

Factors Influencing the Financial Performance of Medium Enterprises in Rwanda - A Case Study of Sosoma Industry

Ufitamahoro Isaac¹, Dr. Patrick Mulyungi²

¹Student, Jomo Kenyatta University of Agriculture and Technology

²Lecturer, Jomo Kenyatta University of Agriculture and Technology

Abstract: *Most SMEs in the country lack the capacity in terms of qualified personnel to manage their activities, fund, access to market and lower level of technology. Another issue has to do with the inadequate capital base of most SMEs in the country to meet the collateral requirement by the banks before credit is given out. Researcher was examined the factors influencing the financial performance of medium enterprises in Rwanda. . Descriptive research design was used in this study to establish whether there is a relationship between factors influencing the financial performance of medium enterprise in Rwanda. In line with this research, the target population is 21 people composed by stakeholders' and staffs of SOSOMA industry. In this study, data collected through self administered questionnaires and documentation technique. Factors influencing the financial performance have an overall correlation with SMEs performance of SOSOMA industry, 0.762 is significant at 5%. These indicate good fit of the regression equation used. Analysis of Variance shows that f -calculated is greater than f – critical that is $5.221 > 0.00$. This implies that the regression equation was well specified and therefore the co-efficient of the regression shows that there is a strong relationship between two variables. The analysis of variance of the predictors of the model is significance at 0.000. Results indicate that access to finance is the most significant in explaining the financial performance with a significance at 0.000 which is less than a p -value of 0.05 and beta value is 0.824. The results revealed that access to finance plays a major role in the financial performance of SOSOMA industry and access to finance continues to be a major problem that SMEs face in their operations. After analysis, it is suggested that SOSOMA industry should incorporate good financial management practices such as preparation and usage of financial information in their operations, preparation of business plan, and the well using of working capital management. Government of Rwanda should be directly involved to help eliminate the financing gap faced by SMEs through direct government interventions through public banks, credit guarantee schemes and other forms of subsidized financing. Most of time interest rates have locked out SOSOMA industry as only large scale borrowers who expect higher returns can bear the high cost of borrowing, the researcher recommends that financial institutions have create special lending structures for this category of SMEs.*

1. Background of the study

In the current global economy, factors influencing the success and performance of small and medium enterprises (SMEs) are progressively being regarded as powerful engines for performance of SMEs and development for most economies in the world (Islam, Khan, Obaidullah & Alam, 2011).

Study by Abor & Quartey (2010), factors influencing the success and performance of SMEs contribute 91% in South Africa SMEs. The view that research on success and performance of SMEs has dominated policy discussions on the theme of industrial development, the importance of SMEs performance cannot be underestimated; especially in face of the recent global business dynamics and industrialization (Akhtar, 2007). While the contributions of small and medium businesses to development are generally acknowledged, entrepreneurs face many obstacles that limit their long-term survival and development. Research on SMEs performance and sustainability has revealed that the rate of failure in developing countries is higher than in the developed world (Ihua, 2008). Scholars have indicated that starting a business is a risky venture and warn that the chances of SMEs owners making it past the five-year mark are very slim. The owners should therefore develop both long-term and short-term strategies to guard against failure (Sausser, 2005).

Studies in small and medium business development and performance are necessary in countries like Rwanda because of the dissimilarities in the process between developed and developing countries (Ihua, 2009). It is also essential to understand the factors influencing small and medium business performance in African countries because they are significantly different from those facing developed countries.

The development of Small and Medium Enterprises (SMEs) via effective financing options have stem debate and growing interest among researchers, policy makers and entrepreneurs, recognizing the immense contribution of the subsector to economic growth. Small and Medium Scale Enterprises (SMES) constitute the driving force of such industrial growth and development. This is basically due to their great potential in ensuring diversification and expansion of industrial production as well as the attainment of the basic objectives of development. SMES utilize local raw materials and technology thereby aiding the realization of the goal of self-reliance. Also, governments at various levels (local, state and federal levels) have in one way or the other focused on the performance of Small and Medium Scale Enterprises for economic gains (Saunders, & Tornhill, 2009). While some governments had formulated policies aimed at facilitating and empowering the growth and performance of the SMEs, others had focused on assisting

Volume 7 Issue 11, November 2018

www.ijsr.net

Licensed Under Creative Commons Attribution CC BY

the SMEs to grow through soft loans and other fiscal incentives in order to enhance the socio-economic development of the economy like alleviating poverty, employment generation, enhance human development, and improve social welfare of the people.

SMEs depend on a variety of sources of financing, both internal and external for performance (Terungwa, 2012). SMEs performance is constrained by internal factors, such as resources and strategic choices and external factors, such as the carrying capacity of the environment or competition. The resource-based view of the firm suggests that competitive advantage stems from the possession and deployment of resources that are in some way superior to those of its competitors. Access to financial provision has been highlighted as one of the major constraints affecting the performance and development of SME in Africa. According to Fadahunsi (2007) the high mortality rate of SMEs is about 85 out of every 100 in Africa as a result of lack of access to sources of financing and entrepreneurial skills.

According to Hudson et al. (2001), the success and performance of SMEs is influenced by two main factors namely external factors and internal factors. Internal factors include aspects of HR (owners, managers, and employees); financial aspects, technical aspects of production; and marketing aspects while external factors consist of government policy, socio-cultural and economic aspects, as well as the role of related institutions such as government, universities, and private companies.

This research is done because until now financial literacy for SMEs has not been achieved optimally. The problem of using banking facilities can hinder the success and performance of SMEs to compete in the global economy. This study is conducted to examine the factors influencing the success and performance of medium enterprise in Rwanda.

2. Statement of the problem

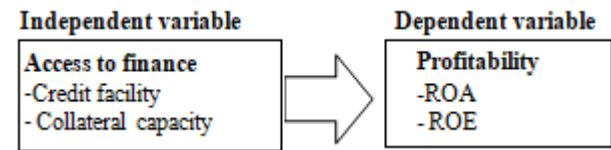
Despite the factors influencing the financial performance of SMEs in Rwanda economy, the financial constraints they face in their operations are daunting and this has had a negative impact on their financial performance. This is worrying for a developing economy without the requisite infrastructure and technology to attract big businesses in large numbers. Most SMEs in the country lack the capacity in terms of qualified personnel to manage their activities, fund, access to market, lower level of technology and etc.

Another issue has to do with the inadequate capital base of most SMEs in the country to meet the collateral requirement by the banks before credit is given out. In the situation where some SMEs are able to provide collateral, they often end up being inadequate for the amount they needed to embark on their projects as SMEs assets- backed collateral are usually rated at 'carcass value' to ensure that the loan is realistically covered in the case of default due to the uncertainty surrounding the survival and growth of SMEs (Binks et al., 2013).

3. Objective of the study

To examine the factors influence the access to finance on financial performance of SOSOMA industry.

4. Conceptual framework



Research Design

Research design is an overall plan for the methods to be used to collect and analyze the data of a research study (Hair et al., 2008). The research design involved coming up with the research approach that helped determine how the information would be obtained. Descriptive research design was used in this study to establish whether there is a relationship between factors influencing the financial performance of medium enterprise in Rwanda. This is because it minimizes biasness in the collection of data (Hussey & Husey, 2007).

Population of the Study

Target population in statistics is the specific population about which information is desired. According to Ngechu (2008), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous. And by population the researcher means the complete census of the sampling frames. According to Mugenda and Mugenda (2009), target population in statistics is the specific population about which information is desired. In line with this research, the target population is 21 people composed by stakeholders' and staffs of SOSOMA industry

Sampling technique

Table 1: Sampling Technique

	Respondents	No of respondents	sampling technique
1	Shareholders	5	Census technique
2	Staffs	16	Census technique
	Total	21	

Data collection techniques

There are several ways of collecting data. The techniques selected for data collection was influenced by research objectives, research design, and the availability of time, funds and personnel. In this study, data collected through self administered questionnaires and documentation technique.

5. Research findings and discussion

Table 2: Appreciation of respondents on access to finance to financial performance

Statements	SA A UN D SD
1. SOSOMA industry has an access to Credit for improving its financial performance.	11(52.4%) 10(47.6%) - - -
2. SOSOMA industry have enough Collateral which can help them for enhancing the financial performance	- 6(28.6%) - 8(38.1%) 7(33.3%)
3. The interest rate of bank influences the financial performance of SOSOMA industry.	9(42.9%) 9(42.9%) 3(14.3%) - -
4. The banks collateral is favorable for the financial performance of SMEs in Rwanda.	2(9.5%) 16(76.2%) 3(14.3%) - -
5. credit facility of commercial banks influences the financial performance of SOSOMA industry	4(19.0%) 16(76.2%) 1(4.8%) - -
Source: Primary data, 2018	

Table 2 shows the appreciation of respondents on how access to finance can influence the financial performance of SMEs. The views of respondents show that access to credit can influence the performance of SOSOMA industry, where 52.4% were strongly agree and 47.6% were agree. SOSOMA industry did not have enough collateral for facilitating them to apply for a loan. Where 52.4% were strongly agreed and 47.6% agreed.

The sources of finance were mainly classified as internal (cash in hand and retained earnings) and external (finance in form of equity and finance in form debt). The results show that almost of (71.4%) of the respondents said that SOSOMA industry did not have enough Collateral which can help SOSOMA for enhancing the financial performance. One of the most commonly used type of external finance by more than a half of firms was loan from the bank (85.8%) influenced by the level of interest rate of banks. In the literature, SMEs seek finance for several reasons but some challenges were obstacles to access for it. Banks collateral is favorable for the financial performance of SMEs in Rwanda, as agreed by 85.7% of the respondents. Whereas access to credit improves economic activities most SME are financially excluded due to the lending terms and conditions by commercial banks and other formal institutions, this acts as a major obstacle to investment.

According to Sacerdoti (2015), among the reasons for lack of access to credit from banks in Sub-Saharan Africa are inability of borrowers to provide accurate information on their financial status, absence of reliable and updated company and land registries, weak claim recovery and collateral realization process such as malfunctioning courts and cumbersome legal and judicial procedures. Other reasons include, long physical distance to the nearest financial services provider, high cost of the credit, socio-economic and demographic characteristics that make them less creditworthy.

The limited access to credit has been attributed to factors such as lack of collateral, high risk profile of SMEs, an oligopolistic banking sector and bias by commercial banks against the SMEs Gallardo et al. (2011). Bank in most Africa countries have made little effort to reach SMEs due to

difficulties in administering loans particularly screening and monitoring small scale borrowers high cost of managing loans and high risk of default Yahie (2013)

6. Conclusion

Without financial sources SMEs can't acquire or absorb new technologies nor do they expend to compete in global markets or even strikes company linkages with larger companies. The results revealed that access to finance plays a major role in the financial performance of SOSOMA industry and access to finance continues to be a major problem that SMEs face in their operations. The study concludes that SMEs should be sensitized about funding programs and financial schemes provided by the government and private sector and that public and private sectors put in place funding programs and financial schemes to assist SMEs.

The researcher concludes that access to finance has significant relationship with the financial performance of SOSOMA industry as measured by return on assets and return on Equity.

7. Recommendations

After analysis, it is suggested that SOSOMA industry should incorporate good financial management practices such as preparation and usage of financial information in their operations, preparation of business plan, and the well using of working capital management. Because credit facility and collateral were found to significantly impact access to finance.

Government of Rwanda should be directly involved to help eliminate the financing gap faced by SMEs through direct government interventions through public banks, credit guarantee schemes and other forms of subsidized financing.

Most of time interest rates have locked out SOSOMA industry as only large scale borrowers who expect higher returns can bear the high cost of borrowing, the researcher recommends that financial institutions have create special lending structures for this category of SMEs. The government should also come to the aid of SMEs by regulating how financial institutions raise and lower their interest rates. This will not only help the government to improve on its economic activities as a result of easy access to credit by SMEs but will also improve on the livelihood of most individuals who are owners and employees of the SMEs enterprises based in Rwanda.

References

- [1] Abor & Quartey (2010), Business Associations and Growth Coalitions in Sub-Saharan Africa. *Journal of Modern African Studies*, 40(4).
- [2] Akhtar, (2007). "Managerial competencies and organizational effectiveness." Working paper, School of Business Administration, University of Michigan.
- [3] Binks et al., (2013). *Entrepreneurship: Strategies and Resources*, Prentice Hall, Economic survey 2004

Publication: Nairobi, Kenya Central Bureau of Statistics
2004. xvi, 243

- [4] Fadahunsi (2007), "Employment, incomes and equity: a strategy of increasing productive employment in Kenya." Geneva: International Labour Organization. .
- [5] Gallardo et al. (2011), Small and Medium Enterprises (SMEs) Development Policy. Kigali.
- [6] Hair et al., 2008).
- [7] Hair *et al.*, (2008). The Place of Micro and Small Enterprises in Kenya in Achievement of Kenya's Vision 2030. *Journal of US-China Public Administration*, 9(12), 1432-1440.
- [8] Hudson et al. (2001), Entrepreneurs' Qualification and the Development of SSI: An Empirical Evidence. *Developing Country Studies*, 4(17), 96-102.
- [9] Hussey & Husey, (2007). Technology Entrepreneurs Human Capital and its Effects on Innovation Radicalness, *Entrepreneurship Theory and Practice*, Bingley, UK: Emerald Group Publishing.
- [10] Ihua, (2009). Influence of Managerial Accounting Skills on SME's on the Success and Growth of Small and Medium Enterprises in Kenya. *Journal of Language, Technology and Entrepreneurship in Africa*, 3(1). 15
- [11] Islam, Khan, Obaidullah & Alam, (2011). The Contribution of Research in Policy Dialogue and Response. Paper Prepared for Urban Research Symposium on Urban Development for Economic Growth and Poverty Reduction. Washington, DC.
- [12] Mugenda and Mugenda (2009), Interest Group Structure and Organization in Kenya's Informal Sector: Cultural Despair or a Politics of Multiple Allegiances? *Comparative Political Studies*, 24(1), 31-55.
- [13] Ngechu (2008), Small Business challenges- The perception problem: Size Doesn't matter. *Washington Business Journal* 2, 4-16
- [14] Sacerdoti (2015), Measuring performance of small-and-medium sized enterprises: the rounded theory approach. *Journal of Business and Public Affairs* 2: 1-10.
- [15] Sauser, (2005). Empirical evidence for a relationship between business growth and the use of structured marketing information amongst food and drink SMEs. Academy of Marketing Conference (5-7 July 2011). University of Kent, United Kingdom.
- [16] Terungwa, (2012), SME policy, academic research and the growth of ignorance,
- [17] Yahie (2013), Resource Small and Medium Sized Enterprises. Physica-Verlag.