Global Journal of Economic and Finance Research

e-ISSN: 3050-5348
p-ISSN: 3050-533X

Vol. 02(10): 1093-1103, October 2025

Home Page: https://gjefr.com/

An Analysis of Effect of Government Grants on Micro & Small-Scale Enterprise Performance. A Case of Kampala Capital City-Uganda

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KEYWORDS: government grants, MSE performance, private credit, Uganda economy, financial inclusion, capacity building

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Publication Date: 17 October-2025
DOI: 10.55677/GJEFR/12-2025-Vol02E10

ABSTRACT

Micro and small-scale enterprises (MSEs) are pivotal to Uganda's economic growth, contributing 25% to GDP and employing 45% of the labor force, yet they face persistent challenges including limited access to finance, high failure rates exceeding 50% annually, and low formalization (10%). Despite government interventions like Emyooga, Parish Development Model (PDM), and over UGX 10 trillion in grants since 2019, MSE performance remains suboptimal, with only 40% adopting good management practices and 33.1% of households still subsistence-dependent. This seminar paper analyzes the effects of government grants on MSE performance in Kampala Capital City, compares them with private credit, and proposes optimization strategies.

Grounded in Profit Maximization Theory (Smith, 1776; Friedman, 1970) and Growth Maximization Theory (Marris, 1960s), the review synthesizes empirical literature revealing that government grants positively influence survival, employment, sales, and innovation (Dvouletý et al., 2018; Srhoj et al., 2021), but are hampered by bureaucratic delays, inadequate monitoring, and exclusion of informal MSEs. Private credit, while dominant (54% via SACCOs), drives 52.4% of performance variance through enhanced resource access (Byamukama et al., 2024), yet imposes high interest rates and collateral barriers, exacerbating the loan gap.

Findings underscore multifaceted performance drivers beyond finance, including organizational culture (12.4% impact; Aketch et al., 2017) and entrepreneurial competencies (30.4%; Abaho et al., 2016). Recommendations advocate blended public-private financing, capacity building (e.g., financial literacy), standardized grant procedures, joint ownership for accountability, and a proposed model integrating business plan approval, disbursements via Microfinance Support Centre, monitoring, recovery, and e-output reporting. This framework, specified as $Y_{it} = \beta_0 + \beta_1$ Funds $\text{Disbursed}_{it} + \ldots + \varepsilon_{it}$, aims to transform 68% of subsistence homesteads into market-oriented entities, fostering sustainable wealth creation and poverty reduction.

CHAPTER ONE
INTRODUCTION

Economic well-being of people is one of the major concerns of world leaders and economies. It predicts the nature of economic, social and political policies of economies world over and seen as a mirror of economies' sustainable growth and development. Policies of developing economies are tailored around achieving sustained economic growth and development among them is indigenization of the economy through transformation of Micro and Small-scale Enterprises (MSEs).

World Bank & IFC define micro enterprises as businesses with up to 10 employees**,** with total assets or annual sales not exceeding US$100,000**.** European Union (EU) defines micro enterprises as firms with fewer than 10 employees and an annual turnover or balance sheet total not exceeding €2 million**.** Uganda's Micro, Small and Medium Enterprises (MSME) Policy (2015) defines micro enterprises as those employing up to 4 people, with total assets not exceeding UGX 10 million

A small enterprise is a business unit that is larger than a microenterprise but smaller than a medium-sized enterprise. According to European Union (EU)**,** A small enterprise is one that employs 10–49 people and has an annual turnover or balance sheet total not exceeding €10 million **(**European Commission, 2003). World Bank & IFC define small enterprises as enterprises that usually have 10–49 employees, with total assets or annual sales between US$100,000 and US$3 million (IFC, 2012). Uganda's MSME Policy (2015) defines a small enterprise as one that employs between 5 and 49 people**,** with total assets between UGX 10 million and UGX 100 million (MTIC, 2015). This discussion is based on the definition of MSME policy (2015) definitions.

Roles of MSEs to the development of the country

MSEs have gained great importance in the 21st century attracting great attention from world politicians, economists and scholars. They are seen as complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country, they are expected to contribute to employment generation, reduce income inequalities and revenue generation. MSEs where high on the agenda of the G& Summit in June 2021 where the G7 urged Governments of the world's leading countries to put MSEs in the centre of recovery.(Ministry of Trade, 2021). Additionally, the private sector in Uganda is dominated by about 1.1 million Micro and Small Enterprises (MSEs) altogether, employing approximately 2.5 million people(AMFIU, 2022). More findings reveal that Micro, small and medium enterprises contribute 25% to the country' GDP and employs about 45% of the country's labour force(U.R.A, 2023). Close to 380,000 employment opportunities have been created under the Presidential Initiative on wealth and job creation – Emyooga (Ministry of Finance, 2023/2024). MSEs in Uganda are critical in accelerating economic growth through the expansion of productive jobs, tax revenue and export revenues, as well as through the reduction of the countries import bill by substituting imports (PSFU, 2011).

MSEs are expected to be the largest source of non-farm employment in Uganda. According to the Ministry of Trade, Industry and Cooperatives (MTIC, 2015), micro and small enterprises account for over 90% of the private sector and provide jobs to a significant proportion of the labor force. This is crucial in a country with a rapidly growing population and high levels of youth unemployment (World Bank, 2019).

By creating self-employment opportunities, especially in rural and informal sectors, MSEs provide income to households that would otherwise remain in poverty. Small trading businesses, roadside vendors, and small-scale agro-processors contribute directly to household welfare (UIA, 2016). As a result, MSEs play a central role in improving standards of living and reducing income inequality. Therefore, promotion of their growth is seen as an avenue for reducing poverty in Uganda.

Generally, Ugandan MSEs face various growth and survival constraints on several fronts, which undermines their performance and thereby limits their impact on the economy. The major constraints faced by MSEs are; laws and regulations, institutional and other attitudinal challenges that inhibit formalization of enterprises and MSE competitiveness, limited access to affordable long-term finance for MSEs i.e. accessibility to loans by private enterprises was at 11.6%, only 1% of household enterprises accessed loans from Saccos, 57% got loans from informal sources and 49% reported that start-up capital was a major challenge(AMFIU, 2022). Furthermore, costly process for their product Certification and Standardization, limited access to markets and information, informality of MSEs, lack of technical and business skills and limited infrastructural facilities(Ministry of Trade, 2015; PSFU, 2023). To address these constraints holistically, the National MSME Policy 2015 was developed in 2015 with the theme: "Sustainable MSEs for Wealth Creation and Social Economic Transformation" (Ministry of Trade, 2021). MSEs operate in all the key sectors of the economy both in production and services hence their concerns should be optimally attended to.

Roles of stakeholders

The policy guides that the Ministry of Trade, Industry and Cooperatives shall be in charge of policy implementation, and overseeing the monitoring and evaluation. The Directorate of MSME sector shall manage and uphold the strategic planning mechanisms in the sector. While all interventions shall be coordinated by the Ministry of Trade, Industry and Cooperatives, all other Ministries shall play a key role in policy implementation and evaluation (MTIC, 2015).

In order to harness and encourage the participation of all stakeholders mentioned, government shall provide necessary support, appropriate incentives, guidelines and collaborative initiatives to private sector, civil society, academia to contribute towards realization of a competitive and well developed MSME sector. Government shall endeavour to build capacity of the private sector and encourage the informal MSEs to formalize their operations in order to enjoy legitimacy through government protection. The financing of MSEs shall be majorly done by the government with support from the private sector (MTIC, 2015).

The policy intends to achieve the following objectives; To provide enabling environment through policy, legal and institutional coordination framework, Institutional Framework for MSME Development, to promote research, product/process development, innovation, value addition and appropriate technologies including ICT, to Promote product and service standards for quality assurance, to support access to markets and business information services, to increase access to credit and financial services, to

enhance capacity building for entrepreneurship, vocational, business and Industrial development skills and to enhance gender equity, inclusiveness and environmentally friendly businesses for sustainable development. (MTIC, 2015).

Role of private sector

The private sector plays a pivotal role in fostering SME growth through financial support, capacity building, market linkages, technology transfer, and policy advocacy as discussed in details.

One of the key challenges facing MSEs in Uganda is limited access to affordable credit. Private commercial banks, microfinance institutions, and Savings and Credit Cooperative Organizations (SACCOs) have emerged as crucial providers of financial services to MSEs. For instance, financial innovations such as mobile money platforms by MTN and Airtel have enhanced financial inclusion, allowing MSEs to transact and access credit more conveniently (World Bank, 2019). Such private sector-led initiatives have expanded MSEs' ability to access working capital, which is essential for growth and expansion.

The private sector also contributes to SME growth by offering training and mentorship programs for capacity building and enhancement. Business associations such as the Uganda National Chamber of Commerce and Industry (UNCCI) and the Federation of Small and Medium-Sized Enterprises (FSME) provide entrepreneurship training, financial literacy, and management skills (MTIC, 2015). Moreover, large corporations sometimes mentor MSEs through subcontracting partnerships, enhancing their managerial and operational efficiency (IFC, 2012).

Private sector actors create market opportunities by integrating MSEs into supply chains and subcontracting arrangements to increase access and business linkages. Agribusiness companies, for example, often rely on smallholder farmers and MSEs for raw materials, thereby linking them to national and international markets (PSFU, 2020). Trade fairs and exhibitions organized by private associations also enhance the visibility of MSEs and create networking opportunities (UIA, 2016)

Private sector associations play a critical role in influencing government policies that affect MSEs. The Private Sector Foundation Uganda (PSFU), as an umbrella body, advocates for a conducive business environment, tax incentives, and regulatory reforms that reduce bureaucratic hurdles for MSEs (PSFU, 2020). This advocacy ensures that government policies remain aligned with the needs of small businesses.

Problem Statement

Uganda over the past five years has been experiencing increase in revenue collection (Ministry of Finance, 2019/2020;2020/2021;2021/2022;202/2023;2023;2024), part of the revenue is invested in micro and small scale enterprises through government grants (Emyooga, PDM, Youth livelihood, women entrepreneurship empowerment, Small Business Recovery Fund to support micro and small enterprises and transform 68% of homesteads from subsistence to market oriented production with the major objective of creating more jobs, increase household incomes and achieve sustainable economic growth and development.((AMFIU, 2023; MSC, 2021/2022). These programs target boda-boda operators, women entrepreneurs, carpenters, salon operators, taxi operators, restaurant owners, welders, market vendors, youth leaders, Persons with Disabilities, produce dealers and mechanics (MSC, 2021/2022).

In order to achieve the policy objective of increasing access to credit and financial services through promoting and strengthening linkages between MSEs and financial institutions for extending flexible credit facilities such as hire purchase, asset/inventory financing, leasing and strengthen SACCO"s credit schemes, establishing a special MSE fund to cater for innovations, start-ups and growth, promoting financial literacy training to entrepreneurs and encouraging responsive borrowing and lending (MSME Policy 2015)**.** The government since 2019 has been funding micro and small enterprises through budget appropriations and presidential donations. The fund has reached UGX10trillions inform of seed capital, skills development for youth, women entrepreneurship groups, small scale business recovery fund, Emyooga and Parish Development Model (PDM) (Ministry of Finance, 2019/2020, 2020/2021, 2022/2023, 2023/2024; MOFPED, 2025/2025)

Despite the various interventions made to transform MSEs in Uganda for the last five years, there is no concrete evidence of complete transformation of these enterprises into self-sustaining and highly commercialized enterprises fetching high incomes to households leading to improved standards of living thus economic growth and development. Performance of MSEs remains low, economic welfare of owners is low leading to low contribution to the country's GDP and development. Findings reveal that percentage growth of formalised MSEs in domestic and export market is 10%, Percentage of MSEs with access to business incubation and industrial infrastructure is 11% and Percentage of MSEs implementing good business and technical management practices is 40% (Ministry of Trade, 2021/2022). Asiimwe (2017) reports that the majority of these enterprises do not reflect the signs of growth such as being profitable or converting into medium or large enterprises. MSEs continue to face high failure rates in terms of those that close annually in Uganda, (Nangoli et al., 2013; Eyaa & Ntayi, 2010; Ernst & Young, 2011). Some reports approximate the rate of collapse in Uganda to be above 50 percent annually (UIA, 2008). Uganda's micro and small enterprises apply limited technology and are characterized by the production of basic, simple consumer goods and with low-capacity utilization at less than 50 % of installed capacity for most manufacturing production units (PSFU, 2023). Close to 64 percent of informal businesses are 6 years or younger; only 36 percent are older than 6 years which implies a high mortality rate among businesses, approximately 57 percent of the small businesses are engaged in retail trade and only 11.5% in the industrial sector(EPRC, 2022).

Furthermore, the prevalent rate of poverty is still high with 30% of the population living below the poverty line (World bank assessment report 2020; UBOS,2021), small scale enterprises have remained small. (Martha, 2024)

The low performance of MSEs has resulted into one third (33.1%) of the households remain in subsistence economy. Twelve percent of persons aged 10 and above had experienced at least some form of probable general psychological distress. The working age group was 25,494,490 persons (57.4% of the population). The unemployment rate was 12.3 percent. The share of Youth (15-24 years) Not in Employment, Education or Training (NEET) was 4,001,528 persons (42.6%), Proportion of population with primary reliance on clean fuels and technology is 3%, Proportion of individuals using the Internet 8.9%, Proportion of persons aged 10 and above who own a mobile telephone 43.3%, 64.5% of the households use wood as the source of energy for cooking and 28.2% use charcoal as source of energy for cooking, For every 1,000 children born alive, 34 die before they mark their 1st birthday signifying low economic welfare of households in Uganda (UBOS, 2024b). Hence necessitating urgent intervention to track the effect of government funding of MSEs and to devise innovative solutions to ensure optimum use of government funds by MSEs for sustainable growth and development.

There is limited information about the effect of government grants on performance of MSEs and the comparison with MSEs getting credit from private lending institutions. This paper seeks to discuss the effect of government grants on performance of MSEs, comparison between the performance of MSEs getting credit from private lending institutions and those getting from government, and establishing innovative strategies to optimize government funds given to MSEs.

Seminar paper objectives

i. To analyse the effect of government grants on MSEs in Uganda.
ii. To analyse the effect of private credit on MSEs in Uganda.
iii. To suggest alternative funding mechanisms to optimize government grants allotted to MSEs

CHAPTER-TWO
THEORETICAL FOUNDATIONS

Theoretical underpinning

This discussion is informed by Profit Maximization Theory: The theory of profit maximization dates back in Adam Smith's time in 1776 in his seminal work "*The Wealth of Nations"*. Smith argued that individuals pursuing their self-interest inadvertently contribute to the overall economic well-being of society. This laid the foundation of the theory that was later modified by neoclassical economists like Alfred Marshall, Léon Walras, and William Stanley Jevons in the late 19th and early 20th centuries. These developed mathematical models that explicitly incorporated profit maximization as a central assumption.

The theory suggests that the main goal of a firm is to maximize its profit, which is the difference between its total revenue and total costs. This concept implies that firms will take actions that lead to the highest possible return, often through reducing costs, increasing efficiency, and optimizing pricing strategies. This suits the objectives of micro and small enterprise establishment that focuses mainly on profit maximization. In 1956, August Losch, a German economist expanded profit maximization theory when he incorporated geographic factors in influencing consumer demand to enable firms maximize profits. In 1970, Milton Friedman asserted that a firm's primary responsibility is to maximize profits so as to suit the interests of shareholders.

This theory assumes that by maximizing profit, firms will contribute to overall economic growth, as resources are efficiently allocated in pursuit of maximizing profit margins. Tripathi (2019) adds that profit maximization is the major objective of firm establishment. He asserts that managers who underscore this objective are replaced by profit driven managers to achieve objectives of firm owners. Levin et al (2004) use the theory in analysis of companies producing multiple products but dealing with impatient customers and the results were productive. He posits that provides a means by which the solution to this complex problem can be calculated with very little data. Profit maximization is the cardinal motive for industrial establishment. profit maximization is seen as a function of optimization of capital, labour and raw materials. This aligns with the theory statement (Mohajan and Mohajan, 2022). Khatun and Afroze (2016) urge that the business depends on its profitability using available necessary inputs, their marginal productivities and factor share in total output. The theory is premised on objectives such as profit maximization, solely owned by entrepreneurs, constant tastes and preferences of consumers, perfect knowledge of the market by both buyers and seller with given production techniques.

However, Profit maximization theory ignores incorporation of time dimension and conditions of risk and uncertainties in the decision-making process by the firm. These affect profitability levels of a firm(Tripathi, 2019). Bijannia and Dekamini (2024) add that profit maximization theory is limited by constraints to profit maximization underscoring its relevance in modern firm management. Firms adopting this theory tend to prioritize financial performance over other objectives such as borate social responsibility or employee welfare. In theory, by focusing on profit maximization, firms are expected to use their resources efficiently and improve market competition. However, the real-world application often reveals that firms also focus on other factors, such as market share, stakeholder relationships, and long-term sustainability, which may conflict with strict profit-maximizing strategies. It ignores government intervention in form of transfer payment financing of firms and re-investment of profits by shareholders for firm's growth and long-term sustainability hence the introduction of growth maximization theory to suit interests

of government funding of MSEs.

The discussion also used **Growth Maximization Theory of Marris** to explain the performance of micro and small enterprises. The Growth Maximization Theory was proposed by Robin Marris in the 1960s. Marris argued that the primary goal of a firm is to maximize its growth, which he defined as an increase in the firm's size, output, and market share. This theory focuses on the strategic decisions of firms and how they seek to balance managerial interests with shareholder interests in pursuit of long-term growth.

Marris highlighted that growth maximization is constrained by the availability of internal and external resources. Internally, firms rely on retained earnings to finance their growth, and externally, they may depend on factors such as market conditions, access to capital, and competition. The firm's growth can lead to greater economies of scale, enhanced market power, and improved ability to compete, although it also comes with the risk of over-expansion and inefficiencies if growth is not properly managed.

Unlike the traditional profit maximization model, which assumes firms only aim to maximize profits, Marris' theory recognizes that managers have personal incentives linked to growth, such as prestige and career advancement (Sloman, Garratt, & Guest, 2018). This makes the model more applicable in modern corporations. Ghosh & Mondal (2018) add that the theory aligns with contemporary strategies where firms reinvest profits into research, development, and diversification to achieve expansion and market dominance.

Ugandan small retail traders often reinvest earnings into stock expansion, ensuring both revenue growth and capital accumulation (MTIC, 2015). This supports performance by reducing financial vulnerability. This is in line with Marris who argued that firm growth depends on maintaining a balance between the growth of demand for products and the growth of financial resources. This balance determines survival and expansion.

According to Marris, managers are motivated by the prestige and security that comes with firm growth (Sloman, Garratt, & Guest, 2018). In MSEs, owners often act as both managers and entrepreneurs. Their drive to expand operations such as moving from a roadside stall to a registered shop reflects growth-seeking behavior, which enhances visibility, customer loyalty, and long-term performance (World Bank, 2019). This has been the target of the government in funding MSEs operations transform 68% of homesteads from subsistence to market oriented production with the major objective of creating more jobs, increase household incomes and achieve sustainable economic growth and development.((AMFIU, 2023; MSC, 2021/2022).

However**,** growth can be difficult to measure consistently for instant sales growth and asset growth making it hard to evaluate whether a firm is truly maximizing growth (Sloman et al., 2018). Marris' model downplays the role of competition, government regulations, and market failures, which can hinder growth irrespective of managerial objectives (Ghosh & Mondal, 2018).

Review of the empirical literature

Performance of MSEs

MSEs are pivotal in influencing major macroeconomic variables of any economy. In Uganda, findings reveal that Micro, small and medium enterprises contribute 25% to the country' GDP and employs about 45% of the country's labour force(U.R.A, 2023). Close to 380,000 employment opportunities have been created under the Presidential Initiative on wealth and job creation - Emyooga(Ministry of Finance, 2023/2024). MSEs in Uganda are critical in accelerating economic growth through the expansion of productive jobs, tax revenue and export revenues, as well as through the reduction of the countries import bill by substituting imports (PSFU, 2011).

Aketch et al (2017) reveals that organizational culture contributes 12.4% performance in MSEs. The organizational culture aspects that had significant effect on performance were found to be mission (β=0.329, sig=0.006) and involvement (β= 0.208, sig=0.042) traits. Consistency (β=0.120, sig=0.467 and adaptability (β=0.120, sig=0.181) traits were found to insignificant contributors to performance of MSEs. This implies that MSEs performance is a multidimensional phenomenon influenced by a wide range of factors in addition to financial factors. Asiimwe (2017) advocates for corporate governance to ensure efficiency and survival of MSEs. He asserts that this greatly improves the performance of MSEs.

Further findings indicate that an increase in the level of a firm's capabilities through competent management, market linkages and marketing capabilities lead to enhanced SME performance. For instance, entrepreneurial competences and firm capabilities predict 30.4 percent of the variance in MSE performance (Abaho et al 2016). This aligns well with earlier findings that MSEs performance is a combination of many factors despite government effort to ensure adequate financing of these enterprises.

Micro and Small enterprises play significant role in employment and income generation, producing import substituting products, mitigating rural-urban drift and mobilization of local resources (Turyahebwa et al, 2013). World Bank (2020) urges that informal businesses are seen to play a complementary role in generating incomes that provide the poor segments of the population with a means of survival and welfare improvement. This eases pressure on government in performing such activities to improve on the well-being of people and achieve economic growth and development.

Effects of government grants on performance of MSEs

MSEs that are majorly owned by youth, women and people with disabilities are financially constrained. This may be attributed to the exclusion of beneficiaries of such programs such as youth, only 33% of the youth can access formal financial services due to legal restrictions, negative attitude of financial providers towards youth and high transaction costs, 64% of the banks in emerging

economies Uganda inclusive are inaccessible for people with disabilities yet they constitute 16% of the population of which economic empowerment programs in form of grants are allocated to people with disabilities (AMFIU, 2023). The government has spent over Ugx9 trillions through grants to MSEs to ensure their sustainable growth. These grants have been given to MSEs through their Saccos, direct transfers and some through Microfinance Support Centre (MSC). However, only 25 saccos were licensed in 2021, 57 in 2022 and only 125 licensed in 2023(AMFIU, 2023). This implies the grants are not fully accessed by MSEs in Uganda since only registered financial institutions are considered.

Xiang and Worthington (2017), reports that government financial assistance helps MSEs improve performance over and above the effects of conventional financing. In addition to that they acknowledged other factors that significantly affect MSEs performance and finance availability which included business size, the level of innovation, business objectives and industry. Their findings are consistent with the role of government support in steady growth and sustainability of MSEs. Government financial support is seen as a tool for transforming micro and small enterprises and it was found to be statistically significant in impacting on their performance. However, the financing was found inadequate and characterized by stringent, unrealistic bureaucratic details (Ojochide et al, 2018). This is in agreement with the current state of financing MSEs in Uganda with many enterprise owners lamenting about inadequate finances received from the government which constrains their expansion and growth.

Dvouletý et al (2018) asserts that government grants have positive outcomes on firms' survival, employment, tangible/fixed assets and sales/turnover. In addition to that, Findings indicate a strong relationship between Government grant, strategy diversification and growth of enterprise value. This explains the performance of MSEs in a diversified environment (Quintiliani, 2017). A similar student was carried out in Korea and revealed a positive relationship existing among the technological development assistance by the Korean government and patent acquisitions and new design registrations of regional MSEs (Doh and Kim, 2014). This emphasizes the need for the government to provide additional support to MSEs in addition to finances for effective transformation of MSEs into medium and large sized enterprises.

Lee and Jo (2019) reveal that government support has multi-dimensional effects on performance of MSEs such expansion of R&D investment and the registration of intellectual property rights, increases investment in tangible and human assets and marketing. These stimulate the performance of micro and small enterprises. However, value added, sales and operating profit have lacked improvement owing to an ineffective recipient selection system that relies solely on qualitative assessments by technology experts. Government interventions in activities of MSEs yields many benefits such as relaxed financing constraints, improving access to finance; - assisting MSEs to grow further by provision of grants and expert advices, offering wide range of financing products to MSEs and entrepreneurs, making it flexible to conduct business in public sector and helping MSEs through tax relaxation. MSEs without collateral may seek government's assistance and by guaranteeing the loan and providing equity investment (Kraja et al. 2014). This affirms the role of government in creating an enabling environment for MSEs to grow into medium and large-scale enterprises. Srhoj et al (2021) point out a positive effect of the government grant scheme for firms of smaller size as the major contributor to profitability levels. This supports the argument that for MSEs to realize high profit levels, government financing should be sufficient and timely.

Effect of Private credit on MSEs performance

Findings support the notion that offering additional services beyond credit to clients bundled or unbundled and when clients use them, individual, business, and household outcomes significantly improve (AMFIU, 2023). This justifies the need for other stake holders in supporting MSEs to transform into large sized enterprises. Further findings reveal that the highest percentage of reporting institutions is SACCOs with 54% supporting MSEs followed by MFIs with 40%, Banks and MDIs share the same composition of 3% and Credit institutions by 1%. This highlights the large space occupied by private credit institutions in supporting MSEs activities. This brings a debate between government grants and private credit in financing of MSEs. In his study, Byamukama et al. (2024) reports that 52.4% access to credit explains the performance of MSEs. This supports the need for financial services that are more inclusive and sensitive to MSEs.

Strict lending standards, high interest rates, and lack of collateral make many MSEs fail to obtain funding (Chilembo, 2021). The loan gap is made worse by financial institutions' common perception of MSEs as high-risk borrowers. Despite these obstacles, nations with strong financial systems and pro-business legislation have made progress in facilitating MSEs' access to financing (Cavoli et al., 2024). Initiatives like digital lending platforms, microfinance, and credit guarantee programs, for example, have proven to be successful in closing the financial gap (Waniak Michalak et al., 2020). This explains why private lending institutions still playing a figure head role in financing activities of MSEs in most economies. Their strict lending standards improve the internal organization of MSEs thus enabling them to realize their set targets.

Private credit institutions ease accessibility to credit. This is in agreement with studies like those by Kyabarongo et al. (2024) suggest that easy access to credit can be a critical driver for an empirical gap in understanding the conditions under which credit access impacts MSE success across different regions (Moses et al., 2023). Additionally, the study highlights the need for further research into non-financial factors influencing MSE growth, such as managerial experience, market dynamics, and resource allocation, as these were outside the current study's scope (Byamukama et al. 2024). Anwar et al. (2020) propose that financial literacy and entrepreneurial experience significantly predict MSE success, further emphasizing the need to consider these variables in future

research. This is because, exploring these elements would provide a more comprehensive understanding of the drivers of MSE growth beyond credit access alone.

An empirical gap also exists in understanding the long-term effects of private credit access on MSE performance, as this discussion provides a cross-sectional view. Additionally, research into regional policy differences, such as interest rate regulations and credit access criteria, could help contextualize these findings further. Expanding the study to include other performance metrics, like profitability and employment generation, could deepen insights into how credit influences SME growth comprehensively.

Byamukama et al. (2024) reports that MSEs face a variety of difficulties, and the major one is the high cost of borrowing associated with private lending institutions. Turyahebwa etal (2013) asserts that financial management practices positively affect profitability of MSEs. This agrees with Byabakama et al. (2024) who recommends that MSEs should be provided with high credits to boost their profit levels. Eton et al (2017) adds to the existing body of knowledge when he revealed that extending credit to MSEs enables them to access essential resources, increase business diversification and increase productivity levels.

Analysis, Discussion and Evaluation

MSEs are pivotal in determining economic growth of economies world over since they are anchored in all key sectors of economies. This aligns with Turyahebwa et al, (2013) who assert that Micro and Small enterprises play significant role in employment and income generation, producing import substituting products, mitigating rural-urban drift and mobilization of local resources. World Bank (2020) adds that informal businesses are seen to play a complementary role in generating incomes that provide the poor segments of the population with a means of survival and welfare improvement. This eases pressure on government in performing such activities to improve on the well-being of people and achieve economic growth and development. This necessitates realistic fiscal and monetary policies intended to boost performance of MSEs.

Government involvement in activities of MSEs significantly improve on their performance. It increases the rate of formalization of MSE, increases accessibility to credit from both government and private lending institutions and supplements their capital base. Kraja et al. (2014) adds that government provision of grants and expert advices, offering wide range of financing products to MSEs and entrepreneurs, making it flexible to conduct business in public sector and helping MSEs through tax relaxation smoothens their operations. Srhoj et al (2021) point out a positive effect of the government grant scheme for firms of smaller size as the major contributor to profitability levels. However, government involved in activities of MSEs should be structured and consistent in terms of fundings, tax policies, formalization procedures and technical assistance to enable MSEs develop realistic business plans.

Private credit lending still remains the major source of capital for MSE in Uganda. This is evidenced by the enterprise owners decrying of inadequate and unreliable funding from the government exposing them to high interest rates from the private lending institutions. Byamukama et al. (2024) reports that MSEs face a variety of difficulties, and the major one is the high cost of borrowing associated with private lending institutions. Strict lending standards, high interest rates, and lack of collateral make many MSEs fail to obtain funding (Chilembo, 2021). The loan gap is made worse by financial institutions' common perception of MSEs as high-risk borrowers and charge them exorbitantly. Initiatives like digital lending platforms, microfinance, and credit guarantee programs, for example, have proven to be successful in closing the financial gap (Waniak Michalak et al., 2020). However, there is urgent need by the government to regulate lending rates and terms of private credit institutions to increase accessibility to loanable funds by MSEs and facilitate enterprise growth.

Other factors affecting the performance of MSES apart from finances are seen to be very significant in explaining the performance of MSES. In many times, these are given less attention. Aketch et al (2017) reveals that organizational culture contributes 12.4% performance in MSEs. Asiimwe (2017) found out that corporate governance ensures efficiency, survival and greatly improves the performance of MSEs. Further findings indicate that an increase in the level of a firm's capabilities through competent management, market linkages and marketing capabilities lead to enhanced SME performance. For instance, entrepreneurial competences and firm capabilities predict 30.4 percent of the variance in MSE performance (Abaho et al 2016). This justifies the fact that performance of MSEs is explained by a combination o very many factors.

CONCLUSION

Government grants impact positively on the performance of MSEs. It facilitates their rapid expansion, supplements on their capital base and improves efficiency in MSEs.

Government grants are inadequate to facilitate full transformation of MSEs into large scale enterprises to achieve full monetization of the economy.

Private credit to MSEs plays a crucial role in explaining the performance of MSEs though associated with high lending costs and strict lending standards that limit many MSEs from accessing loans.

Inadequate information exists about proper procedures for accessing government grants provided for MSEs. This makes many MSEs miss out on government grants provided every year.

There are no clear monitoring and evaluation systems to report the performance of MSEs before and after accessing government grants so as to ascertain their effect on MSE performance.

Government majorly concentrates on financial grants in facilitating MSEs activities. Other attributes such as technical assistance, marketing of their products, research and development and physical infrastructures that hinder their performance are less attended to.

RECOMMENDATIONS

The government should adequately finance MSEs to ensure full monetization of the economy, achieve sustained economic growth and significant employment generation.

Need for non-financial support to MSEs to improve on their performance. There is need for the government to provide additional support in areas of technology, management, research and development, international publicity and negotiations, marketing and physical infrastructure which are key to the growth and development MSEs. Sophocleous (2019) concretizes this reasoning basing of the findings from his study that revealed that credit access alone is insufficient for business growth unless coupled with sound financial management.

There should be standardized procedures for accessing government grants by MSEs to ensure full utilization of the grants.

Monitoring and evaluation system of MSEs receiving government grants and their performance should be put in place.

Joint ownership of funded MSEs. The government should sign pacts with owners of MSEs to take part in the management of MSEs receiving state funds to ensure time recovery of funded and improve the quality of management and accountability.

Promotion of Public–Private Partnerships (PPPs) in SME Financing**.** A blended financing approach can be adopted. Partnerships with commercial banks, microfinance institutions, and venture capital firms can help leverage more resources while reducing government's fiscal burden. This requires the government to provide credit guarantees that reduce lending risks and encourage private banks to lend more to MSEs.

Strengthen financial literacy and accountability mechanisms. Government should integrate financial literacy training and mentorship into funding programs (PSFU, 2020). This ensures that loans and grants are invested productively rather than diverted to personal consumption, enhancing repayment rates and firm growth.

Model of proper government funding of MSEs

1.Capacity building

- Financial Literacy Programs**:** Training MSE owners in bookkeeping, credit management, business management, business planning and investment planning.
- Business Development Services: Incubators, mentorship, and advisory centers supported by government.

2. **Business plan approval**

- Statement of the vision, mission, goals and objectives
- Production plan
- Marketing plan
- Financial plan
- Organizational plan and
- Action plan

3. **Government funding allocation**

- The government through ministry of finance, economic planning and developments budgets for MSEs and the parliament passes the budget basing on their business plans,

4. **Government funds disbursement.**

- The government releases funds through Microfinance support center and other banking institutions basing on approved budget appropriations.

5. **Monitoring and evaluation**

- This requires the government to closely monitor the MSEs given grants. It fully participates in overseeing their operations and giving technical assistance to ensure profitability and progress.

6. **Grants recovery and recycling.**

- This involves collecting the money given to MSEs as per agreed repayment schedules and re-distributing it to other MSEs

7.**Output reporting**

- MSEs report the increase in output as a result of government funds to the e-output website created by the directorate of Micro and Small Enterprises under the ministry of Trade, Commerce and Industry. This enables the government to track effects of its funding of MSEs. This reporting should be done annually basing on the nature of the business.

Model specification.

$Y_{it}=\beta_0+\beta_1 FundsDisbursed_{it}+\beta_2 CapacityBuilding_{it}+\beta_3 BusinessPlanQuality_i+\beta_4 Monitoring_{it}+\beta_5 RecoveryRated_t + \beta_6 Reporting_{it}+X_{it}'\gamma+\alpha_i+\delta_t+\varepsilon$

Where;

α_i = firm fixed effects (controls for time-invariant firm heterogeneity)
δ_t = year fixed effects
X_{it} = vector of controls listed above
ε_{it}= idiosyncratic error

Interpretation:
β_1 measures % change in sales associated with a 1 unit increase in funds disbursed.
If $\beta_1>0$ and $\beta_6>0$: funding alone helps but is *much more* effective when accompanied by capacity building — supports combined funding + training approach.

Explanation of variables.
Dependent variable
Y_{it}= measures MSE's performance in year t. This performance is defined as;

- $Y_{it}=\ln(Sales_{it})$ (annual sales, log)
- $Y_{it}=\ln(Output_{it})$ (annual physical output, log)
- $Y_{it}=ProfitMargin_{it}$ (ProfitMargin)
- $Y_{it}=Employment_{it}$ (number of employees)

Independent variables:
Capacity Building$\{_{it}\}$. This is explained as intensity of capacity building received by MSE_i in year t. Could be index or score combining:

- number of financial literacy trainings attended,
- access to incubators/mentorship (binary or count),
- hours of advisory services.
  (Continuous index or standardized z-score; higher = more capacity building.)

Business Plan Quality$\{_i\}$. This is measured as approved business plan quality. Could be a score (0–100) based on presence of vision, production plan, marketing plan, financial plan, org plan, action plan; or categorical (poor / fair / good / excellent).
Government Allocation$\{_{dt}\}$. This is government budget allocation for MSEs in district/region *d* and year t (real currency units per MSE or per capita). If individual-level allocation exists, use amount allocated to firm *i*.
Funds Disbursed$\{_{it}\}$. This is the actual amount disbursed to MSE *i* in year *t* (log), or disbursement timeliness indicator (timely =1 if within approved schedule).
Monitoring$\{_{it}\}$. This measures the intensity of monitoring & evaluation received (binary or index: number of visits, technical assistance hours).
Recovery Rate $\{_{dt}\}$. This is measured by local-level proportion of grants recovered/recycled (percentage).
Reporting$\{_{it}\}$. This measures compliance of MSEs to truck the effect of a government grant: 1 if firm reports output to e-output website in year t, 0 otherwise; or frequency of reporting.

LIST OF ABBREVIATIONS
MSEs- Micro and Small Enterprises
IFC-International Finance Corporation
MMSES-Micro, Small and Medium Enterprises
MTIC- Ministry of Trade, Industry and Commerce
UIA- Uganda Investment Authority
AMFIU- *Association of Microfinance Institutions of Uganda*
URA-Uganda Revenue Authority
PSU-Private Sector Foundation Uganda
PDM-Parish Development Model
MSC-Micro finance Support Centre
GDP- Gross Domestic Product
UBOS-Uganda Bureau of Statistics
ICT- Information Communication Technology

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