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FACTORS INFLUENCING THE FINANCIAL PERFORMANCE OF MEDIUM ENTERPRISES IN RWANDA: A CASE STUDY OF SOSOMA INDUSTRY

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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 that 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 that 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.**

Keywords: **SOSOMA industry, SMEs performance, government interventions, financial performance.**

1. INTRODUCTION

BACKGROUND TO 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 (Sauser, 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 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.

Research 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).

Objective of the Study:

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

2. CONCEPTUAL FRAMEWORK

INDEPENDENT VARIABLE

Factors influencing success of SMEs

Access to finance

-Credit facility

- Collateral capacity

DEPENDENT VARIABLE

Financial performance

Profitability

-ROA

- ROE

Research Design:

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.

Target Population and Data Collection Techniques:

In line with this research, the target population is 21 people composed by stakeholders' and staffs of SOSOMA industry. On this research Researcher was used Census technique, all respondents was taken. In this study, data collected through self administered questionnaires and documentation technique.

3. RESULTS AND DISCUSSION

Table 1: 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					

Table1 show the appreciation of respondents on how access to finance can influence the financial performance of SMEs. The views of respondent's shows that access to credit can influence the performance of sosoma industry, where 52.4% were strongly agree and 47.6% were greed. 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.

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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).

3.1 Regression Analysis:

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.426[a]	.762	.614	221
Predictors: (Constant), Access to finance				

Table 2, presents the coefficients of model fitness on how factors influencing the financial performance of medium enterprises in Rwanda explained by access to finance. Factor influencing the financial performance have an overall correlation with performance of SOSOMA industry. 0.762 is significant at 5%. These indicate good fit of the regression equation used.

The rule of Thumb said that, usually an R square of more than 50% is considered as better. This study proves the rule of Thumb the R^2 is (0.762). In this study the rule of thumb is that, usually an R square of more than 50% is considered as better.

Table 3: ANOVA[b]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	24.612	3	6.401	5.221	.000[a]
	Residual	742	8	.010		
	Total	32.355	11			

a. Predictors: (Constant), Access to finance.
b. Dependent Variable: Financial performance.

Table 3 shows the overall significance of the regression estimation model. It indicates that the model is significant in explaining the relationship between factor influencing success of SMEs and financial performance at 5% level of significance. Analysis of Variance shows that f-calculated is greater that 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.

Table 3: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.132	.081		1.728	.000
	Access to finance	.824	.043	.052	1.631	.000

a. Dependent Variable: Financial performance

From Table 4.14, the regression model therefore becomes:

Y=0.132+0.824x2+ ε

On Table 3 the regression coefficients of the predictors (factors influencing success of SMEs) are presented. Results indicate that access to finance is the most significant in explaining the financial performance with a significance at 0.000 which is less that a p-value of 0.05 and beta value is 0.824.

Access to finance is positively related to the financial performance and therefore a unit increase of access to finance would lead to an increase in the financial performance of SOSOMA industry. However, this is significant at 5% level of confidence.

4. CONCLUSIONS

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 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.

5. 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 have shares and employees in SOSOMA Industry.

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