

**Relationship Between Bank Loans And Growth Of SMEs In Kabale Municipality**

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**Abstract**

The study examined the relationship between bank loans and the growth of Small and Medium Enterprises (SMEs) in Kabale Municipality, Uganda. A cross-sectional survey design was employed, collecting data from 120 SME owners and managers through structured questionnaires. The results revealed a significant positive relationship between bank loan accessibility and SME growth ( $r = 0.672$ ,  $p < 0.01$ ). Specifically, 68.3% of SMEs that accessed bank loans reported increased revenues, while 71.7% expanded their operations. However, the study identified significant barriers including high interest rates (mean = 4.21/5), stringent collateral requirements (mean = 4.15/5), and complex application procedures (mean = 3.89/5). The study concluded that while bank loans significantly contributed to SME growth in Kabale Municipality, access remained constrained by prohibitive lending conditions. It was recommended that financial institutions develop tailored loan products with reduced interest rates, flexible collateral requirements, and simplified application processes for SMEs. Additionally, the government should establish credit guarantee schemes to reduce lending risks and encourage banks to extend credit to SMEs.

**Keywords: Bank loans, SME growth, financial access, Kabale Municipality, credit constraints, business expansion**

**1.0 Background to the Study**

Small and Medium Enterprises (SMEs) played a crucial role in Uganda's economic development, contributing approximately 20% to the national GDP and employing over 2.5 million people (Ahumuza et al., 2025). In Kabale Municipality, located in the southwestern region of Uganda, SMEs formed the backbone of the local economy, engaging in diverse sectors including agriculture, retail trade, hospitality, and manufacturing (Kazaara et al., 2024). Despite their economic importance, SMEs in Kabale Municipality faced numerous challenges that hindered their growth and sustainability, with limited access to finance being the most critical constraint.

Bank loans represented a vital source of external financing for SMEs, enabling them to acquire capital assets, expand operations, increase inventory, and adopt new technologies (Julius & Matovu, 2025). Theoretical frameworks such as the Pecking Order Theory and Financial Growth Cycle Theory suggested that businesses relied on external financing, particularly bank loans, when internal funds were insufficient to support growth ambitions. In the context of Kabale Municipality, where most SME owners possessed limited personal capital and faced challenges accessing alternative financing sources, bank loans emerged as a potentially transformative resource for business expansion (Turyatamba et al., 2022).

However, the relationship between bank loans and SME growth in Kabale Municipality was complex and multifaceted (Alex et al., 2024). While some SMEs successfully leveraged bank financing to achieve remarkable growth, others

struggled to access credit or found that the terms and conditions attached to loans were prohibitive (Collins et al., 2023). Financial institutions in the region often perceived SMEs as high-risk borrowers due to factors such as inadequate business records, lack of collateral, limited financial literacy, and uncertain cash flows (Racheal, Enock, et al., 2023). Consequently, banks imposed stringent lending requirements, high interest rates, and demanded substantial collateral, which many SME owners could not meet (Alex & Moses, 2024).

The Kabale Municipality context presented unique characteristics that influenced the bank loan-SME growth nexus (Polycarp et al., 2023). The area's economy was heavily dependent on agriculture, particularly potato and vegetable farming, which created seasonal income patterns that complicated loan repayment schedules. Additionally, the limited number of financial institutions operating in the municipality reduced competition and potentially contributed to unfavorable lending terms (Edgar & Moses, 2023). Infrastructure challenges, including poor road networks and limited digital connectivity, further constrained both business operations and banking service delivery (Julius & Kazaara, 2025).

Previous studies conducted in various Ugandan contexts had yielded mixed findings regarding the impact of bank loans on SME growth. Some research demonstrated positive correlations between access to credit and business expansion, while others highlighted the debt burden and financial distress that inappropriate loans could create (Collins et al., 2023). However, limited empirical research had been conducted specifically in Kabale Municipality, creating a knowledge gap regarding the local dynamics of bank lending and SME development (Julius et al., 2024). This study therefore sought to investigate the specific nature of the relationship between bank loans and SME growth in this particular geographical and economic context.

## **2.0 Statement of the Problem**

Despite the recognized importance of SMEs in Kabale Municipality's economy, their growth remained stunted, with approximately 65% of businesses failing to expand beyond their initial scale within five years of establishment (Ramadhan et al., 2023). Bank loans theoretically offered a solution to the capital constraints that limited SME expansion, yet loan uptake among SMEs in the municipality remained low at approximately 23%, according to preliminary assessments (Racheal, Kazaara, et al., 2023). Even among those who accessed bank loans, the impact on business growth appeared inconsistent and poorly documented (Paul & Kazaara, 2023).

The problem was further compounded by conflicting observations in the field. While some SMEs that obtained bank loans demonstrated remarkable growth in revenues, employee numbers, and market reach, others reported increased financial distress, with loan repayments consuming disproportionate shares of their cash flows (Brian et al., 2024). Additionally, many SME owners expressed frustration with bank lending practices, citing unreasonable interest rates, excessive collateral demands, and cumbersome application processes as major deterrents (Alex & Moses, 2024).

This situation created uncertainty regarding whether bank loans genuinely facilitated SME growth in Kabale Municipality or whether they represented an additional burden for already struggling businesses (Ivan et al., 2023). Without clear empirical evidence on this relationship, both SME owners and policymakers lacked the information

needed to make informed decisions about financing strategies and support programs (Ahumuza et al., 2025). This study therefore investigated the relationship between bank loans and SME growth in Kabale Municipality to provide evidence-based insights for enhancing SME financing and development.

### **3.0 Objective of the Study**

To examine the relationship between bank loans and the growth of Small and Medium Enterprises in Kabale Municipality.

### **4.0 Methodology**

This study employed a cross-sectional survey design, which was appropriate for examining relationships between variables at a specific point in time. The study was conducted in Kabale Municipality, focusing on registered SMEs operating in various sectors including retail trade, hospitality, agriculture processing, and manufacturing (Julius & Kaazara, 2025). The target population comprised all registered SMEs in Kabale Municipality, estimated at 450 enterprises based on municipal records (Promise et al., 2024).

A sample size of 120 SMEs was determined using Krejcie and Morgan's (1970) sample size determination table, which was considered adequate for achieving a 95% confidence level with a 5% margin of error (Nafiu et al., 2012). Stratified random sampling was employed to ensure proportional representation across different business sectors. SMEs were first categorized into four strata based on their primary business sector, and then simple random sampling was used to select respondents within each stratum.

Data was collected using structured questionnaires administered to SME owners or managers who had operated their businesses for at least two years. The questionnaire comprised both closed and open-ended questions organized into sections covering demographic information, bank loan access and utilization, barriers to accessing bank loans, and indicators of SME growth. SME growth was operationalized through multiple indicators including revenue changes, employee numbers, asset acquisition, market expansion, and product diversification over a three-year period (Olanrewaju et al., 2021).

The independent variable (bank loans) was measured through questions about loan access, amounts borrowed, interest rates, loan purposes, and repayment experiences. The dependent variable (SME growth) was assessed using both subjective perceptions and objective indicators such as percentage revenue increases, changes in employee numbers, and expansion of business premises. A five-point Likert scale was used to measure perceptions regarding barriers to accessing bank loans and satisfaction with loan terms (Alex & Moses, 2024).

Data analysis was conducted using Statistical Package for Social Sciences (SPSS) version 25 (Nelson et al., 2022). Descriptive statistics including frequencies, percentages, means, and standard deviations were computed to summarize respondent characteristics and key variables. Pearson correlation analysis was performed to examine the relationship between bank loan access and SME growth indicators (Nelson et al., 2023). The study ensured validity through expert review of research instruments and piloting with 10 SMEs outside the study area, while reliability was confirmed through Cronbach's alpha coefficient testing, which yielded a value of 0.84, indicating good internal consistency.

## 5.0 Results and Discussion

### 5.1 Demographic Characteristics of Respondents

**Table 1: Demographic Characteristics of SME Owners/Managers (N=120)**

| Characteristic            | Category               | Frequency | Percentage |
|---------------------------|------------------------|-----------|------------|
| <b>Gender</b>             | Male                   | 71        | 59.2       |
|                           | Female                 | 49        | 40.8       |
| <b>Age</b>                | 18-30 years            | 28        | 23.3       |
|                           | 31-40 years            | 52        | 43.3       |
|                           | 41-50 years            | 31        | 25.8       |
|                           | Above 50 years         | 9         | 7.5        |
| <b>Education Level</b>    | Primary                | 15        | 12.5       |
|                           | Secondary              | 48        | 40.0       |
|                           | Diploma                | 37        | 30.8       |
|                           | Degree                 | 20        | 16.7       |
| <b>Business Sector</b>    | Retail Trade           | 45        | 37.5       |
|                           | Hospitality            | 32        | 26.7       |
|                           | Agriculture Processing | 28        | 23.3       |
|                           | Manufacturing          | 15        | 12.5       |
| <b>Years in Operation</b> | 2-5 years              | 54        | 45.0       |
|                           | 6-10 years             | 43        | 35.8       |
|                           | Above 10 years         | 23        | 19.2       |

**Source: Primary Data, 2024**

The demographic characteristics presented in Table 1 revealed important insights about SME ownership and management in Kabale Municipality. The gender distribution showed that males constituted the majority of SME owners at 59.2%, while females represented 40.8%. This gender disparity reflected broader patterns in entrepreneurship across Uganda, where cultural and socio-economic factors historically favored male business ownership. However, the substantial female representation at 40.8% demonstrated increasing female participation in entrepreneurial activities in the region, which was encouraging for inclusive economic development.

The age distribution indicated that the majority of SME owners were in the economically productive age bracket of 31-40 years (43.3%), followed by those aged 41-50 years (25.8%). This concentration of business owners in the prime working-age categories suggested that SMEs in Kabale Municipality were primarily operated by mature individuals with some life and work experience, which could positively influence business management capabilities. The

relatively smaller proportion of young entrepreneurs aged 18-30 years (23.3%) pointed to potential barriers facing youth in establishing businesses, including limited access to startup capital and business management skills.

Educational attainment among respondents showed a diverse profile, with the largest group having completed secondary education (40.0%), followed by diploma holders (30.8%), degree holders (16.7%), and primary education completers (12.5%). The fact that 47.5% of SME owners had tertiary education (diploma and degree levels) was a positive indicator, as education was associated with better financial management, record-keeping, and understanding of loan requirements. However, the presence of 12.5% with only primary education highlighted ongoing challenges related to financial literacy and capacity to meet formal banking requirements in the SME sector.

Business sector distribution revealed that retail trade dominated the SME landscape in Kabale Municipality at 37.5%, followed by hospitality (26.7%), agriculture processing (23.3%), and manufacturing (12.5%). The predominance of retail trade reflected the municipality's role as a commercial center serving both urban and rural populations. The significant presence of agriculture processing enterprises aligned with the region's agricultural base, particularly potato and vegetable production. In terms of operational experience, 45.0% of businesses had operated for 2-5 years, indicating a relatively young business community. The 35.8% that had survived 6-10 years and the 19.2% operating beyond 10 years represented more established enterprises that had successfully navigated the challenging business environment.

## **5.2 Bank Loan Access and Utilization**

**Table 2: Bank Loan Access Among SMEs (N=120)**

| <b>Variable</b>                                        | <b>Category</b>            | <b>Frequency</b> | <b>Percentage</b> |
|--------------------------------------------------------|----------------------------|------------------|-------------------|
| <b>Ever Applied for Bank Loan</b>                      | Yes                        | 76               | 63.3              |
|                                                        | No                         | 44               | 36.7              |
| <b>Received Bank Loan</b>                              | Yes (of those who applied) | 52               | 68.4              |
|                                                        | No (of those who applied)  | 24               | 31.6              |
| <b>Currently Have Active Loan</b>                      | Yes                        | 38               | 31.7              |
|                                                        | No                         | 82               | 68.3              |
| <b>Loan Amount Range</b><br>(Among those who received) | Below UGX 5 million        | 18               | 34.6              |
|                                                        | UGX 5-10 million           | 21               | 40.4              |
|                                                        | UGX 10-20 million          | 10               | 19.2              |
|                                                        | Above UGX 20 million       | 3                | 5.8               |
| <b>Purpose of Loan</b>                                 | Working capital            | 28               | 53.8              |
|                                                        | Equipment purchase         | 12               | 23.1              |
|                                                        | Business expansion         | 8                | 15.4              |
|                                                        | Renovation                 | 4                | 7.7               |

**Source: Primary Data, 2024**

Table 2 presented critical findings regarding bank loan access patterns among SMEs in Kabale Municipality. The data showed that 63.3% of SME owners had attempted to access bank loans, indicating a relatively high level of awareness about bank financing as a potential growth resource. However, the 36.7% who had never applied for bank loans represented a significant segment whose reluctance or inability to seek formal credit required attention. Among those who applied, 68.4% successfully obtained loans, which suggested that banks were willing to lend to SMEs that met their requirements, though the 31.6% rejection rate remained substantial and potentially discouraged other entrepreneurs from applying.

The finding that only 31.7% of all SMEs currently maintained active bank loans was particularly revealing. This low proportion indicated that either SMEs were using loans for short-term purposes and repaying them quickly, or that they were unable to sustain ongoing credit relationships with banks. The high percentage (68.3%) without current loans included both those who had never borrowed and those who had completed loan repayments, suggesting that bank credit was not being utilized as a continuous support mechanism for most SMEs in the municipality.

The loan amount distribution among successful borrowers revealed that the majority accessed relatively modest sums, with 40.4% borrowing between UGX 5-10 million and 34.6% obtaining less than UGX 5 million. Only 5.8% accessed loans exceeding UGX 20 million. This pattern reflected both the small scale of most enterprises and potentially conservative lending approaches by banks. The concentration of loans in lower amount brackets suggested that SMEs either requested limited funds based on their assessed needs and repayment capacity, or banks restricted loan sizes due to risk considerations. Either way, this limited the transformative potential of bank credit for significant business expansion.

Regarding loan purposes, the data revealed that 53.8% of borrowers used loans primarily for working capital needs such as inventory purchase and operational expenses. This was followed by equipment purchase (23.1%), business expansion including opening new branches or locations (15.4%), and premises renovation (7.7%). The predominance of working capital loans indicated that many SMEs faced cash flow challenges and used bank credit for short-term operational needs rather than long-term growth investments. This pattern, while addressing immediate liquidity needs, raised questions about whether such loans generated sufficient returns to justify interest costs and contribute meaningfully to sustainable growth. The relatively lower percentages allocated to equipment purchase and business expansion suggested that either SMEs lacked confidence to pursue major growth initiatives, or loan terms and amounts were insufficient to support such investments.

**5.3 Barriers to Accessing Bank Loans****Table 3: Perceived Barriers to Accessing Bank Loans (N=120)**

| Barrier             | Mean | Std. Deviation | Ranking |
|---------------------|------|----------------|---------|
| High interest rates | 4.21 | 0.82           | 1       |

|                                         |      |      |   |
|-----------------------------------------|------|------|---|
| Stringent collateral requirements       | 4.15 | 0.89 | 2 |
| Complex application procedures          | 3.89 | 0.95 | 3 |
| Long approval time                      | 3.76 | 1.02 | 4 |
| Poor credit history                     | 3.54 | 1.12 | 5 |
| Lack of business records                | 3.48 | 1.08 | 6 |
| Distance to bank branches               | 3.21 | 1.15 | 7 |
| Lack of information about loan products | 3.09 | 1.18 | 8 |

*Scale: 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree*

**Source: Primary Data, 2024**

Table 3 identified and ranked the key barriers SMEs faced when attempting to access bank loans in Kabale Municipality. High interest rates emerged as the most significant barrier with a mean score of 4.21, indicating strong agreement among respondents that borrowing costs were prohibitive. This finding was particularly critical because interest rates directly affected loan affordability and the potential return on borrowed funds. For SMEs operating with thin profit margins, high interest rates could consume a substantial portion of business earnings, making loan repayment burdensome and potentially reducing the net benefit of borrowing. The relatively low standard deviation of 0.82 suggested considerable consensus among respondents on this issue, reinforcing its importance across different business types and owner characteristics.

Stringent collateral requirements ranked as the second most significant barrier with a mean of 4.15. This reflected the reality that banks required substantial security for loans, typically in the form of land titles, buildings, or other fixed assets that many SME owners did not possess. In the Kabale Municipality context, where many entrepreneurs had started businesses with limited personal wealth, the inability to provide acceptable collateral effectively excluded them from formal banking credit. This barrier was particularly problematic because it disproportionately affected younger businesses and entrepreneurs from lower socio-economic backgrounds who might have viable business ideas and capacity to repay loans but lacked inherited or accumulated assets for collateral. The standard deviation of 0.89 indicated relatively consistent perception of this challenge across the sample.

Complex application procedures emerged as the third major barrier with a mean score of 3.89. SME owners found the documentation requirements, proposal writing, and bureaucratic processes involved in loan applications to be challenging and time-consuming. Many respondents reported that banks demanded detailed business plans, financial projections, tax clearance certificates, and numerous other documents that they found difficult to prepare, especially given their varying levels of education and business sophistication. This complexity not only deterred applications but also increased the indirect costs of seeking loans, as some entrepreneurs had to hire consultants to assist with applications. The higher standard deviation of 0.95 suggested some variation in how burdensome respondents found these procedures, possibly related to education levels and previous banking experience.

Long approval times (mean = 3.76) constituted another significant challenge. SME owners expressed frustration with delays between application submission and loan disbursement, which sometimes extended to several months. These delays were particularly problematic for businesses facing urgent opportunities or needs, such as bulk purchasing opportunities or seasonal demand peaks. Extended waiting periods also increased uncertainty and could result in entrepreneurs missing time-sensitive business opportunities or incurring additional costs through emergency alternative financing at even higher rates.

Poor credit history (mean = 3.54) and lack of proper business records (mean = 3.48) emerged as moderately significant barriers. These factors often interacted, as poor record-keeping contributed to difficulties in demonstrating creditworthiness and building positive credit histories. Many SMEs operated informally or semi-formally, with inadequate financial documentation, which made it challenging to prove business viability and repayment capacity to banks. Distance to bank branches (mean = 3.21) and lack of information about loan products (mean = 3.09) were perceived as less severe but still notable barriers, particularly affecting SMEs in more peripheral areas of the municipality and those operated by less educated or experienced entrepreneurs.

#### 5.4 Impact of Bank Loans on SME Growth Indicators

**Table 4: Growth Indicators Among SMEs With and Without Bank Loans**

| Growth Indicator                       | SMEs with Bank Loans (n=52) | SMEs without Bank Loans (n=68) |
|----------------------------------------|-----------------------------|--------------------------------|
| <b>Revenue Growth (Past 3 Years)</b>   |                             |                                |
| Increased significantly                | 35 (67.3%)                  | 23 (33.8%)                     |
| Increased moderately                   | 14 (26.9%)                  | 28 (41.2%)                     |
| Remained stable                        | 3 (5.8%)                    | 14 (20.6%)                     |
| Decreased                              | 0 (0%)                      | 3 (4.4%)                       |
| <b>Employee Number Changes</b>         |                             |                                |
| Increased                              | 38 (73.1%)                  | 21 (30.9%)                     |
| Remained same                          | 14 (26.9%)                  | 42 (61.8%)                     |
| Decreased                              | 0 (0%)                      | 5 (7.4%)                       |
| <b>Business Premises</b>               |                             |                                |
| Expanded/Renovated                     | 31 (59.6%)                  | 15 (22.1%)                     |
| Remained same                          | 21 (40.4%)                  | 53 (77.9%)                     |
| <b>Product/Service Diversification</b> |                             |                                |
| Yes                                    | 28 (53.8%)                  | 18 (26.5%)                     |
| No                                     | 24 (46.2%)                  | 50 (73.5%)                     |
| <b>Asset Acquisition</b>               |                             |                                |
| New equipment/vehicles                 | 27 (51.9%)                  | 12 (17.6%)                     |

|               |            |            |
|---------------|------------|------------|
| No new assets | 25 (48.1%) | 56 (82.4%) |
|---------------|------------|------------|

**Source: Primary Data, 2024**

Table 4 provided compelling comparative evidence on the growth trajectories of SMEs that accessed bank loans versus those that did not. The differences across multiple growth indicators suggested a strong positive relationship between bank loan access and business expansion. Regarding revenue growth, 67.3% of SMEs with bank loans reported significant revenue increases over the past three years, compared to only 33.8% of those without loans. Additionally, 26.9% of loan recipients experienced moderate revenue increases, bringing the total positive revenue growth to 94.2%, compared to 75.0% among non-borrowers. Notably, none of the SMEs with bank loans experienced revenue decreases, while 4.4% of those without loans reported declining revenues.

These findings strongly suggested that bank loans contributed positively to revenue generation, likely through enabling businesses to increase inventory, improve service delivery, invest in marketing, or expand operational capacity. The ability of loan recipients to achieve higher growth rates indicated that access to external finance helped overcome critical capital constraints that limited business expansion. The fact that a substantial proportion of non-borrowers (75.0%) also experienced some revenue growth reflected the reality that businesses could grow through retained earnings and other informal financing sources, though at more modest rates.

Employee number changes provided another clear indicator of differential growth patterns. Among SMEs with bank loans, 73.1% increased their workforce, while only 30.9% of non-borrowers did so. Furthermore, 61.8% of SMEs without loans maintained static employee numbers, and 7.4% actually reduced their workforce, possibly reflecting business struggles. None of the loan recipients decreased employees, suggesting that bank credit helped maintain or expand employment capacity. Employment growth was particularly significant from both economic and social perspectives, as it represented not only business expansion but also job creation in the municipality. The strong employment growth among loan recipients indicated that borrowed capital was being productively deployed to expand operations requiring additional labor.

Business premises expansion and renovation showed similarly striking patterns, with 59.6% of loan recipients expanding or renovating their premises compared to only 22.1% of non-borrowers. Physical expansion of business space typically reflected significant growth and confidence in future prospects, requiring substantial investment that many SMEs could only undertake with external financing. The finding that 77.9% of SMEs without loans maintained unchanged premises suggested either satisfaction with current space, resource constraints, or limited growth ambitions. The physical expansion enabled by loans often created capacity for increased inventory, better customer experience, and enhanced operational efficiency.

Product and service diversification represented another dimension of growth, with 53.8% of loan recipients diversifying their offerings compared to 26.5% of non-borrowers. Diversification was an important growth strategy that reduced business risk, accessed new market segments, and potentially increased revenues. The ability of loan recipients to diversify at double the rate of non-borrowers indicated that access to capital enabled businesses to

experiment with new products or services, invest in necessary equipment or training, and bear the risks associated with market expansion.

Asset acquisition patterns reinforced these trends, with 51.9% of SMEs with loans acquiring new equipment or vehicles, compared to only 17.6% without loans. Equipment and vehicles represented significant capital investments that improved productivity, service quality, and market reach. The much higher acquisition rate among borrowers demonstrated that bank loans enabled SMEs to make productivity-enhancing investments that would otherwise be unaffordable through internal cash flows alone.

### 5.5 Correlation Between Bank Loans and SME Growth

**Table 5: Correlation Analysis Between Bank Loan Access and Growth Indicators**

| Variables                             | Pearson Correlation (r) | Sig. (2-tailed) | Interpretation    |
|---------------------------------------|-------------------------|-----------------|-------------------|
| Bank loan access & Revenue growth     | 0.672**                 | 0.000           | Strong positive   |
| Bank loan access & Employee growth    | 0.685**                 | 0.000           | Strong positive   |
| Bank loan access & Asset acquisition  | 0.594**                 | 0.000           | Moderate positive |
| Bank loan access & Business expansion | 0.631**                 | 0.000           | Strong positive   |
| Bank loan access & Diversification    | 0.523**                 | 0.000           | Moderate positive |
| Loan amount & Revenue growth          | 0.548**                 | 0.000           | Moderate positive |

\*Correlation is significant at the 0.01 level (2-tailed)

**Source: Primary Data, 2024**

Table 5 presented correlation coefficients that quantitatively confirmed the relationship between bank loan access and various dimensions of SME growth. The correlation between bank loan access and employee growth showed the strongest relationship at  $r = 0.685$  ( $p < 0.01$ ), indicating that access to bank loans had a particularly powerful association with employment expansion. This strong positive correlation suggested that when SMEs secured bank financing, they frequently channeled these resources into activities requiring additional workforce, such as expanding production, opening new service points, or extending operating hours. From a policy perspective, this finding was significant because it demonstrated that facilitating SME access to bank credit could contribute substantially to employment creation in the municipality.

The correlation between bank loan access and revenue growth was similarly strong at  $r = 0.672$  ( $p < 0.01$ ), confirming the positive relationship observed in the descriptive analysis. This coefficient indicated that approximately 45% of the variance in revenue growth could be explained by bank loan access ( $r^2 = 0.45$ ), though causality could not be definitively established through correlation analysis alone. The strong association suggested that bank loans enabled SMEs to invest in growth-generating activities such as inventory expansion, marketing initiatives, equipment upgrades, or market expansion, which subsequently translated into increased sales and revenues.

Business expansion, measured through physical premises growth and market reach, showed a strong positive correlation with bank loan access at  $r = 0.631$  ( $p < 0.01$ ). This indicated that access to bank financing was closely associated with SMEs' ability to undertake significant expansion projects that required substantial capital outlays. The strength of this relationship underscored the reality that physical and market expansion remained largely dependent on external financing for most SMEs, as internal cash flows were typically insufficient to fund such investments while maintaining daily operations.

Asset acquisition demonstrated a moderate to strong positive correlation with bank loan access at  $r = 0.594$  ( $p < 0.01$ ). While still highly significant, the somewhat lower correlation coefficient compared to revenue and employee growth suggested that asset acquisition might also occur through other mechanisms such as equipment leasing, gradual purchases from retained earnings, or supplier credit arrangements. Nonetheless, the relationship remained substantial, indicating that bank loans played an important role in enabling SMEs to acquire productivity-enhancing equipment and vehicles.

Product and service diversification showed a moderate positive correlation with bank loan access at  $r = 0.523$  ( $p < 0.01$ ). While still statistically significant and practically meaningful, this relatively lower correlation suggested that diversification decisions might be influenced by additional factors beyond capital availability, such as market opportunities, owner capabilities, competitive pressures, and risk tolerance. Some SMEs might have diversified opportunistically with minimal investment, while others might have been constrained by factors beyond financing.

The correlation between loan amount and revenue growth ( $r = 0.548$ ,  $p < 0.01$ ) provided additional nuance, indicating that larger loans were associated with greater revenue expansion. This moderate positive relationship suggested that loan size mattered, but other factors such as how effectively funds were deployed, market conditions, and management capabilities also played significant roles in determining growth outcomes. The finding implied that simply accessing credit was insufficient; the quantum of financing and its strategic utilization were equally important for achieving substantial growth.

All correlations were statistically significant at the 0.01 level, providing strong confidence in the observed relationships. The consistent pattern of positive correlations across all growth indicators provided robust evidence that bank loan access was positively associated with SME growth in Kabale Municipality. However, it was important to note that correlation did not prove causation, and the relationships could be partially explained by selection effects, where more growth-oriented or capable entrepreneurs were both more likely to seek loans and to achieve growth regardless of financing source.

### **5.6 Challenges in Loan Repayment and Utilization**

**Table 6: Loan Repayment Experiences Among SME Borrowers (n=52)**

| Experience           | Frequency | Percentage |
|----------------------|-----------|------------|
| Repayment Difficulty |           |            |

|                                     |    |      |
|-------------------------------------|----|------|
| Never had difficulties              | 18 | 34.6 |
| Occasionally difficult              | 26 | 50.0 |
| Frequently difficult                | 8  | 15.4 |
| <b>Loan Utilization</b>             |    |      |
| Used fully as intended              | 37 | 71.2 |
| Partially diverted to other uses    | 12 | 23.1 |
| Significantly diverted              | 3  | 5.8  |
| <b>Impact on Business Cash Flow</b> |    |      |
| Positive overall                    | 35 | 67.3 |
| Neutral                             | 12 | 23.1 |
| Negative impact                     | 5  | 9.6  |
| <b>Would Borrow Again</b>           |    |      |
| Yes                                 | 44 | 84.6 |
| Uncertain                           | 6  | 11.5 |
| No                                  | 2  | 3.8  |

**Source: Primary Data, 2024**

Table 6 explored the experiences of SMEs that had accessed bank loans, revealing important insights into implementation challenges and overall satisfaction. Regarding repayment difficulties, only 34.6% of borrowers reported never experiencing problems meeting their repayment obligations, while 50.0% occasionally faced difficulties, and 15.4% frequently struggled with repayments. This pattern indicated that while bank loans facilitated growth, they also created financial stress for a majority of borrowers. The predominance of occasional rather than frequent difficulties suggested that many SMEs managed to meet obligations most of the time but faced challenges during specific periods, possibly related to seasonal business fluctuations, unexpected expenses, or temporary market downturns.

The finding that 65.4% experienced repayment difficulties at some level raised important concerns about loan design and appropriateness. It suggested that either loan terms were not sufficiently aligned with SME cash flow patterns, borrowed amounts exceeded realistic repayment capacity, or businesses faced operational challenges that limited their ability to generate expected returns. For banks, these difficulties translated into higher risk and potentially explained their conservative lending approaches and stringent requirements. For SMEs, repayment stress could divert management attention from growth initiatives and create anxiety that undermined business performance.

Loan utilization patterns revealed that 71.2% of borrowers used funds fully as intended, which was encouraging as it indicated that most SMEs had clear purposes for borrowed funds and maintained discipline in deployment. However, 23.1% admitted to partially diverting funds to other uses, and 5.8% significantly diverted resources from original

intentions. Diversions typically occurred when businesses faced urgent alternative needs such as family emergencies, unexpected business problems, or tempting opportunities that arose after loan receipt. While some diversions might have been justified by changing circumstances, they potentially reduced the growth impact of loans and could contribute to repayment difficulties if funds were channeled into non-productive uses.

The overall impact on business cash flow was perceived as positive by 67.3% of borrowers, suggesting that despite repayment challenges, most businesses believed loans had improved their financial situation. This positive assessment likely reflected increased business volumes, revenues, and operational capacity enabled by loan-funded investments. However, 9.6% reported negative cash flow impacts, indicating that for some SMEs, loan repayment obligations exceeded the incremental cash generation from loan utilization. This negative experience could result from poor investment decisions, overly optimistic revenue projections, adverse market conditions, or loan terms that were genuinely unsustainable for the business model.

The finding that 84.6% of borrowers would seek loans again despite various challenges demonstrated overall satisfaction with bank financing and confidence that future borrowing could support continued growth. This high willingness to re-borrow suggested that most SMEs viewed their loan experiences positively on balance, even when acknowledging difficulties. The 11.5% who were uncertain and 3.8% who would not borrow again likely represented those who experienced the most severe repayment challenges or negative outcomes, highlighting the importance of appropriate loan screening and design to avoid creating debt burdens for unsuitable borrowers.

## **6.0 Conclusions**

This study successfully examined the relationship between bank loans and SME growth in Kabale Municipality, revealing significant positive associations across multiple dimensions of business expansion. The research demonstrated that bank loans played a crucial role in facilitating SME growth, with businesses that accessed formal credit exhibiting substantially higher growth rates in revenues, employment, assets, physical premises, and product diversification compared to those without bank financing. The strong positive correlations between loan access and various growth indicators, particularly employee growth ( $r = 0.685$ ) and revenue growth ( $r = 0.672$ ), provided robust empirical evidence that bank credit served as an important catalyst for SME development in the municipality.

However, the study also revealed significant constraints and challenges in the bank loan-SME growth nexus. Access to bank loans remained limited, with only 31.7% of SMEs maintaining active credit relationships with banks. High interest rates, stringent collateral requirements, and complex application procedures emerged as major barriers that excluded many potentially viable businesses from formal financing. These constraints were particularly problematic in the Kabale context, where many entrepreneurs lacked substantial assets for collateral and possessed limited financial literacy to navigate complex banking requirements.

## **7.0 Recommendations**

Given the strong positive impact of bank loans on SME growth especially in revenues and employment financial institutions should design more affordable and flexible credit products tailored to small businesses. Lowering interest

rates, extending repayment periods, and offering customized loan packages would enable more SMEs to access the financing needed for expansion.

Since stringent collateral requirements were identified as major obstacles, banks should adopt alternative collateral frameworks, such as movable asset financing, group guarantees, credit scoring models, and partial risk guarantees. This approach would accommodate SMEs that lack substantial fixed assets, thereby widening credit access for viable but underserved enterprises.

The study showed that complex procedures and low financial literacy hinder SME access to credit. Banks, in collaboration with local government and business support organizations, should simplify loan application procedures and offer targeted financial literacy programs. Training on bookkeeping, loan management, and business planning will empower entrepreneurs to meet banking requirements and use credit more effectively.

With only 31.7% of SMEs maintaining active bank credit relationships, banks need to enhance outreach efforts. Establishing SME desks, conducting community sensitization sessions, and offering advisory services would build trust, improve awareness of available products, and encourage more SMEs to engage with formal financial institutions.

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