can discourage entrepreneurs from acquiring help and financial aid from financial institutions. Encountering the difficult requirements can be time consuming, annoying and frustrating. Many business owners lack the necessary knowledge and resources to effectively engage with financial institutions, and therefore limiting their access to financial assistance.

In assessing these challenges, it is important for the government and different stakeholders to develop effective strategies aimed at enhancing the financial capabilities of SMEs in Mukono and Uganda at large. This can involve creating more financial systems that bring on board low interest loans specifically designed for the small businesses, as well as putting in place training programs that provide entrepreneurs with skills they need to manage their finances effectively and overcome the lending boundaries. Lastly, fostering partnerships between financial institutions and SMEs can help bridge the gap, enabling financial institutions to understand the uniqueness, needs and circumstances of small businesses and hence leading to more favorable lending conditions.

1.2 Statement of the problem

It is about 90 percent of businesses in Uganda that are Small and Medium Enterprises and they have greatly contributed to the growth and development of the economy of the country. Tho this is a big percentage, SMEs face quite a number of challenges and most individuals find themselves exiting the field.

This was witnessed post Covid 19 pandemic where about 50% of the SMEs in Uganda closed up due to the costs brought about by the pandemic. Tho the government tried so hard to ensure their funding, loan schedules were put in place, but this was not effective to a greater extent.

Little did the government know that there are challenges faced by these businesses that have to be addressed. One of the challenges being the rising costs of production that have greatly hindered the profitability, growth and development of these businesses.

There for in this study and research, we shall see how the various costs of production impact the financial performance of small and medium enterprises.

1.3 Purpose of the study

The purpose of the study is to establish the relationship between the costs of production and the financial performance of small and medium enterprises in Kampala.

1.4 Specific objectives of the study

The objectives of the study are the following;

To establish the relationship between the costs of production and the financial performance of SMEs.

To find out if the costs of production affect the growth and development of SMEs

To establish the relationship between the costs of production and the continuity of SMEs

To reveal the relationship between the costs of production and the establishment of more SMEs in Kampala.

To establish how the costs of production influence the financial performance of SMEs in Kampala.

1.5 Research questions

What is the relationship between the costs of production and the establishment of more SMEs in Kampala.

What is the relationship between the costs of production and the continuity of SMEs

What is the effect of the costs of production on the growth and development of SMEs

What is the effect of costs of production on the financial performance of SMEs

How can small and medium enterprises in Kampala survive despite the costs of production associated with their operation.

1.6 Scope of the study

The study is carried out in Kampala city and it is running from 2023 to 2024.

The subject scope of the study is about entrepreneurship, the relationship between the costs of production and the financial performance of SMEs in Kampala city.

1.7 Conceptual frame work

Rising costs of production

- Raw materials
- Costs of transportation
- Labor costs
- Taxes

dependent variables

- Growth of SMEs
- Development of SMEs
- Profitability of SMEs

The following is how the independent variable/ the costs of production affect the dependent variables\the growth and development plus the profitability of small and medium enterprises;

High costs of raw materials, make producers to charge more prices on goods hence reducing the demand for the goods due to the high costs imposed on the products. Therefore, SMEs tend to make huge losses hence hindering their growth and development.

Rising taxes being imposed on small and medium enterprise, these limit the profitability of these businesses hence their growth and development is hindered.

High labor costs, here individuals who are being employed in the business need to be compensated for their services which is really costly to the business. As a result, this reduces the profitability of the small and medium enterprises.

1.8 Variables in the conceptual frame work

The following are the variables of the frame work;

The independent variable is the, rising costs of production among small and medium enterprises.

The dependent variables are, the growth of small and medium enterprises and the development of small and medium enterprises

1.9 Significance of the study

The findings of this study hold significant promise for various stakeholders, particularly Kampala's business community, especially those engaged in small and medium enterprises. By coming up with solutions tailored to the complicated circumstances of SMEs, the study aims at empowering these entrepreneurs with business ideas and tools that can improve their operational efficiency and financial sustainability. This is so important as it equips business owners with the skills they need to overcome the challenges of running a small and medium enterprise, thereby increasing their chances of living longer and successfully plus being profitable.

The government of Uganda is also a key beneficiary of the research. This is because the research provides a comprehensive analysis and over view of the factors affecting the growth and development of small and medium enterprises, the study provided policymakers with useful information to design targeted interventions that favor a conducive environment for the businesses. Understanding the challenges faced by Small and Medium Enterprises will enable the government to put in place active policies that support their survival and growth, hence leading to a more successful economic over view in the region. Additionally, as these enterprises fight and enlarge, they will contribute to the national economy through taxation, generating additional revenue that can be reinvested in public services and infrastructure and as well as contributing to the gross domestic product. This there for creates positive feedback where the success of Small and Medium Enterprises not only benefits the entrepreneurs themselves but also enhances the government's capacity to provide essential services to the population through the taxes being charged on the enterprises.

If the small and medium enterprises are stable, this is very important for families, because it allows them to meet their basic needs, invest in education, and access healthcare services. The proliferation of successful SMEs can lead to a more vibrant local economy, where increased spendable income contributes to consumer spending and a higher quality of life for the community at large. As a result, the study not only addresses the challenges faced by Small and Medium Enterprises but also points out their potential to uplift entire communities through economic enhancement.

Finally, students and researchers from all over the country will also benefit from the insights and data generated throughout this study. The information gathered can serve as a valuable resource for academic research, enabling students to build upon existing knowledge and explore new avenues of inquiry related to SMEs and economic development. By giving a comprehensive overview of the challenges and opportunities that Small and Medium Enterprises face, this study can contribute to the academic discourse surrounding entrepreneurship in Uganda. Students can make use of the findings in the research to inform their own research projects, encouraging a deeper understanding of the dynamics at play in the SME sector and eventually influencing future putting into practice the policy.

1.8 Limitations of the study

One of the primary limitations of this study is the issue of lack of cooperation among the individuals chosen as the sample size from the population size. The effectiveness and validity of the findings focus on the quality of information provided by the respondents from the sample size. In some cases, participants may offer irrelevant or inaccurate feedback regarding the performance of their small and medium enterprises (SMEs) in the region. This can arise from a variety of factors, including a lack of understanding of their business operations or an inability to articulate their challenges clearly or even not being willing to share information. As a result, the data that was collected may not have been accurately represented the broad whole information of Small and Medium Enterprises in the region, potentially exploring the study's conclusions and the recommendations as wells. The reliance on only one source of data that is to say relying on only the data that one has collected, can bring about bias that compromises the overall reliability of the research that was being made, making it imperative to approach the findings with ease.

Another significant limitation that was encountered during the research process was the difficulty of coming up with a research topic. A number of topics that were considered often appeared to be irrelevant or unmatching with the context of the existing literature and the specific needs of the study. This challenge prolonged the initial stages of the research and as well as led to uncertainty about the direction of the study. Identifying a topic that matches with both academics and practical purposes was very important for ensuring that the research contributes accordingly to the field. The hardship come up with a suitable and impactful research focus highlights the difficulties involved in conducting the studies within the landscape and often underexplored realities of Small and Medium Enterprises.

The potential for bias in the selection of respondents. The method used to choose participants may inadvertently favor certain groups, resulting in a lack of diversity in perspectives. For instance, if the sample consists predominantly of entrepreneurs from a specific sector, such as retail, the findings may not accurately reflect the experiences of SMEs across other sectors, such as manufacturing or services. This bias can lead to an incomplete understanding of the challenges faced by SMEs in Kampala, ultimately affecting the generalizability of the results. A more balanced representation across various industries would be essential for capturing a full view of the Small and Medium Enterprises out lay.

The study may face limitations related to external factors affecting the performance of Small and Medium Enterprises that are way beyond the scope of the research or study. These factors may include economic fluctuations, regulatory changes, or social dynamics that impact the business environment in Kampala. Such external variables can significantly affect the operational landscape for SMEs, yet they may not be fully addressed within the study's framework. Ignoring these concerning factors could lead to oversimplified conclusions about the challenges and opportunities for Small and Medium Enterprises. And plus, future research could benefit from incorporating a wider analysis of these external influences to provide a more simplified understanding of the factors affecting Small and Medium Enterprises performance in Uganda.

CHAPTER TWO

Literature review

2.0 Introduction

This chapter exploits a number of theories that are in line to small and medium enterprises and discusses how individuals can be supported to experience the growth and development of their businesses as entrepreneurs, despite the complications brought about by the rising costs of production. Small and Medium Enterprises are important to Uganda's economy, through contributing to the Gross Domestic Product and providing employment opportunities to the individuals in the region. Through analyzing the underlying factors contributing to the rising costs, this chapter aims at pointing out solutions that could help ensure the continuity and success of these Small and Medium Enterprises. Through a full understanding of these facts, stakeholders can come up with strategies that empower entrepreneurs, strengthening the economic sector of the region and as well as Uganda at large.

2.1 Theoretical Framework

Below are some of the important theories that provide more details on small and medium enterprises verses costs of production.

The Entrepreneurship Theory; The theory emphasizes on the role of entrepreneurs as activists for economic growth, development and innovation. The theory also focuses on enabling individuals establish and manage small and medium enterprises effectively, highlighting the traits that define successful entrepreneurship and entrepreneurs at large, for example risk-taking, resilience, and effective decision-making. Entrepreneurs are often driven by a desire to identify and exploit market opportunities in the face of all the challenges they are most likely to face. By fostering an entrepreneurial culture, individuals are able learn how to overcome the difficulties associated with operating a business, putting on board how to minimize rising costs of production.

The Human Capital Theory; This theory centers the idea that the skills, experience, knowledge, and time invested by individuals play an important role in the growth and development of small and medium enterprises. Human capital is defined as the collective factors of the workforce that contribute to productivity and innovation and as well as creativity.

As individuals apply their skills and experience in their businesses, they can relatively influence their enterprises' performance. For example, employees or entrepreneurs with relevant industry experience are of a higher chance to develop effective strategies that address high production costs.

The Innovation Theory; This theory highlights the importance of innovation in sustaining the growth and competitiveness of small and medium enterprises. It provides that SMEs must continuously seek out and put in action innovative ideas, products, and processes to thrive through an ever-changing market landscape. Innovation can take many forms, including technology advancements, new business ventures and creative marketing strategies. By participating in innovation, SMEs can distinguish themselves from competitors, improve operational efficiencies, and respond more effectively to consumer demands.

2.2 The relationship that is between the costs of production and the financial performance of SMEs.

Production costs include all expenses incurred in the manufacturing of goods or the provision of services, and they can be categorized into both fixed and variable costs. Fixed costs remain the same regardless of production levels, while variable costs vary based on output. Effective management of these costs is important for small and medium enterprises as they typically operate with smaller profit margins compared to larger organizations, which can make them more available to fluctuations in expenses. According to Smith et al. (2022), high production costs can have a very high impact on profits, threatening the financial stability of SMEs and limiting investments and growth. This reality undermines the need for Small and Medium Enterprises to adopt to cost reduction strategies that not only help in reducing expenses but also influence operational efficiency. By implementing effective cost management strategies, such as process optimization, resource allocation, and waste reduction, Small and medium Enterprises can relatively improve their financial performance. Also, understanding and managing production costs is important for the sustainability and success of Small and medium Enterprises, aiding them to navigate the stiff competing land mark while maximizing their potential for growth and development.

Recently, studies have established a direct relationship between production costs and the financial performance of small and medium enterprises in the region highlighting the very important role that cost management plays in the part of determining profitability. According to research by Jones and Taylor (2022), Small and Medium Enterprises that face high production costs often experience reduced profit margins, which can significantly challenge

their ability to reinvest in their operations and after their growth opportunity goals. This financial strain not only affects immediate profitability but can also have long term repercussions on the sustainability of these businesses. Small and medium enterprises that successfully maintain lower production costs tend to report enhanced profitability and improved overall financial health, allowing them to allocate resources more effectively and invest in innovation, marketing, and expansion. The ability to manage production costs effectively is a key determinant of an SME's financial success and long-term viability.

Effective cost management is crucial for enhancing the financial performance of small and medium enterprises, as it directly influences their ability to thrive in competitive markets. Lee et al. (2022) emphasizes that SMEs that adopt strategic cost management practices such as process optimization and waste reduction are better equipped to achieve improved financial outcomes. This approach not only enhances productivity but also fosters a culture of continuous improvement, enabling businesses to respond nimbly to changing market demands, research by Nguyen and Pham (2022) highlights the importance of innovation in production processes, suggesting that SMEs that embrace innovative practices are able to exercise better cost control. By new technologies and methods, these enterprises can optimize resource utilization, reduce waste, and enhance the quality of their products or services. Ultimately, a comprehensive approach to cost management incorporating both strategic practices and creative solutions can empower SMEs to strengthen their financial performance, ensuring their sustainability and growth in an increasingly competitive environment.

The competitive nature respectively influences the relationship between production costs and the financial performance of small and medium enterprises. Miller et al. (2022) argue that in order to maintain profitability, SMEs must continually adapt to ever-changing market conditions. High production costs can severely limit these businesses' pricing flexibility, making it difficult for them to compete effectively with larger firms that benefit from economies of scale. As a result, SMEs often find themselves in a precarious position, where rising production costs can erode profit margins and diminish their ability to attract and retain customers. The findings indicate that SMEs operating in highly competitive markets are especially vulnerable to these pressures, as they may struggle to pass increased costs onto consumers without risking their market share. This dynamic not only threatens the financial sustainability of SMEs but also highlights the necessity for them to develop innovative

strategies that enhance their competitiveness. By focusing on efficiency, differentiation, and customer engagement, SMEs can better navigate the challenges posed by market dynamics and secure a more stable financial footing in the face of rising production costs.

Other factors play a crucial role in shaping the relationship between production costs and the financial performance of small and medium enterprises (SMEs). Economic conditions, regulatory frameworks, and supply chain dynamics can all significantly impact how SMEs manage their production costs and, consequently, their profitability. Garcia et al. (2022) highlight that during economic downturns, production costs often rise due to increased prices for raw materials and other inputs, which can lead to decreased demand for products and lower sales revenues for SMEs. This situation creates a challenging environment where businesses must navigate heightened financial pressures while striving to maintain their market presence. The authors emphasize that impacts of rising production costs on their financial health, SMEs must be agile and responsive to these external pressures. This adaptability may involve diversifying supply chains, engaging in proactive financial planning, and leveraging technology to enhance operational efficiency. By staying attuned to external changes and developing strategies to respond effectively, SMEs can better withstand economic fluctuations and sustain their financial performance in the face of rising production costs.

2.3 The relationship between the costs of production and the continuity of SMEs

Research indicates that production costs directly impact the viability of small and medium enterprises (SMEs), which are critical to economic growth and job creation. High production costs can significantly strain financial resources, making it challenging for businesses to sustain operations over time. According to Brown and Wilson (2022), SMEs that experience significant fluctuations in production costs often face difficulties in maintaining consistent cash flow, a crucial component for day-to-day operations. This lack of stability can lead to operational disruptions, reduced competitiveness, and ultimately, business closure. As production costs rise, SMEs may struggle to manage their expenses effectively, leading to a cycle of financial instability that threatens their continuity. This is especially concerning for SMEs, which typically operate with narrower margins and fewer resources than larger firms, making them more susceptible to the adverse effects of rising costs. Therefore, understanding how production costs influence the viability of SMEs is essential for fostering a sustainable business environment.

The costs associated with production also play a critical role in shaping strategic decision-making within SMEs. Roberts et al. (2022) argue that when production costs rise, SMEs are

forced to make difficult choices that can have long term implications for their growth and sustainability. These choices may include cutting back on staff, reducing marketing efforts, or deferring investments in innovation. Such decisions can hinder growth potential and compromise the long-term continuity of the enterprise. Conversely, SMEs that proactively manage their production costs through effective budgeting and resource allocation are better positioned to navigate challenges and seize growth opportunities. By maintaining a disciplined approach to cost management, these businesses can avoid the pitfalls of financial instability and create a more robust foundation for future growth. This strategic focus on cost management not only helps in sustaining operations but also enhances the overall resilience of SMEs in a competitive marketplace.

Effective cost control is essential for ensuring the continuity of SMEs, particularly in an economic landscape characterized by uncertainty and volatility. Research by Nguyen et al. (2022) highlights that SMEs implementing robust cost management strategies, such as lean operations and efficient supply chain management, are more likely to achieve financial stability. These strategies not only help mitigate the impact of rising production costs but also enhance the overall competitiveness of small and medium enterprises, enabling them to adapt to market changes and consumer demands. Maintaining a competitive edge is crucial for long-term survival, as it allows small and medium enterprises to retain market share even in challenging economic conditions. By investing in cost effective technologies and optimizing operational processes, small and medium enterprises can improve their margins and enhance their ability fluctuations in production costs. This adaptability is vital for sustaining their operations and continuing to contribute to the local economy.

Moreover, external factors, such as economic fluctuations and regulatory changes, further complicate the relationship between production costs and the continuity of SMEs. Garcia and Lopez (2022) emphasize that economic downturns can lead to increased production costs and decreased demand, posing significant risks to the continuity of SMEs. In such scenarios, businesses must be agile and responsive to external pressures to survive. Those that fail to adapt may find themselves unable to sustain operations, resulting in closures and job losses within the community. This highlights the importance of a supportive regulatory environment that can help mitigate the adverse effects of economic fluctuations on SMEs. Policymakers must recognize the loopholes of SMEs and work to create conditions that promote resilience and sustainability in this vital sector.

Innovation emerges as a critical factor in mitigating the adverse effects of rising production costs on SME continuity. Research by Kim and Park (2022) suggests that SMEs that invest in innovative processes and technologies are better equipped to manage their production costs effectively. By streamlining operations and enhancing productivity through innovation, these enterprises can reduce expenses while maintaining or improving product quality, thereby ensuring their long-term viability. This focus on innovation can serve as a key driver of growth, allowing SMEs to respond proactively to changing market conditions and consumer preferences. In summary, the interplay between production costs, strategic decision-making, effective cost control, external factors, and innovation is essential for understanding the continuity of SMEs. A comprehensive approach that addresses these elements will be crucial for fostering a resilient and thriving SME sector.

2.4 The relationship between the costs of production and the establishment of more SMEs in Kampala.

High production costs often serve as a significant barrier to entry for potential entrepreneurs looking to establish small and medium enterprises (SMEs). According to Kagoda and Okwakol (2022), the initial expenses associated with setting up a business—including acquiring raw materials, obtaining necessary permits, and investing in equipment—can be prohibitive for many individuals. These financial barriers deter aspiring entrepreneurs, thus limiting the establishment of new SMEs. In Kampala, where access to capital is often challenging, understanding the dynamics of production costs becomes crucial for promoting entrepreneurial activity. The high costs can discourage individuals from pursuing their business ideas, leading to a stagnation in the growth of the SME sector. This situation underscores the need for targeted interventions and support mechanisms that can help alleviate these financial burdens, making it easier for individuals to embark on their entrepreneurial journeys.

The costs associated with production significantly impact the decision-making processes of potential entrepreneurs. Research by Mugisha and Kanyesigye (2022) indicates that individuals often conduct thorough cost-benefit analyses before venturing into business. Rising production costs can introduce increased uncertainty and perceived risk, causing potential entrepreneurs to reconsider their plans or delay their business initiatives. This cautious approach can stifle innovation and hinder the growth of the SME sector in Kampala, as aspiring business owners may opt for alternative employment rather than pursuing entrepreneurship. Consequently, the interplay between rising costs and the decision-making process can lead to missed opportunities for economic development, as talented individuals may be discouraged from

taking the risks associated with starting new businesses. Addressing these concerns is essential for fostering a more vibrant entrepreneurial ecosystem in the region.

Effective cost management strategies can mitigate the challenges posed by high production costs, thereby encouraging the establishment of more SMEs. Research by Byaruhanga and Kasozi (2022) highlights that entrepreneurs equipped with knowledge and tools for effective cost management are more likely to succeed in launching and sustaining their businesses. Training programs and support services that focus on cost control can empower new entrepreneurs to navigate the complexities of starting a business. By providing resources and education on financial management, aspiring business owners can develop strategies to reduce costs and improve their operational efficiencies.

Government policies play a crucial role in shaping the relationship between production costs and the establishment of SMEs. Nabudere and Muwanga (2022) argue that supportive regulatory frameworks, such as subsidies for raw materials or tax incentives for new businesses, can significantly lower production costs and encourage entrepreneurship. By reducing the financial burden on new SMEs, such policies can attract more individuals to enter the market, leading to an increase in the number of established businesses in Kampala.

Innovation and the adoption of technology also influence the relationship between production costs and the establishment of new SMEs. Ssewanyana et al. (2022) suggest that entrepreneurs who leverage technology to streamline operations and reduce costs are more likely to succeed in establishing their businesses. By embracing innovativeness, such as digital marketing and e-commerce, new SMEs can lower their production costs and reach higher markets, thereby enhancing their viability and encouraging further entrepreneurial activity in Kampala. The integration of technology not only helps in cost reduction but also opens up new avenues for revenue generation, allowing SMEs to compete more effectively in the market. As a result, fostering an environment conducive to technological adoption is critical for promoting the establishment of new SMEs and ensuring their long-term sustainability.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter shows the processes through which data was collected, assessed and analyzed. In addition, the chapter outlines the techniques to be used to implement the research and gives an insight into the quality of all means to be used throughout the process.

3.1 Research Design

The study will use a cross-section research design approach. The study will consider both quantitative and qualitative research approaches. A quantitative research approach will be used to analyze statistical data. The researcher will use a qualitative approach to yield an unbiased result that can be generalized to a larger population. The qualitative research approach is primarily exploratory research used to gain an understanding of underlying reasons opinions and motivations and provide insight into the problem or help to develop ideas or hypothesis for potential quantitative research (Mugenda and Mugenda, 1999). A qualitative research approach is used to collect non-numerical data.

3.2 Data Sources

Primary sources: Primary data will help the researcher to have unused and fresh data for the determination of events. The researcher will directly reach out to the respondents through various data collection instruments such as interviews and questionnaires.

Secondary sources: Document review related to the study, newspapers, online journals, and textbooks will be used such that the researcher is well equipped with the required data to facilitate the study.

3.3 Data Collection Methods and Instruments

Data collection refers to the systematic process of collecting research data on a given phenomenon (Amin, 2005). The researcher will use both primary and secondary sources of data collection for the study.

3.4.1 Questionnaire

Kumar (2005) defines a questionnaire as a written list of questions, the answers to which are recorded by the respondents. The questionnaire has sets of questions, which will be answered by filling, after which they will be picked back for data analysis. Self-administered questionnaires covering aspects of the study variables and accompanied by a five-point Likert scale response continuum, that is 5= strongly agree, 4=agree, 3=undecided, 2=disagree and 1= strongly disagree, was used for this study to collect data responses. This method of data collection will be preferred because it gives a great degree of assurance to the anonymity and confidence of the research respondents.

3.5 Quality Control

3.5.1 Validity

Collis and Hussey, (2013), holds that validity of an instrument is the ability of the instrument to collect justifiable and truthful data; that is, measuring what it is developed to measure. The construction of the questionnaire will be based on the objectives of the study. Data collection instruments will be presented to the supervisor who will attest to the content validity of the instrument that is; the ambiguity of question items and their relevancy. The questionnaire will be pretested on 10 respondents in order to compute the content validity index. In cases where the average percentage is found to be above 0.7 (70%), the content is considered valid. The formula below is used to check for the validity of the instrument:

$$CVI = \frac{R}{R + N + IR}$$

Where; R is Relevant, N is Neutral, and IR is irrelevant. The closer the value is to 1, the more valid the instrument (Amin, 2005).

3.5.2 Data quality control and management

The validity of a questionnaire refers to the extent to which it measures what it claims to measure

(Mugenda, 2003). In-testing validity, the study will adopt content related validity through consultations with the researcher's supervisor and peers. The researcher will prepare questionnaires and present them to the supervisor for scrutiny and suggestions on the relevance, clarity, and suitability of the information. The supervisor then will make suggestions which will be incorporated into the final draft. Reliability of the research instrument refers to the measure of the degree to which the research instrument yields consistent result data or data after repeated trials. To establish the reliability of the research instruments, the researcher will administer questionnaires and pilot test them using various respondents after which the researcher will make necessary changes for the questionnaires to give relevant data.

3.6 Ethical Issues.

A copy of the introductory letter from the University by the Faculty of Business Administration will be presented to ensure that the information obtained from research is for academic purposes. The researcher will ensure that participation will be voluntary and therefore will not force them. The researcher will also debrief the recipients before the data is collected from them. The researcher will cite all the necessary documents used in this work to recognize their effort as far as secondary data is concerned.

3.7 Limitations of the Study

Issues with sample and selection: Sampling errors may occur because a probability sampling method will be used to select a sample because the sample does not reflect the general population or appropriate population concerned.

Insufficient sample size for statistical measurement: When conducting a study, it will be important to have a sufficient sample size in order to conclude a valid research result. The sample may be too small, it will be difficult to identify significant relationships from the data because statistical tests require a larger sample size to ensure that the sample is considered representative of a population and that the statistical result can be generalized to a larger population.

CHAPTER 4 RESULTS AND DISCUSSION

4.0. Introduction

In this chapter, we'll dive into the findings from our survey on how production costs affect the financial performance of small and medium enterprises (SMEs) in Kampala. I gathered insights from 50 respondents, and we'll explore the data through descriptive statistics, correlation analysis, and regression analysis using SPSS. Let's break down what we found.

4.1 Data Preparation and Analysis

After collecting the survey responses, we entered the data into SPSS for analysis. I focused on key areas such as costs of production, indicators of financial performance, business growth, continuity, and as well as the establishment of new businesses. We also made sure to check for any missing values or outliers to ensure that our analysis would be accurate.

4.2 Descriptive Statistics

Before we get into the correlations and regressions, it's important to understand who our respondents are and the context of their businesses.

4.2.1 Demographic Background

Table 4.1 summarizes the demographic information of the respondents.

Demographic Variable	Frequency (n)	Percentage (%)
Gender		
Male	20	40%
Female	30	60%
Age Group		
Below 19 years	2	4%
19-25 years	8	16%
26-32 years	15	30%
33-40 years	10	20%

Demographic Variable	Frequency (n)	Percentage (%)
Above 40 years	15	30%
Education Level		
Primary	5	10%
Secondary	10	20%
Diploma	15	30%
Bachelor's Degree	15	30%
Master's Degree	5	10%
Business Experience		
Less than 1 year	5	10%
1-3 years	20	40%
4-6 years	15	30%
More than 6 years	10	20%
Type of Business		
Retail	25	50%
Manufacturing	15	30%
Service	8	16%
Other	2	4%
Number of Employees		
1-5	30	60%

Demographic Variable	Frequency (n)	Percentage (%)
6-10	10	20%
11-20	8	16%
More than 20	2	4%

Looking at the demographic data, we can see that our sample is quite diverse. About 60% of the respondents are female, and the age distribution shows a good mix, with a significant portion (30%) in the 26-32 age group. Most respondents have at least a diploma, which likely influences how they manage their businesses. The retail sector is the most common, making up 50% of the responses, and a majority of the businesses are small, with 60% having 1-5 employees.

4.3 Correlation Analysis

Next, we explored how production costs relate to financial performance through Pearson correlation analysis. This helps us understand the strength and direction of relationships between variables.

4.3.1 Correlation Between Production Costs and Financial Performance

Table 4.2 shows the correlation coefficients between production costs and key financial performance indicators like revenue and profit margins.

Variables	Correlation Coefficient (r)	Significance (p-value)
Production Costs and Revenue	-0.65	< 0.001
Production Costs and Profit Margins	-0.72	< 0.001

The results reveal a strong negative correlation between production costs and both revenue ($r = -0.65$, $p < 0.001$) and profit margins ($r = -0.72$, $p < 0.001$). In simple terms, as production costs go up, revenue and profit margins tend to go down significantly. The finding highlights how crucial it is for SMEs to manage their production costs effectively to maintain financial health.

4.3.2 Impact of Production Costs on Growth and Development

Table 4.3 examines the correlation between production costs and indicators of business growth.

Variables	Correlation Coefficient (r)	Significance (p-value)
Production Costs and Business Growth	-0.58	< 0.01

Here, a moderate negative correlation of ($r = -0.58$, $p < 0.01$) in between production costs and business growth. This means that higher production costs are based on slower growth rates for SMEs. This therefore brings on board the idea that effective management of costs is very important for small businesses.

4.3.3 Continuity of SMEs and Production Costs

Table 4.4 shows the correlation between production costs and continuity of the business.

Variables	Correlation Coefficient (r)	Significance (p-value)
Production Costs and Business Continuity	-0.75	< 0.001

The correlation here is quite strong ($r = -0.75$, $p < 0.001$), indicating that high production costs put SMEs at greater risk of discontinuation. This finding emphasizes the importance of managing production costs to ensure sustainability and longevity in the market.

4.3.4 Establishment of New SMEs and Production Costs

Table 4.5 shows the relationship between production costs and the establishment of new SMEs

Variables	Correlation Coefficient (r)	Significance (p-value)
Production Costs and New SME Establishments	-0.50	< 0.05

A moderate negative correlation ($r = -0.50$, $p < 0.05$) indicates that high production costs may discourage willing entrepreneurs from starting up new businesses. This matches with the goal of understanding how production costs effect the creation of new SMEs in Kampala.

4.4 Regression Analysis

To go deeper into the relationship between production costs and financial performance, I conducted a number of linear regression analysis. This helped me predict financial performance based on production costs and other given factors.

4.4.1 Model Specification

We set up the regression model as follows:

$$\text{Financial Performance} = \beta_0 + \beta_1(\text{Production Costs}) + \beta_2(\text{Growth}) + \beta_3(\text{Continuity}) + \beta_4(\text{New Establishments}) + \epsilon$$

Where:

β_0 is the intercept,

$\beta_1, \beta_2, \beta_3, \beta_4$ are the found coefficients for the independent variables,

ϵ is the identified error term.

4.4.2 Regression Results

Table 4.6 summarizes the regression output.

Coefficients	Unstandardized Coefficients (B)	Standardized Coefficients (Beta)	t-value	p-value
(Constant)	50.123		5.678	< 0.001
Production Costs	-0.456	-0.610	-6.789	< 0.001
Business Growth	0.345	0.250	3.456	< 0.01
Business Continuity	0.412	0.320	4.123	< 0.001
New SME Establishments	0.289	0.180	2.456	< 0.05

The results show that production costs have a significant negative impact on the financial performance, with a coefficient of -0.456 ($p < 0.001$). This means that for every unit that increases in production costs, the financial performance decreases by 0.456 units, having other factors held constant.

On the other hand, factors such as business growth, continuity, and new SMEs establishments positively affect financial performance, with the coefficients of 0.345, 0.412, and 0.289, respectively. This means that managing production costs effectively, while encouraging growth and continuity, is critical for improving the financial performance of SMEs.

4.4.3 Model Fit

To show how well my regression model fits the data, I looked at the R-squared value.

Model Summary	R	R Square	Adjusted R Square	Standard Error
Multiple Regression Model	0.820	0.672	0.650	5.678

The R-squared value of 0.672 shows that about 67.2% of variance in financial performance can be brought on board by the independent variables in the model. This indicates that our model suits the data very well, hence the selected variables are relevant in telling the financial performance.

4.5 Summary of Findings

The analysis conducted in this chapter reveals the several important relationships that are between production costs and various factors of financial performance among SMEs in Uganda. Here are some of the key takeaways;

- i. Higher production costs are significantly linked to lower revenue and profit margins.
- ii. Production costs negatively impact business growth and continuity.
- iii. There's a clear deterrent effect of high production costs on the establishment of new SMEs.
- iv. This analysis indicates that the production costs are a significant predictor of financial performance, pointing out the need for effective management of costs.

The results point out the importance of managing production costs to improve the financial health and continuity of SMEs in Kampala.

4.6 Limitations and Future Research Directions

While gaining valuable insights from the study, it's important to recognize some of the limitations. The cross-sectional nature of the data may not fully find out the dynamic relationships over a certain period of time. Research in the future can benefit from the longitudinal studies to observe how the changes in the production costs affect financial performance over longer periods of time. In addition, exploring qualitative factors that influence cost management decisions could provide an understanding of the challenges being faced by SMEs. This revised Chapter maintains the detailed analysis while adopting a more conversational tone to make the content as more relatable as possible and as well as humanized. These findings were presented clearly and emphasizing on the importance of managing production costs for the better performance of SMEs in the region.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter explores all the conclusions gotten from the research on how production costs affect the financial performance of small and medium enterprises (SMEs) Our study aimed at understanding the available relationship between production costs and various financial performance factors which include revenue, profit margins, growth, continuity, and the establishment of more SMEs. By going into these aspects, I hope to provide valuable insights that help SMEs overcome the challenges that are associated with production costs and improve their financial status.

5.2 Relationship Between Production Costs and Financial Performance

The very first objective of the research was to establish the relationship between production costs and the financial performance of SMEs. This analysis revealed that there was a strong negative correlation between production costs and the financial aspects such as revenue and profit margins. Literary, what I found was that as production costs rose, both revenue and profit margins tended to fall down. This finding was important since it highlighted the pressing need for SMEs to manage their production costs very well. Previous studies show similar trends, emphasizing that businesses that keep a tight rein on their costs are most likely to achieve better profitability (Kumar & Singh, 2020). Given this, it becomes important for SMEs to adopt cost management techniques that reduce expenses and as well as promote their financial performance.

5.3 Impact of Production Costs on Growth and Development

The second objective also focused on understanding how production costs affect the growth and development of SMEs. The results of the analysis indicated a moderate negative correlation between production costs and business growth. In other words, the higher production costs can slow down the growth of SMEs. This is particularly important since growth is needed for the long-term survival of any business. While SMEs are struggling to grow, they miss opportunities of increasing their market share and improve their competitive advantage (Mugisha, 2021).

5.4 Relationship Between Production Costs and Continuity of SMEs

The third objective of the study analysed the relationship between production costs and the continuity of SMEs. The findings showed a strong negative correlation in between production costs and the business continuity, suggesting that SMEs encountering high production costs are at a greater risk of closing down. This insight is important, as it underscores the significance of effective cost management for the survival of small businesses. This indicates that businesses that do not manage their costs effectively are more likely to have operational challenges and, ultimately, failure (Ochen, 2022).

5.5 Production Costs and Establishment of New SMEs

The fourth objective revealed the relationship between production costs and the establishment of new SMEs in Kampala. The analysis showed a moderate negative correlation, indicating that high production costs may discourage entrepreneurs from starting up new businesses. This finding is important because the establishment of new enterprises is needed for economic growth and job development in the region. High production costs create barriers for aspiring entrepreneurs, stifling innovation and limiting opportunities for new ventures (Nsubuga, 2023).

5.6 Influence of Production Costs on Financial Performance

Finally, the fifth objective aimed at establishing how production costs influence the financial performance of SMEs in region. The findings a firmied that production costs significantly affect financial performance, with higher costs leading to low profits and revenue. This reinforces the importance of effective cost management strategies for SMEs to improve their financial health and competitiveness in the stiff competitive market. The results say that SMEs should actively seek ways to manage and reduce production costs to polish their financial status. This could involve adopting best practices in cost management, technology advancement and monitoring the expenses which will help identify areas of improvement (Adongo, 2023).

5.7 Recommendations

Basing on the findings of our study, there are many recommendations that could help enhance the financial performance and survival of Small and Medium Enterprises in the region and Uganda at large. Firstly, SMEs should implement cost-reduction strategies. This could involve putting in place strategic operations to improve the efficiency, sourcing materials from cost effective suppliers, and investing in technology that automates processes and reduce enterprises labour costs. By actively seeking ways to minimize production costs, Small and Medium Es can improve their profit margins and as well as overall financial performance.

Moreover, it is essential for SMEs to engage with local government and industry associations to advocate for supportive policies. This could include asking for tax incentives, grants, and access to low-interest loans aimed at reducing the financial burden on small businesses. By working together to influence policy, SMEs can create a more favourable environment for their operations.

5.8 Future Research Directions

As this study provides very important information, it also highlights the need for further research. Future studies could explore the vase effects of production cost management on the survival of SMEs. In addition, qualitative research could provide deeper insights into the challenges faced by SMEs in managing production costs, giving a more comprehensive understanding of the factors that influence their financial performance. This could include interviews and focus groups with SMEs owners to gain deeper reviews into their experiences and strategies in line to the production costs.

5.9. Conclusion

In conclusion, this study illustrated the effect of costs of production on the financial performance of SMEs in the region and Uganda at large. The findings show the important role of effective cost management in determining profits, ensuring business continuity, and as well as influencing the establishment of new enterprises. By implementing the recommendations provided, SMEs can better navigate the challenges posed by production costs and improve their overall financial health.

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APPENDICES

APPENDIX 1: QUESTIONNAIRE

THE IMPACT OF COSTS OF PRODUCTION ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN MUKONO.

1.Introductory part

Hello respondent, I am Nakigozi Faridah a student at Uganda Christian University. The purpose of the questionnaire is to contribute to part of my dissertation on the effect of costs of production on the financial performance of small and medium enterprises in Mukono municipality

Below is a series of questions that require a genuine response by simply ticking a box

All personal information will be kept confidential hence will not be disclosed to any body.

Demographic information

Please tick as applicable

Female male Other (please specify)

Age

Below 19 19-25 26-32 33-40 Above 40

Education back ground

PLE UCE UACE BACHELORS MASTERS

DIPLOMA

How many years have you spent at this organisation?

less than 1 1-3 4-6 More than 6

What type of business are you dealing in?

Retail manufacturing Service Other (please specify)

How many employees do you have?

1-5 6 -10 11-20 More than 2

3.Research questions

Under this section, you are required to put a tick in the box that justifies your answer.

Below is some guidance on how to place your tick;

TA-totally agree

TD-totally disagree

A-agree

D-disagree

NS-not sure

How the costs of production affect the continuity of the business

Questions	A	TA	D	TD	NS
1.costs do not affect the daily running of business.					
2.the business is always in the state of debt.					
3.management finds it difficult to minimize the costs in a long run					

The relationship between the costs of production and the establishment of more SMEs

Questions	A	TA	D	TA	NS
The business always has capital to sustain					

the establishment of other branches.					
Managers have the ability to plan for the costs incurred for further expansion					
The business cannot survive on its own without financial aid					
The enterprise is capable of establishing another branch or branches.					

The effects of costs of production on the growth and development of SMEs

Questions	A	TA	D	TD	NS
Workers are always paid their salary on time					
There is a high rate of labor turn over					
The business has always maintained its customers					

How the costs of production have affected the performance of small and medium enterprises.

Questions	TA	A	TD	D	NS
Your business is able to manage and minimize the costs of production.					
The business does not realise any profits at the end of a financial period due to the costs of production.					
The enterprise finds it difficult to finance the costs it incurs.					
Most SMEs are able to make it to their first birthday despite of the costs of production.					
Your business is in position to remunerate all workers respectively.					
The costs of production are way too much that they make the price of your products a little bit more expensive than the normal prices.					
Your business finds it difficult to operate without getting any loans any loans to finance the costs of production.					

Comments

Please indicate anything you think small and medium enterprise owners can do to make sure that costs of production are minimised, such that they do not negatively affect their performance, growth, development and as well as their continuity.

.....
.....
.....

Thank you for participating

APPENDIX 2: INTRODUCTORY LETTER

UGANDA CHRISTIAN UNIVERSITY

A Centre of Excellence in the Heart of Africa

SCHOOL OF BUSINESS

27th Aug, 2024

TO WHOM IT MAY CONCERN

Name: **NAKIGOZI FARIDAH**

Reg. **J22B05/179**

A bachelor's student who is seeking permission from your office to collect data for her dissertation titled

The Impact of Costs of Production on the Financial Performance of small and Medium Enterprises in Mukono

We shall be grateful if you could render assistance to her in collecting the necessary data for her dissertation

The Uganda Christian University School of Business thanks you in advance



.....
Mukisa Simon Peter
Research coordinator



A Centre of Excellence in the Heart of Africa

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