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MICROFINANCE CREDIT AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN WAKISO TOWN COUNCIL, WAKISO DISTRICT: A CROSS-SECTIONAL STUDY.

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ABSTRACT

Background
Despite widespread access to microfinance services in Wakiso Town Council (WTC), over 73% of Small and Medium Enterprises (SMEs) report poor financial performance. This study investigated the relationship between microfinance credit and SME financial performance in WTC, Wakiso District, Uganda.

Methods
A cross-sectional design was used to collect primary data from 277 SMEs using structured questionnaires, supplemented with secondary data from WTC financial records. Financial performance was assessed through profitability (ROA), liquidity, and solvency indicators. Pearson correlation and regression analysis were conducted using SPSS v29.

Results
Most SMEs (57.8%) had been operational for less than 5 years, and 61.7% relied on microfinance institutions for funding. Correlation analysis showed a weak negative association between access to microloans and profitability ($r = -0.128$, $p = 0.033$), but a positive correlation between effective use of microloans and profitability ($r = 0.181$, $p = 0.003$). Satisfaction with loan terms showed a negative correlation with profitability ($r = -0.124$, $p = 0.039$). High borrowing frequency was positively associated with improved solvency ($r = 0.122$, $p = 0.043$). Regression analysis revealed that microfinance credit variables accounted for 7.7% of the variance in SME financial performance ($R^2 = 0.077$, $F(8, 268) = 2.783$, $p = 0.006$).

Conclusion
Access to microloans alone does not significantly enhance SME profitability in WTC. Overborrowing and rigid loan conditions may undermine benefits. Effective loan utilization and tailored financial literacy interventions are essential to strengthen SME financial performance.

Recommendations
Stakeholders should revise loan structures to include flexible terms, monitor credit use, and implement financial literacy programs to help SMEs maximize microfinance benefits.

Keywords: *Microfinance credit, Financial performance, Small and Medium Enterprises (SMEs), Microloans, Loan terms, borrowing frequency, Wakiso Town Council.*
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INTRODUCTION

Small and Medium Enterprises (SMEs) are pivotal to Uganda's economy, constituting over 90% of private sector businesses and driving employment, innovation, and GDP growth[5]. Despite their importance, many SMEs experience persistent financial challenges, including declining profitability, liquidity constraints, and mounting debt, even amidst expanded access to microfinance credit[6]. Wakiso Town Council exemplifies this paradox: While microfinance Institutions (MFIs) have proliferated, over 73% of local SMEs (predominantly in retail and services) report deteriorating financial performance. This discrepancy suggests that factors beyond credit access, such as financial literacy, loan terms, and borrowing practices, may mediate outcomes[3]. Thus, this study sought

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to examine the relationship between microfinance credit (focusing on microloans accessibility, terms or conditions, and borrowing frequency) and SME financial performance in Wakiso Town Council.

METHODS

Study Design and Area

This study employed a cross-sectional design using a quantitative research approach to establish the relationship between microfinance credit and the financial performance of SMEs in WTC.

Wakiso Town Council (WTC) is an administrative unit located in Wakiso District, Central Uganda, approximately 26 kilometers northwest of Kampala, the capital city. It has a dense concentration of registered SMEs, mainly in the service and retail trade sectors. These enterprises often rely on microfinance institutions (MFIs) for funding, making WTC an ideal location for the study.

Population and Sampling

The study targeted a population of 2,475 registered SMEs. Using Krejcie and Morgan's formula, a sample size of 277 SMEs was determined[1] and selected using stratified random sampling to ensure representation across SME types and sectors.

Data Collection Instruments

Primary data was collected using a structured questionnaire consisting of closed-ended items on a 5-point Likert scale. The questionnaire assessed aspects such as accessibility to credit, satisfaction with loan terms, frequency of borrowing, and financial performance indicators (profitability, liquidity, and solvency). The instrument was pretested for validity and reliability.

Validity and Reliability

The content validity index (CVI) for the instrument was above the 0.7 threshold, and Cronbach's alpha coefficient was 0.871, indicating high internal consistency.

Data Analysis

Data was analyzed using IBM SPSS Statistics version 29[2]. Descriptive statistics summarized demographic data. Pearson correlation analysis was used to examine relationships between microfinance variables and financial performance. Multiple linear regression was employed to determine the predictive power of microfinance credit components on SME performance.

Bias Mitigation

Stratified random sampling ensured diverse SME representation, while self-administered anonymous questionnaires reduced response bias; pretesting eliminated ambiguous or leading questions (CVI > 0.7, Cronbach's α = 0.871), and trained research assistants followed standardized procedures during data collection.

Ethical Approval and Consent

Ethical approval was obtained from the Mbarara University of Science and Technology Research Ethics Committee (MUST-REC) on June 5, 2024 (Ref: MUST-2024-1455). Before data collection, all participants provided written informed consent after receiving detailed explanations in either English or Luganda, based on their preference. They were assured of their right to withdraw at any time, and strict measures were implemented to maintain data confidentiality throughout the study.

RESULTS

Demographic Characteristics of SMEs

The study collected data from 277 SMEs, yielding a response rate of 82.7% out of 335 questionnaires distributed. Most SMEs (57.8%) had been operational for less than five years, highlighting the youthful nature of businesses within WTC. A majority of respondents (61.7%) identified microfinance institutions as their primary source of funding. In terms of business sector, the majority were engaged in retail trade (42.2%), followed by service provision (33.6%), manufacturing and processing (15.2%), and agriculture and other informal activities (9.0%). This distribution reflects the dominant entrepreneurial activities in the area, which rely heavily on microfinance credit to sustain operations.

Likert Scale-Based Descriptive Results

Respondents were asked to rate their perceptions of microfinance credit accessibility and its influence on their financial performance using a 5-point Likert scale (1 = Strongly Disagree, 5 = Strongly Agree). Overall, access to microloans was perceived as moderately adequate, with a mean score of 3.12 (SD = 0.92). However, the loan sizes offered were generally considered insufficient to meet business needs (M = 2.85, SD = 1.01). Satisfaction with loan terms, such as interest rates and repayment periods, was low, as shown by a mean score of 2.79 (SD = 1.07), and interest affordability scored even lower (M = 2.68, SD = 1.13), indicating moderate dissatisfaction. Respondents expressed moderate agreement regarding the frequency of borrowing being appropriate for their business operations

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(M = 3.33, SD = 0.88). When asked whether microfinance credit improved their profitability, responses were largely neutral (M = 3.01, SD = 0.96), as was the case for liquidity improvements (M = 2.95, SD = 1.00). A slightly more positive perception was recorded regarding solvency, with a mean of 3.05 (SD = 0.89), suggesting that consistent borrowing may help businesses better manage their liabilities over time.

Correlation Analysis

To assess the relationships between microfinance credit components and financial performance indicators, Pearson correlation coefficients were computed. A weak negative correlation was found between access to microloans and profitability (ROA) ($r = -0.128$, $p = 0.033$), suggesting that access alone may not translate into improved financial outcomes. Conversely, effective utilization of loans showed a significant positive correlation with profitability ($r = 0.181$, $p = 0.003$). Satisfaction with loan terms and conditions was also negatively correlated with profitability ($r = -0.124$, $p = 0.039$), indicating that rigid or unfavorable loan terms may hinder financial performance. A positive relationship was found between high borrowing frequency and solvency ($r = 0.122$, $p = 0.043$), suggesting that regular borrowing, when managed well, may support long-term financial stability.

Regression Analysis

Multiple regression analysis was conducted to determine the extent to which microfinance credit variables predicted the financial performance of SMEs. The regression model was statistically significant, $F(8, 268) = 2.783$, $p = 0.006$, with an R^2 value of 0.077. This indicates that the independent variables—access to credit, loan terms, and borrowing frequency—collectively explained 7.7% of the variance in financial performance. Specifically, access to microloans negatively influenced profitability ($B = -0.153$, $SE = 0.061$, $t = -2.505$, $p = 0.013$), while effective loan utilization had a positive and significant effect ($B = 0.194$, $SE = 0.059$, $t = 3.288$, $p = 0.001$). Loan terms remained a significant barrier to profitability ($B = -0.128$, $p = 0.040$). Borrowing frequency showed a positive but statistically insignificant effect ($p > 0.05$).

DISCUSSION

This study sought to examine how various components of microfinance credit—namely, access to loans, loan terms or conditions, and borrowing frequency—affect the financial performance of SMEs in Wakiso Town Council. The results showed that access to credit in isolation does not necessarily translate into improved business profitability. A weak negative association was found, suggesting that easy access may lead to unintended challenges such as overborrowing or poor financial planning, especially where financial literacy is limited.

Notably, SMEs that utilized microfinance funds more effectively reported better financial outcomes. This reinforces the idea that the impact of credit is largely influenced by how well it is managed and deployed. A loan that is channeled into productive activities such as inventory expansion, asset acquisition, or process improvement is more likely to yield financial gains than one used[7] for non-essential or non-investment purposes.

The findings also revealed that many SMEs were dissatisfied with the loan terms, particularly regarding interest rates and repayment periods. This dissatisfaction was associated with lower profitability levels. Rigid[5] or unfavorable conditions may strain cash flow and discourage reinvestment, which in turn impairs financial growth. This highlights the importance of designing SME-friendly credit packages that consider repayment capacity and the unique operational cycles of small businesses.

A moderately positive association was observed between borrowing frequency and solvency, suggesting that repeated but well-managed borrowing may help stabilize businesses by enabling them to build credit history and access larger funding amounts over time. However, frequent borrowing alone does not guarantee profitability. Sound financial decision-making, strong internal controls, and investment into income-generating activities must accompany it.

GENERALIZABILITY OF THE FINDINGS

Although this study was confined to Wakiso Town Council, the results may apply to other urbanizing areas in Uganda and similar low-income settings with comparable SME ecosystems. Including diverse enterprise sectors such as retail, services, and light manufacturing supports the broader applicability of the findings. Nonetheless, caution is needed when extending the conclusions to rural enterprises or informal businesses that operate outside regulatory or microfinance frameworks. Future studies could expand the geographic scope and include rural areas to compare outcomes across different economic environments.

CONCLUSION

This study examined the relationship between microfinance credit and the financial performance of SMEs in Wakiso Town Council, focusing on credit accessibility, loan terms and conditions, and borrowing frequency. The results revealed that while access to credit is widespread, it does not automatically lead to improved profitability. Poor loan utilization, rigid terms, and overborrowing may undermine financial performance. Conversely, SMEs that made effective use of microfinance credit experienced better outcomes, especially in profitability and solvency. These findings underscore the importance of designing SME-focused credit schemes that go beyond access to emphasize education, flexible terms, and financial planning support.

LIMITATIONS OF THE STUDY

The cross-sectional design limits the ability to establish causal relationships between microfinance credit and SME financial performance. The analysis was confined to formally registered SMEs in Wakiso Town Council, which may exclude insights from informal businesses or SMEs in rural areas and SMEs outside WTC. The study focused on quantitative data and did not capture in-depth qualitative perspectives that could further enrich the findings. Future research should consider longitudinal designs and mixed-methods approaches across wider geographic regions.

RECOMMENDATIONS

Tailor loan terms to SME realities: MFIs should provide more flexible repayment schedules, reasonable interest rates, and adaptable grace periods that align with SME cash flow patterns.

Promote financial literacy programs: Stakeholders, including MFIs and local government, should integrate training on loan management, budgeting, and investment to support more strategic credit utilization.

Monitor loan utilization: MFIs should implement mechanisms to track how borrowed funds are used, ensuring they contribute to productive investments rather than consumption.

Segment SME credit packages: Microfinance products should be diversified to match enterprise size, sector, and risk profile, rather than offering a one-size-fits-all model.

Encourage multi-stakeholder support: Policymakers and business development agencies should collaborate to offer complementary support services such as mentorship, market access, and tax incentives to improve SME sustainability alongside credit provision.

LIST OF ABBREVIATIONS

SME Small and Medium Enterprises

MFI Microfinance Institution

WTC Wakiso Town Council

ROA Return on Assets

FP Financial Performance

CVI Content Validity Index

SPSS Statistical Package for Social Sciences

R^2 Coefficient of Determination (R-squared)

MUST Mbarara University of Science and Technology

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CONFLICTS OF INTEREST

The authors declare no conflict of interest.

AUTHOR CONTRIBUTIONS

Maureen Kantono conceived the research concept, designed the study, collected and analyzed data, and drafted the manuscript.
Dr. Nsambu Kijjambu Frederick provided academic supervision, guidance on methodology and statistical analysis, and critically revised the manuscript.

DATA AVAILABILITY

The data underlying this study are available from the corresponding author on reasonable request. De-identified participant responses and SPSS output files can be provided to support validation or further analysis.

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