

# **IMPACT OF GOVERNMENT POLICIES ON ACCESS TO CREDIT FOR SMALL BUSINESS IN KATHMANDU**

A Dissertation submitted to the Office of the Dean, Faculty of Management in partial  
fulfilment of the requirements for the Master's Degree

**by**

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## CERTIFICATION OF AUTHORSHIP

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled “**Impact of Government Policies on Access to Credit for Small Business in Kathmandu**”. The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor it has been proposed and presented as part of requirements for any other academic purposes.

The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of the dissertation.

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## REPORT OF RESEARCH COMMITTEE

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## ABBREVIATIONS

ACT	-	Access to Credit
ANOVA	-	Analysis of Variance
CBK	-	Central Bank of Kenya
CBN	-	Central Bank of Nigeria
CSI	-	Cottage and Small Industries
CT	-	Credit Terms
DCSIN	-	Department of Small and Cottage Industries of Nepal
GDP	-	Gross Domestic Product
MFI	-	Micro-Finance Institutions
OECD	-	Organization for Economic Cooperation and Development
PSME	-	Performance of Small and Medium Enterprises
SFI	-	Specialized Financial Institutions
SME	-	Small and Medium Enterprises
SPPS	-	Statistical Package for Social Scientist
USA	-	Unites State of America

## ABSTRACT

This study is motivated by the difficulty faced by SMEs in accessing credit from commercial banks to sustain business growth and performance. The study aims to identify, analyze and examine different factors that affect the performance of entrepreneurs in Small and Medium enterprises (SMEs) of the Kathmandu district. The study is conducted to fulfill the following objectives; (i) To examine the relationship between access to credit and performance of SMEs in Kathmandu District. (ii) To examine the relationship between the credit terms and performance of SMEs in Kathmandu District (iii) To analyze the effect of access to credit and credit term on the performance of the SMEs in Kathmandu District.

The study is based on the descriptive and analytical survey design. Primary data was collected using self administered questionnaires issued to respondents who were owners/managers of the registered SMEs in Kathmandu district. A sample size of 70 respondents was taken into account out of 225 population for the study using convenience and purposive sampling method. Correlation and multiple regression analysis are carried out to establish the association among the variables.

The results indicated a significant positive association among the variables of credit terms and performance of SME. Similarly, access to credit and performance of SMEs also have a significant positive relationship. Regression analysis revealed that access to credit and credit term combinely contributed 18% of the variance in performance of SMEs. In order to improve access to credit by SMEs, commercial banks and other lending institutions need to adjust credit terms in line with what borrowers can afford. If there is easy accessibility of the credit with the favorable credit terms for the SMEs then the overall performance of the SMEs can be enhanced.

**Keywords:** *Entrepreneurs, small and medium enterprises, credit terms, access to credit, productivity and performance of SMEs.*

# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

Small and Medium Enterprises (SMEs) have been recognized as a driving force for economic growth in any nation. In recent days, both developed and developing countries support for SMEs development and growth has increased. In developed and developing countries, small and medium enterprises firms make significant economic and social contribution.

SMEs are important both to the individual and to the nation. To the individual, they provide employment and raise the standard of living of both employers and employees. To the nation, they complement large scale modern sector enterprises and utilize agricultural and other raw materials that would have gone to waste, they serve limited or closed markets that warrant only small scale production, they mobilize resources otherwise left out of the mainstream formal mobilization channels and they provide the necessary platform for take-off into large scale modern production.

Small and medium enterprises (SMEs) remains one of the most reviewed topics in literature, especially as its impact on all kind economics cannot be overlooked. Evidence shows that a dynamic and growing SMEs sector can contribute to the achievement of a wide range of development objectives, including: the attainment of income distribution and poverty reduction and creation of employment (Daniels & Ngwira, 1993); savings mobilization, production of goods and services that meet the basic needs of the poor (Cook & Nixson, 2000).

SMEs serve as a mechanism for job creation in many countries around the globe (Shehu & Mahmood, 2014). Largely, the sector serves as a livewire for economic survival for nations all over the world. Thus, the global consideration is said to be on the issues like job creation, poverty reduction, which is the significant issues encouraging the support of SMEs development among many nations. Comprehensively, a quiet number of the countries adapted the platform of SMEs to solve their socio-economic problems and improve their GDP.

Worldwide, the small and medium enterprises (SMEs) have been accepted as the engine of economic growth and for promoting equitable development. Small and medium enterprises (SMEs) are the major source of income, a breeding ground for entrepreneurs and a provider of employment in many countries. Small and medium enterprises (SMEs) play a valuable role in job creation and make significant contributions to economic growth in developed and developing countries alike. As a result, establishing a dynamic small and medium enterprises (SMEs) features prominently on the economic development agendas of practically all countries around the world (Tambunan, 2005).

SMEs have been identified the world over as the stepping stones for industrialization. In today's increasingly globalized economy, Small and medium enterprises (SMEs) are usually feeder industries for larger industries and they are crucial for economic growth and development (Kongolo, 2010). Small and medium enterprises (SMEs) particularly have a vital role to play in the development of nation. Empirical evidences have shown that they contribute to employment, alleviate poverty and increase productivity level in a nation. Small and medium enterprises (SMEs) are very important for employment creation and are important sources of economic growth (Tambunan, 2005). Small and medium enterprises (SMEs) are now considered to be the major source of dynamism, innovation and flexibility in emerging and developing countries, as well as to the economies of most nations. They contribute substantially to economic development and employment generation. Small and medium enterprises (SMEs) form as a potential economic back-bone of many regions and make a large contribution to employment than large companies.

### **1.1.1 Small and Medium Enterprises (SMEs) in Nepal**

A small scale enterprise is an enterprise or a firm employing less than 5 but with a maximum of 50 employees where as a medium sized enterprise is considered a firm, which employees between 50-100 workers.

The Industrial Enterprises Act of Nepal (1992) classifies cottage industries as traditional industries that utilize specific skills or raw materials and resources, which are labor intensive and are related to national tradition, art and culture. Industries with a fixed capital investment of up to 30 million Nepalese rupees are

classified as small industries. Enterprises with a fixed capital investment of between 30 and 100 million Nepalese rupees are classified as medium-sized, and those with a fixed capital investment of more than 100 million Nepalese rupees are categorized as large. According to the Department of Industry, registered industries with an average of 12 employees per business numbered 27,658 (of which 4,678 were cottage industries and 22,980 were small-scale industries) compared to only 731 medium and large industries with an average of 99 employees per business during the period 1993/94 and 1995/96. The total number of cottage, small and medium enterprises surged by whopping 360.89 percent to 320,000 by the end of last fiscal year 2015-16, compared to 69,431 a decade back (fiscal (2005-06), according to the Department of Cottage and Small Industries of Nepal.

Most of the Nepalese SMEs are involved in processing and manufacturing of food items, consumer and household goods, and textiles and related products, both for exports as well as the domestic market. Rice, pulses, oil and flour mills, dairy, aerated soft drinks, fruit juices and processed products, noodles, biscuits and light snack products, chocolates and candy, mineral water, dried vegetables, and some other household utilitarian and consumption goods have dominated SMEs activities in Nepal. Other areas of SMEs' involvement include forest fiber based industries, wooden and metal handicrafts, handmade paper and products, apparels and garments, woolen carpets, pashmina shawls and rugs and leather. SMEs' involvement is also high in metal and plastic household utensils, wooden, plastic and metal furniture, printing press, polythene pipes, utensils, jute products, poultry products, livestock products, wire drawing, nail and iron rod, sheet metal, gig and black pipes, rubber tires and tubes, plywood and boards, color paint products and zinc oxide. Agro-based industries like tea, vegetables and horticulture products, dairy and milk products, animal husbandry and floriculture are other areas where SMEs have started to invest. Due to the opening up of investment for infrastructure development to the private sector, investment in micro hydropower and tourism resorts and complexes have also been witnessed in some regions. At the micro, cottage and family level, a sizeable number of unregistered enterprises operate on a seasonal basis.

In Nepal, the role of SMEs seems relatively greater which is very positive in terms of the country's economic growth. Even more positive fact is the fact that the most of the Nepalese SMEs are involved in the manufacturing of handicrafts, textiles, garments, food items etc and in travel and tourism industry, all of which generate large sum of foreign currencies in Nepal and supports for the economic growth of nation.

The export of Nepalese crafts started from the mid 60's of the last century. However, the systematic export started only from early 70's. Crafts have long been a major line of Nepalese exports. Currently, it has been the largest overseas export item of the country next to readymade garments and carpets. More than 20 handicraft products mainly the pashmina products, woolen goods, silver jewellery, Nepalese handmade paper and paper products, metal craft, woodcraft, cotton goods etc. are being exported to about 85 countries. USA (which alone absorbs around 25% of the total export of handicraft products), Britain, India, Canada, Germany, Japan, Italy, France, Australia, Netherlands and China are its major foreign buyers.

Small and medium-sized enterprises (SMEs) comprise a substantial part of the economic activity of developing countries. Small and medium enterprises (SMEs) play an important role in creating self-employment opportunities, mobilizing and using local resources, and raising the income of the rural population. During the year 2001, SMEs accounted for 96 percent of total industrial establishments, contributed 83 percent in employment generation by industrial sector, and shared about 80 percent in the industrial sector's contribution to nation a gross domestic product (GDP). At present, SMEs account for more than 90% of the total industrial establishments which generate more than 75% of employment in the industrial sector and shares more than 70% in the industrial sector is contribution in National GDP.

Despite the importance and the contribution of the SME sector to the national economy, the sector itself is encountering serious adjustment problems under a changing and dynamic environment. In general, SMEs in Nepal have traditional management practice, undeveloped entrepreneurial culture, low capital base, outdated and less efficient production process and technology, and poor knowledge and information about business opportunities and marketing. Obviously, the challenges for the Nepalese SMEs are mounting. The challenges have become

more profound due to the recent trends of globalization and economic liberalization. These challenges need to be addressed or it may result in a situation where the Nepalese SMEs may lose out to the regional and global players. Marketing constraints is observed to be one of the major disadvantages faced by the Nepalese SMEs. Given their size and limited access to resources, their production capacity is limited are unable to execute large orders. Fear of commercial disputes arising from delayed delivery, improper packaging, unforeseen costs, poor quality and failure to meet technical specifications also prevents them from approaching organized export markets.

But, although SMEs play a crucial role in economic growth and employment the small and medium enterprises (SMEs) in developing countries face a financing gap (Beck & Demirguc-Kunt, 2006; Dube, 2013) related to difficulties in small and medium enterprises (SMEs) access to finance that undermines economic prosperity small and medium enterprises (SMEs) are a fundamental part of the economic fabric in developing countries like Nepal, and they play a crucial role in furthering growth, innovation and prosperity.

On the financial front, SMEs, more often than not, are unable to generate enough credit to carry out relatively larger volume of work. The lack of awareness on the part of entrepreneurs regarding financial institutions that may give them credit is one reason for their inability to raise financial resources. Even when SMEs manage to get credit, the relatively short time for repayment and high interest rates do not help their cause.

Finance is probably among the greatest hindrances to small and medium enterprises (SMEs) in improving financial performance and competitiveness in Nepal. Consequently, improving a business and implementing policy were essential aspects for small and medium enterprises (SMEs) development and finance have been found to be limitation for local and international competitiveness (Beck & Demirguc-Kunt, 2006; Shariff, Mohd & Peou, 2010). Unfortunately, they are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of small and medium enterprises (SMEs) in developing countries rating access to finance as a major constraint. It has been reported that the main challenges affecting small and medium enterprises (SMEs)

in Nepal include lack of knowledge of small and medium enterprises (SMEs), access to bank credit.

A crucial element in the development of the SME sector is access to finance, particularly to bank financing, given the relative importance of banking sector in serving this segment. More importantly, a number of studies using firm – level survey data have shown that SMEs not only perceive access to finance and cost of credit to be greater obstacles than large firms, but these factors constrain SMEs performance more than large firms (Schiffer and Weder, 2001; Beck, Demirgüç-Kunt, and Maksimovic, 2006; and Beck, Demirgüç-Kunt, Laeven, and Maksimovic, 2006).

The practice of credit rationing by financial institutions using interest rates has locked out most poor individuals as only large scale borrowers who expect higher returns can bear the high cost of borrowing Stiglitz and Weiss (1981). Due to the potential for adverse selection resulting from information asymmetry between lenders and borrowers, lenders are often discouraged from using the interest rate as a way to ration credit. Most rural individuals particularly rely on informal credit facility from buyers and sellers of consumer goods like shops and farmers. However, where there is no full information about the level of risk and credit worthiness of the individual, access to credit facility from both formal and informal lenders is constrained. The establishment and launch of the credit reference bureaus is expected to change the credit landscape since information on the credit worthiness is to be made available hence reducing the degree of information asymmetry. However, launch of this body does not suffice since information on most potential borrowers and first timers remain unknown.

In this way, despite the SME's large contribution in country's economic development; their performance were mainly inhibited by a number of constraints like: operations as an informal sector, the size of their operations is too small to enable employment of economies of scale, poor production technology, limited access to markets, limited a managerial skills, government bureaucracy and limited, lack of training opportunities and high cost of inputs and limited access to banking facilities (Cook & Nixon, 2000) which acts as barriers to the emergence and growth of a sustainable small and medium enterprises sector. We all know that, SMEs form the building blocks for a country's development and Finance is

the lifeblood of every business firm. So, the success of SME is therefore paramount to the country. Finance is the lifeblood of every business firm but, access to finance remains as a key constraint to SME growth, development and the success in Nepal as it create effect even in the overall performance of SMEs. Hence, this study is going to undertake mainly to investigate the effect of credit terms and access to credit on the financial performance of SMEs.

## **1.2 Problem Statement**

SMEs comprise a substantial part of the economic activity of developing countries like Nepal. In Nepal, the role of SMEs is often relatively greater. SMEs play an important role in creating self-employment opportunities, mobilizing and using local resources and raising the income of the population. SMEs are of necessity to a nation's industrialization process. They are regarded as the facilitators of economic growth and for enhancing development.

One foremost way of promoting SMEs is by having easy access to finance .Finance is of high importance for the growth of SMEs. Broadly speaking, the provision of credit to the SMEs is an increasingly common weapon in fight to reduce poverty and promote economic growth. In Nepal, on the financial front, SMEs more often than not, are unable to generate enough credit to carry out relatively larger volume of work.

Despite of SMEs large contribution in countries development and economic growth in various aspects such as increased profit, increase of business outlast/ premises which in turn create employment, leads into increase of business assets, business diversification and sales return, however, their growth and development in developing countries are mainly inhibited by access of finance, poor managerial skills, and lack of training opportunities and high cost of inputs (Cook & Nixon, 2000). The SMEs face limited access to financial services from formal financial institutions to meet their working and investment needs (Kessy & Temu, 2010).

Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that credit augment income levels, increases employment and thereby alleviate poverty. It is believed that access to credit enable poor people to overcome their liquidity constraints and undertake some investments. However the lack of access to credit to start or expand small scale

enterprises has often plagued this sector of the economy. Most SMEs tend to rely on the personal resources of their owners, and or loans from friends and relatives to fund the enterprises. The expectation has been that, after initial takeoff of the small scale enterprises, the business should be able to raise funds from the formal sector especially MFIs or banking industries to expand its operations. The credit facilitates the enterprise growth, increases incomes and creates job.

Access to credit is indicated as a key problem for SMEs worldwide. In some cases, even where credit is available, the entrepreneur may have difficulties because the lending conditions may require collateral for the loan. Credit constraints operate in variety of ways in Nepal where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends or relatives. Lack of access to long-term credit for small enterprises forces them to rely on high cost short term finance. For Nepalese SME's, the formal banking system is too expensive and inconvenient. Whereas banks consider SMEs with no transaction history are too risky because their ability to repay loans is not yet known. These Unbanked SMEs may also not have collateral to access formal credit. Another issue is that these unbanked SMEs might not have the skills to run the business professionally. They may not have proper bookkeeping procedures, inventory systems, business plans or income statements making it hard for a bank to evaluate them (Frempong, 2007).

There is the impact of credit on SMEs development like availability of credit helps in the improvement in their sales, profits, assets, cash flows, management practices and family welfare. New jobs and linkages with other organizations had also been created. This therefore, demonstrates that access to credit influences performance of SMEs. Performance is the outcome derived from efficiency and effectiveness in optimum utilization of resources and productivity. Kamyabi and Devi (2011) performance defined as the measurement of firm's financial ability which includes the level of profit, investment level with both growth in sales and profit and the performance of SMEs depends a lot on a financial institutions' support.

In the context of Nepal also, there is a widespread concern that banking systems are not providing enough support to new economic initiatives and in particular to the expansion of SMEs and agriculture sector. It is argued that faster economic growth will not be possible without deepening of the financial system and in

particular, more financial support from the banking sector to the SMEs .Banks remain highly liquid and reluctant to expand credit other than to most creditworthy borrowers which in most cases excludes the SMEs .

Due to this reason, over the years performance of SMEs has been deteriorating and majority of them have closed down. This trend of performance could be as a result of SMEs failure to access credit from the financial institutions probably due to unfavorable credit terms. In Nepal, the failure rate of SMEs is in the increasing trend that is due to lack of skills and access to finance among other reasons. Most of the businesses are reported to be failing within the first five years while 5 to 10% survive and make it to maturity. While the contributions of small businesses to development are generally acknowledged, SME entrepreneurs face many obstacles that limit their long term survival and development. Research on small business development has shown that the rate of failure in developing countries is higher than in the developed world.

SMEs have continued to suffer on business capital improvement in Nepal, although there are several financial institutions which provide loans. In Nepal, most of the SMEs have low return on capital employed, low net profit margin and kept a small capital size. Also, some of SME fail to run their daily operations because of financial incapacity. Therefore, the relationship between the financial institutions and SME continue deteriorating due to failure to fulfill their loan obligations. Although the measures been put in place by microfinance operations to overcome the challenges of SMEs in Nepal, still SMEs owners lack collateral securities which micro finances need in order to give out loans and this in turn raises the interest rates charged on loans which scares away traders and vendors from borrowing.

Lack of access to credit is indicated as a key constraint for the success of SMEs as it influence on the performance of SMES. Hence, this study is conduct to find out the answers of the following questions:

- i. What is the relationship between access to credit and performance of SMEs in Kathmandu District?
- ii. What is the relationship between credit term and performance of SMEs in Kathmandu District?

- iii. What is the effect of access to credit and credit term on the performance of SMEs in Kathmandu District?

### **1.3 Objectives of the Study**

Understanding the effect of credit terms and access to credit on the performance is an empirical issue. The study aims to identify, analyze and examine different factors that affect the performance of entrepreneurs in Small and Medium enterprises (SMEs) of the Kathmandu district. This study aims to provide two important contribution to the field of Finance and Banking with respect to the level of credit accessibility of entrepreneurs for the small and Medium enterprises (SMEs). More specifically, the objectives of the study are as follows:

- i. To examine the relationship between the access to credit and the performance of SMEs in Kathmandu District.
- ii. To examine the relationship between credit term and performance of SMEs in Kathmandu District.
- iii. To analyze the effect of access to credit and credit term on the performance of the SMEs in Kathmandu District.

### **1.4 Rationale of the Study**

This study intends to shed light on the relationship between the independent variables (access to credit) and dependent variable (performance of SMEs). This can help them to come out with substantive possible alternative policy interventions which might help to address problems and challenges which small and medium enterprises face.

The study can offer empirical evidence on the impact of credit term and access to credit on the financial performance of entrepreneurs in SMEs, in Kathmandu district. Academic researchers will also find the results useful, for the study will add to existing body of knowledge and provide a source of reference to their further studies. The study will provide information and knowledge about the importance of creditworthiness of SMEs which will help them to improve their chance of getting credit.

The result of this study is expected to benefit financial institutions like commercial banks, micro-finance banks etc. and other interested bodies associated with the finance sector in Kathmandu district to improve the quality of credit services to

their clients and understand their shortcomings so that they can offer services which add value to their clients and have a competitive advantage over their competitors. The financial institutions will gain an understanding emanating from provisions of credit to SMEs.

A study of this nature is equally very important because it is going to enlighten the government and the public on the role of financial institutions (commercial banks) in the SMEs sector.

### **1.5 Limitations of the Study**

The limitations of the study are as follows:

- The study covers only the Small and Medium enterprises (SMEs) that are located in the Kathmandu district. The present study mainly focuses on the licensed or registered small and medium enterprises (SMEs) under which it may includes Thanka, handicrafts, textiles, garments, furniture too. Since the study is based on the SMEs that are operating within the Kathmandu district so the result of this study can be generalize with the similar kind of SMEs only.
- The study is based only on the primary data collection and data are collected through administering the questionnaires to the respondents.
- In this study, the performance of entrepreneurs in SMEs is measured on the basis of the perception of the owner/manager of the SMEs

## **CHAPTER II**

### **LITERATURE REVIEW**

This chapter examines available literature on the relationships between the different variables used in this study. The researcher has reviewed literature on the relationship between credit terms and performance as well as the relationship between the, the effect of credit terms and access to credit on financial performance of SMEs and the relationship between access to credit and performance of SMEs .This chapter also highlights the various theories related to credit term, credit access, and performance of SMEs .This is followed by a review of the existing empirical studies conducted by researchers locally and internationally.

#### **2.1 Theoretical Review**

This section explores the various theories related to access to credit, credit term and the performance of SMEs.

##### **2.1.1 Financial Inclusion Theory**

Financial inclusion refers to the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost, in a fair and transparent manner, by mainstream institutional players .An inclusive financial sector that provides access to credit for all bankable people and firms, to insurance for all insurable people and firms, to saving and payment services for everyone .Inclusive finance does not require that everyone who is eligible use each of the services, but they should be able to choose them if desired.

##### **2.1.2 Minimalist Approach**

Under this approach only credit access is the mean to success of SMEs. Minimalists base their approach on the premise that there is a single missing piece for enterprise to grow, usually considered to be lack of affordable and accessible short-term credit Ledgerwood (1999). Minimalist approaches normally offer only financial intermediation such as savings, credit, insurance, credit card and payment

systems. Credit provision is restricted to those who can secure it with tangible collateral, commercial banks and non-bank financial institution use this approach.

### **2.1.3 Ground Based Approach**

The approach operates on the principle that credit is the most important constraint entrepreneurs. Micro credit is most often extended without traditional collateral. Physical collateral is a requirement for borrowing which lock out many SMEs from accessing credit. The group based approach can use either newly formed groups or already existing ones. Group based approach is also referred to as joint liability. Members make a weekly contribution to a joint account in the name of the group, which acts as a savings account for each member and account in the name of the group, which acts both as a savings account for each member and a loan guarantee fund. Members can only receive a second and bigger loan after the first loan is repaid. The responsibility for loan administration by the group provides peer pressure, which keeps up repayment. SMEs can use this approach to improve their access to credit.

### **2.1.4 Imperfect Information Theory**

This theory is based on the assumption that banks can't differentiate cost effectively between low risk and high risk loan applicants. In addition it is thought that formal institutions are unable to compete successfully with informal lenders because such lenders have access to better information about credit applicants than formal institutions can obtain cost effectively. Imperfect information theory suggests that it would be difficult for banks to both operate profitably in developing countries credit markets and to attain extensive outreach. On the basis of this model, it would be difficult for economists, bankers, financial analysts, donors and government decision makers to muster much enthusiasm for advocating entrance of commercial banks into micro credit markets.

### **2.1.5 The Modigliani and Miller Hypothesis under Corporate Taxes**

Modigliani and Miller (1958 and 1963) hypothesis under corporate taxes highlighted the important issues involved in financial structure decisions namely: the cheaper cost of debt compared to equity; the increase in risk and in the cost of equity as debt increases; and the benefit of the tax deductibility of debt. They argued that in the absence of taxes, the cost of capital remained constant as the

benefits of using cheaper debt were exactly offset by increase in the cost of equity due to increased risk. With taxes and deductibility of interest charges they concluded that firms should use as much debt as possible. Myers (1984) described the compromise static trade-off theory which firms would use a good deal of debt to take advantage of tax deductibility but not too much to avoid the increasing likelihood of costly bankruptcy. SMEs can therefore acquire credit from financial institution to meet their recurrent expenditure against their future profits.

### **2.1.6 The State Trade-off Theory**

The origin of modern capital structure theory lies in the work of Modigliani and Miller (1958) in their proposition – often referred to as the “irrelevance theorem”. The theorem suggests that, as an implication of equilibrium in perfect capital markets, the choice of capital structure does not affect a firm’s market value. However, the theory proposed by Miller and Modigliani (1958) was revised in 1963 to represent a real life scenario. Modigliani and Miller (1963) introduced the effect of tax and interest deductibility of debt. By revising the two propositions, Miller and Modigliani (1963) showed the effect of tax rates and interest rate deductibility on the capital structure and expected return of the firm’s shares. Firms, through interest rate deductibility of debt, could shift payments from going to the government and instead direct them to the firm’s shareholders and creditors by increasing leverage (Miller and Modigliani, 1963). The tax deductible effect of interest on debt creates tax savings for the firm and makes debt financing cheaper than equity finance. Miller and Modigliani (1963) suggested that a firm should have 100% debt in its capital structure and this enables the firm to take absolute advantage of the tax-shield but theoretically, 100% tax shield does not exist in reality because of the interest repayment obligations of debt. Debt leads to a legal obligation to pay interest and principal. If a firm cannot meet its debt obligations it is forced into bankruptcy and incurs associated costs.

Berger and Udell (1998) pointed out since the seminal work of Modigliani and Miller (1958 and 1963) on the significance of capital structure, yet the seemingly simple question of how firms should best finance their assets remains a contentious issue. Although there is no consensus, two other competing theories have emerged. These are the agency theory and the pecking order theory.

### **2.1.7 Adverse Selection Theory of Financial Markets**

The adverse selection theory of financial institutions originates from the work of Stiglitz and Weiss (1981). In his explanation interest charged by a credit institution are assumed to have a dual role of sorting potential borrowers (leading to adverse selection) and affecting the actions of borrowers (leading to incentive effect). Interest rates thus assumed to affect the nature of the transaction and do not necessarily clear the market. Both effects are seen as a result of the imperfect information inherent in credit markets. Formal lenders insistence on collateral security rations a large number of borrowers out of the credit market, leaving only the few who can afford the required collateral. According to Stiglitz and Weiss (1981), lenders would like to identify borrowers most likely to repay their loans since the banks' expected returns depend on the probability of repayment. Formal institutions fail to cater for the credit needs of small firms who are perceived to be too risky and small enterprises often have greater access to informal credit facilities than to formal sources.

Adverse selection arises because in the absence of perfect information about the borrower, an increase in interest rates encourages borrowers with the most risky projects, and hence least likely to repay, to borrow, while those with the least risky projects cease to borrow. Interest rates will thus play the allocative role of equating demand and supply for loanable funds, and will also affect the average quality of lenders' loan portfolios. Lenders will fix the interest rates at a lower level and ration access to credit. Imperfect information is therefore important in explaining the existence of credit rationing for small and medium enterprises.

Stiglitz and Weiss' theory was designed to apply quite generally, rather than in a specific context of informal credit in developing countries. In the latter context, the theory has often been criticized for its underlying assumption that lenders are not aware of borrower characteristics. The close knit character of many traditional rural and close knit urban societies implies that lenders possess a great deal of information about relevant borrowers' characteristics, such as business ability, size and quality of assets, and risk attitudes. Criticism for this theory stems from the fact that it ignores the fact that borrowers themselves who can seek ways to assure the lender that they are not "lemon" and hence have access to credit. .

### **2.1.8 The Pecking Order Theory of Financial Structure**

This model attempts to avoid the resulting risk that profitable investment projects will be foregone by seeking to finance them internally. If retained earnings are insufficient, they will opt for debt rather than equity finance, because debt providers, with a prior claim on the firm's assets and earnings, are less exposed than equity investors to errors in valuing the firm. Managers will only opt for equity finance as a last resort in this model. In these circumstances, corporate gearing will reflect a company's need for external funds and — unlike the trade-off approach — there will not necessarily be any target or optimal level of gearing. This model was initially proposed by Myers (1984) and suggests that firms tend to finance their needs in a hierarchical fashion, first using internally available funds, followed by debt, and finally external equity.

Central concern appears to be a concentration by small firms on sources of finance that minimize intrusion into business. Consequently firms do not have an optimal debt-equity ratio but rather it varies, justified by the firm's need of external finance. The pecking-order model to a great extent tells the way certain characteristics of a firm may influence gearing decisions. As Myers suggested, some entities follow a certain hierarchy to determine which the next alternative source of finance is, and that fear of intrusion and dilution of power in an entity may cause a certain sources to be selected. Myers (1984) suggests that issuing debt secured by collateral may reduce the asymmetric information related costs in financing. The difference in information sets between the parties involved may lead to the moral hazard problem (hidden action) and/or adverse selection (hidden information). Hence, debt secured by collateral may mitigate asymmetric information related cost in financing.

### **2.1.9 Information Asymmetry Theory**

As mentioned earlier, information asymmetry is when owners and managers of SMEs have more, and better, information about their business than do lenders, in terms of both the financial state and risks facing their business. Thus, complete and accurate information about the firm is not available to the lender and bank. This makes lending decisions difficult and affects optimal loan contracts (Lean & Tucker 2001). Several studies show that one of the most significant factors

affecting SME access to finance is the existence of information asymmetry (Berger & Udell 1998; Coleman 1998). This is because investors and lenders always require information about the firm's financial conditions and performance to properly evaluate the probability of success and growth potential of the project before providing finance.

However, this information is limited and not always available. The consequence of such a lack of information is that creditors will charge higher rates to mitigate the risk involved in financing SMEs and to compensate for the possibilities of failure (Keasy & Watson 1993). Peterson and Rajan (1994) stated that when information asymmetry exists, most banks and lenders are likely to reduce the extent of lending or resort to credit rationing, even when SMEs are willing to pay a fairly high risk-adjusted interest rate.

Lehmann and Neuberger (2001) posit that the more complete and accurate the information provided to the banks and institutional investors by SMEs, the more favorable the loan contract terms in terms of interest rates and collateral requirements. However, the costs of gathering and analyzing such information are high and hence to avoid the cost, banks and lenders limit their focus to the desired and relevant information. Thus, when information asymmetry exists, one of three scenarios with respect to banks evaluating loan applications from SMEs tend to occur: the bank (i) accepts the loan application but with a high risk-adjusted interest rate; (ii) accepts the application with imposition of high collateral requirements; or (iii) rejects the loan application.

Generally, SME managers lack the required skills to manage the financial affairs of the firm and hence tend to provide low-quality information. As banks and other institutional investors rely on past financial information as an indicator of the current performance and future profitability of an SME, it needs to reduce the information asymmetry by building a close relationship with the bank (Keasy & Watson, 1993). The firms that have established a good relationship with banks have easier access to bank credit and appear to be less sensitive to liquidity considerations than firms without such a relationship. Most studies related to financing SMEs report that asymmetric information affects SME access to bank credit and is therefore one of the main obstacles to obtaining external finance.

The consequence of information asymmetry between credit providers and SME owners/managers result is a reduction of the supply of finance to firms. This can lead to two main problems: (i) adverse selection; and (ii) moral hazard (Berger & Udell 1998; Lean & Tucker 2001; Peterson & Rajan 1994; Stiglitz & Weiss 1981), as discussed below.

#### **2.1.9.1. Adverse Selection**

Adverse selection arises when banks have insufficient information regarding both the expected quality of SME management and their projects. This problem occurs when the entrepreneurs possess greater and better information about their risky business projects than do their potential lenders. In such cases, lenders would either charge the borrower higher interest rates or require higher levels of collateral to reduce the negative effect of the information asymmetry and to cover the high risk of bad debts (Lean & Tucker 2001; Stiglitz & Weiss 1981). To avoid high interest rates and high collateral requirements, SMEs must provide sufficient and complete information to financial providers.

#### **2.1.9.2 Moral Hazard**

The second consequence of information asymmetry is moral hazard. This is a situation when business owners have a tendency to take a greater risk to protect against the cost that could be incurred by the other party. As a result of the moral hazard problem, the bank can accept the loan application of an SME upon the provision of appropriate collateral, compounded by the trend towards longer-term debt. Alternatively, the bank can reject a loan application from a small firm due to moral hazard, market concentration, centralization of lending decisions, and the increasing use of computer credit scoring (Lean & Tucker 2001). Therefore, imposing high collateral on lenders can resolve incomplete information and reduce moral hazard concerns (Chan & Thakor, 1987). In addition, the willingness to provide collateral represents a 'signal to the bank that the entrepreneur believes the project is likely to succeed—otherwise he or she would not commit their personal resources to it. However, as not all SMEs can provide appropriate collateral, many small businesses fail to expand (Binks & Ennew 1997; Lean & Tucker 2001).

Willingness of financial providers to provide funds to SMEs is reduced as a result of information asymmetry (Berger & Udell 1998; Peterson & Rajan 1994).

However, Meza and Webb (1987) demonstrate that as the inability of financial providers to find out all of the relevant characteristics of borrowers, the information asymmetry can lead to an oversupply of finance rather than an undersupply. However, some researchers suggest that the availability of financial information will decrease the extent of the moral hazard and adverse selection problems, and eventually facilitate easy access to finance for SMEs (Binks, Ennew, & Gay, 1992).

## **2.2 Empirical Review**

This section presents review of global and local empirical literature on the credit term, access to credit and the performance of SMEs.

Wang, et al; (2023) studied on supply chain finance and innovation efficiency: An empirical analysis based on manufacturing SMEs. This paper firstly demonstrates the positive and negative effects of supply chain finance on the innovation efficiency of China's small and medium-sized enterprises (SMEs) in the manufacturing industry from the theoretical point of view. Based on the data of 267 manufacturing companies in China Growth Enterprise Market from 2015 to 2019, the DEASBM method was used to measure the comprehensive innovation efficiency of different companies, and it was further decomposed into technological innovation efficiency and organizational innovation efficiency. Afterwards, it conducts an empirical analysis through the double fixed effect model, and explores the difference in the impact of supply chain finance on innovation efficiency in enterprises with different industries and different property rights. The results show that supply chain financial services have a strong positive impact on the comprehensive innovation efficiency, technological innovation efficiency and organizational innovation efficiency of manufacturing SMEs. Further, supply chain finance has the most significant improvement on the technological innovation efficiency of the sample of private traditional enterprises, but it has a significant inhibitory effect on the organizational innovation efficiency of the sample of state-owned high-tech enterprises. Therefore, this paper suggests that the development of supply chain financial services should increase support for traditional manufacturing industries; appropriately tilt resources to private enterprises; improve relevant supply chain financial laws and regulations, establish

and improve corresponding institutional arrangements, and encourage state-owned enterprises to participate in market competition.

Onyedikachi et al; (2022) studied on The Impact of Government Policies and Small Scale Enterprise Development Activities on Economic. This research explores how government policies, SSE advancement, expansion, and promotion affect SSE performance and economic growth in Nigeria. The research contributes to various theoretical models, including the Organizational Theory of Innovation and the Schumpeterian Theory of Innovation. These models serve as the foundations for innovation performance, competitive advantage and organizational strategic management. It also promotes ethical decision-making in terms of policies, progress, expansion, promotion and enterprise/company performance. The study used survey based research approach. The study sampled a valid respondents of 250 to make a generalization using Yaro Yamane formulae. The study used Cronbach's Alpha, Pearson's Correlation, Durbin-Watson, ANOVA, and OLS Regression. The results reflects the level of significant impact of the regressed variables on the SSEs and economic growth at 10%, 1%, 5%, and 1%, significant P-values. This indicate that SSE progress, expansion and promotion are significant factors or elements that can impact positively on SSE development and economic growth (EG). The study accept all hypotheses in this study due to their relevance to the measured variable. Effective government policy boosts SSE performance and economic growth. The study agree that good government policy for SMEs is vital to most economies' long-term growth and prosperity. Effective government policies affect SSEs' long-term viability. The correlation analysis connected all variables positively. These issues may affect SSE's performance and economic growth. Effective government policies, SSE advancement, expansion, and promotion are combined efforts between the government and entrepreneurs. It will help firms or organizations to expand, find new possibilities, and improve. Besides, the ability of entrepreneurs to continue to develop and offer services depend on having access to financial resources to expand their businesses is a means to contribute to economic growth and development because the continual function of these SSEs will create employment, reduced unemployment and generate revenue through taxes for development intervention. Hence, a need for government to create the enabling environment for small scale business activities

to thrive. This research informs the government to strengthen policies to support the private sector growth in Nigeria and elsewhere around the globe.

Nwosu and Orji (2021) ascertained the impact of access to formal credit on enterprise performance. The study used Nigerian Enterprise Surveys data for 2010 to construct a direct measure of credit constraint. From propensity score estimations, the results showed that access to formal credit matters and has a significant impact on enterprise performance indicators. Firms that are credit constrained have significantly lower output per worker, capital per worker, employment of labor and investment in fixed assets for expansion compared to firms that are not credit constrained. This is more pronounced for women-owned enterprises after adjusting for bias in the estimations and controlling for sampling weights. This study suggested that one way to support the growth of enterprises in Nigeria is to make access to formal credit less stringent. Also, government and monetary authorities should support credit expansion policies for medium and small enterprises in Nigeria.

Mole and Namusonge (2020), sought to establish the factors influencing access to credit among small and medium scale enterprises in Kitale Municipality. The study was guided by the following objectives: to find out how lending procedures affect access to credit by small and medium scale enterprises; to find out how collateral requirements influence access to credit by SMEs; to establish the relationship between the credit bureau referencing policies and access to credit by SMEs; and to find out the influence of education and entrepreneur training and access to credit by SMEs. A descriptive survey design method was used to collect data. The target population was made up of the 726 SME's registered with Kitale Municipal Council. Stratified random sampling technique was used to determine the sample size. Using the Krejcie and Morgan formula a sample size of 256 SME's was considered for the study. Data was collected by the use of questionnaires and interviews. Piloting of the study was carried out in the to ascertain the validity and reliability of the instruments. Data analysis included the use of descriptive and inferential statistics. Descriptive statistics involved the use of frequency tables, pie charts, graphs and percentages while inferential statistics involved the use of correlation analysis. The study established that among the factors that lending procedures, collateral requirement, credit bureau referencing policies and training

offered by finance Institutions significantly influence access to credit facility by SME from financial institutions. The key recommendation was that information symmetry should be enhanced between CRBs and financial institutions on one hand and SMEs on the other hand.

Waked (2019) assessed the factors that affect access to finance from Saudi banks in Saudi Arabia and identified the obstacles that affect Saudi SME performance. The first objective of this thesis was to identify the types of finance available to SMEs in Saudi Arabia by identifying internal and external sources of capital. The study tested hypotheses on the relationship between certain characteristics of owners/managers and their businesses, and their need to finance, together with the difficulties they face in accessing finance from Saudi banks. The study also identified current financial products and services provided to SMEs, as well as the loans policies and conditions of Saudi banks and other financial institutions with regard to SMEs. The primary data in this study were gathered via questionnaire responses from 270 SMEs in Saudi Arabia, and interviews with five Saudi banks and four government and private sector funding agencies. These data were analyzed using the following methods: descriptive analyses, chi-square tests, *t*-tests, correlation tests and analysis of variance and then used to address the hypotheses and to meet the objectives of the study. The research found that there are some significant relationships between owners/managers characteristics (like education & training, and experience) and firms' characteristics (like business size, business ownership type, availability of business plan, and financial ratios), and the difficulties faced in accessing bank credit, as well as the need to obtain funds from Saudi banks. It was found also that the main reasons for most owners/managers failing to obtain finance from Saudi banks were lack of collateral, poor financial performance, infeasible business plans, incomplete information and projects not qualifying for the Kafalah programme. The study found also that difficulties most Saudi entrepreneurs faced when they applied for loans from Saudi banks included high collateral requirements, high interest rates, long time-lags to receive insufficient finance, and rather challenging loan criteria and application conditions. This indicates the need to improve the availability of credit conditions that offered to SMEs by Saudi banks in order to enhance their access to banks' credit. The findings of the study also demonstrate internal and

external obstacles such as availability of capital, competition, customer satisfaction and marketing as the most significant obstacles affecting business performance. In concluding the thesis, the implications of the findings of this research for entrepreneurs, banks, academics and government are discussed. This study makes some recommendations in order to develop the SME sector in Saudi Arabia, and promote access to finance from banks through establishing a trusting relationship between SMEs and banks. Finally, suggestions are made for future useful research in this area.

Amornkitvikai and Harvie (2016) elaborated the key sources of finance existing for Thai manufacturing SMEs and their importance for SME performance as measured by technical efficiency, export performance, and technological innovation. This study also examined the key factors enhancing SME access to external finance. The results confirmed that retained earnings are crucial to increase SME technical efficiency, but loans from unlicensed moneylenders deteriorate their export performance. For external finance, government-owned specialized financial institutions (SFIs) play a leading role in enhancing SME technical efficiency and export performance, but the results from the survey revealed that few Thai manufacturing SMEs actively seek external finance from these institutions. Foreign commercial banks also help enhance SME technical efficiency. The results showed that larger SMEs have superior performance as measured by export performance and technological innovation performance. The results also revealed that financial institutions in Thailand still rely on collateral-based lending and SME financial transparency through audited financial statements to reduce asymmetric information and adverse selection costs.

Kapkiyai and Mugo (2015) described the relationship between trade credit and SME financial performance for a sample of 50 audited Kenyan Small and Medium Enterprise firms. It discusses on how trade credit affects three measures of financial performance namely; liquidity, profit margin and return on assets. Documentary guide was used in the study to collect secondary data and the data collected were keyed and coded into SPSS package version 20. Analysis was conducted using both inferential and descriptive statistics specifically mean and standard deviation. Inferential statistics where Pearson correlation coefficient to determine the degree of relationship while Multiple regression model was used to

test the hypotheses. Findings indicated that trade credit positively affected liquidity, profit margin and return on assets. The results appeared to be consistent with pecking order theory by SMEs in pattern of using trade credit instead of other external source of finance.

Kibet, Dennis, Achesa and Gedion (2015) discussed the effects of microfinance credit on the performance of Small and Medium enterprises in Uasin Gishu County, Kenya. The study targeted over 5,000 entrepreneurs with a sample size of 47 SMEs. The study employed an ex-post facto design. The instruments used in this study were open and closed ended Questionnaires, observation and interview guide. Face and content validity was used to ascertain the conceptual clarity and investigative bias. The study used simple random sampling of 47 SMEs out of the SMEs there were 17 SMEs did not take loan with MFIs while 30 SMEs have loans with MFIs. Data was presented through the use of frequency tables, pie charts and percentages. Data was analyzed using inferential statistics. In the final analysis, the research clearly found that MFC have a positive effect on the performance of SMEs with a level of significant of less than 5%. In order to enhance a sustained and accelerated growth in the operations of SMEs credits should be client-oriented and not product- oriented. It's concluded that MFIs are concerned with provision of financial services to people who are economically poor and who therefore experience financial exclusion in that they do not have ready access to mainstream, commercial financial services. It is concerned with provision of financial services to poor people using means which are just, fair and sustainable for example they accept social collateral rather than financial collateral, access to larger amounts of loan if repayment is performance is positive, easy way to access finance in not much paper work, and easy and short procedures.

Winnarja and Jinjark (2015) employed the World Bank Enterprise Survey data to investigate the relationship between firm characteristics and SME finance for the People's Republic of China, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The study used descriptive and analytical research designs. They found that SMEs in these countries rely heavily on internal funds due to a lower level of financial and capital market development. In addition, they found that firm characteristics are likely to be correlated with bank borrowing; line of credit availability; and collateral, credit, and lender type. Smaller SMEs are likely to have

a significant and negative association with bank borrowing and line of credit availability. Finally, export market participation, firm age, and financial audit make a significant and positive contribution to SME finance.

Irene (2014) determined the effect of bank financing on the financial performance of SMEs in Nairobi County, Kenya. This research was conducted through a descriptive research design. The descriptive research design was considered appropriate as it enables description of the characteristics of certain groups, estimation of the proportion of people who have certain characteristics and making of predictions. This study used quantitative, secondary data. The secondary data sources were obtained from the KPMG Top 100 SMEs survey in Kenya over a period of 5 years (2009-2013). The data was collected based on the information about the variables. Quantitative data was analyzed by descriptive analysis while qualitative data through content analysis. The study provides information to policy makers, scholars, academicians and investors on the effect of bank financing on the financial performance of SMEs. From the findings, the study established that bank financing and SMEs' size positively affected the SMEs' financial performance while SMEs' tangibility had an inverse relationship with the SMEs' financial performance. The study concluded that there exists a significant positive relationship between bank financing and the financial performance of SMEs based in Nairobi County, Kenya. The study recommended that the CBK should continuously reform the terms of bank financing to increase SMEs' access to access credit from the financial institutions. The study also recommends the management of the SMEs should intensify SMEs' size so as to enhance their financial performance. The study findings informs the banking policy guiding the implementation of SME financing by various financial institutions as it proves that SMEs rely on bank financing to increase their financial performance.

Kinya (2014) identified the factors affecting the performance of SMEs in Nakuru Town of Kenya. The research employed a survey research design and employed a stratified random sampling. In his study, he found that performance of SMEs was influenced by finance, management skills, macro environment, and infrastructure. The finding of the study indicates that access to finance had the potential to positively affect performance of SMEs.

Kiboki, Sakawa and Kiriago (2014) examined the factors that affect access to credit by SSEs in Mt. Elgon District. The study addressed four objectives namely; establish the relationship between owner/manager characteristics, business characteristics, SSE performance and belonging to a social group and access to credit from MFIs. The study null hypotheses were derived from the objectives. The study adapted a descriptive survey design. This design was used to determine the nature of an existing state of affairs within the population. The target population was all small scale enterprise operations in Mt. Elgon district. Only SSEs that had existed for more than 2 years were considered totalling around 1200. The target population was stratified into homogenous categories as wholesalers, retailers, and restaurant and service delivery. Samples of 120 SSEs were randomly and proportionally drawn from the population strata. A structured questionnaire was used to collect data. An interview schedule was used to solicit for in depth information from key informants pertaining access to credit by SSEs. Data was summarized and presented using percentages, means and standard deviation chi-square and t- tests were used to establish relationships between categorical and continuous data respectively. Based on the findings of the study, it was concluded that owner characteristics, business characteristics, group membership affects access to credit by SSEs in Mt. Elgon constituency. Owners /mangers should acquire skills adequate to drive the performance of their businesses. The study recommends that SSE owners should be encouraged to form groups which provide social capital that attracts MFI service easily.

Kamunge, Njeru and Tirimba (2014) examined the factors affecting the performance of small and micro enterprises (SMEs) traders at Limuru town market in Kiambu County, Kenya. The study employed a descriptive research design to achieve the objectives. The target population under study was the 965 licensed SMEs by Limuru sub-county operating in Limuru Market in 2014. The study used a questionnaire to collect the required data from a sample of 274 SMEs. The data collected was coded, quantified and analyzed quantitatively and qualitatively. Quantitative data was analyzed by the use of statistical package for social sciences (SPSS). The study concluded that access to finance and availability of management experience are the key socio-economic factors affecting the performance of businesses in Limuru Town Market. The other key factors that

were found to affect businesses in Limuru Town Market positively are: access to business information, access to infrastructure and government policy and regulations. The study recommended that the government should start offering basic business and financial management skills as this will enable entrepreneurs to make informed investment decisions as well as enhance their entrepreneurial skills that enable them to recognize and exploit the available business opportunities.

Muguchu (2013) sought to find out whether there is relationship between access to credit and financial performance of SMEs in Nairobi, Kenya. The study employed descriptive analysis as well as regression analysis to analyze the data collected. The target population under study was the licensed SMEs by Nairobi City Council in 2013. Of the licensed SMEs in Kenya, an estimated 50,000 licensed SMEs are located in Nairobi. Cluster sampling of SMEs in the central business district in Nairobi was done by clustering the SMEs based on the streets where they are located. A sample of 40 SMEs within the central business district was selected for the survey. Quantitative data was analyzed with the use of statistical package for social sciences (SPSS). Descriptive analysis as well as regression analysis found that there was a positive relationship between access to credit and ROA. The study recommends financial institution to have special lending structures for SMEs to enable them access credit.

Ismael (2013) examined the empirical relationship between credit terms, credit accessibility and the performance of agricultural cooperatives in Rwanda. Drawn from the literature, independent variables, credit terms and credit accessibility were formulated to link each research question together. A random sample of 196 active agricultural cooperatives was obtained from various districts in the southern province. Correlation and regression models were used to test whether the performance of agricultural cooperatives is affected by credit terms and credit accessibility and also if there is any relationship between the two. The findings revealed a positive and significant relationship between credit terms, credit accessibility and the performance of agricultural cooperatives; the two independent variables explain about 17.6% of the performance of agricultural cooperatives. The study revealed that credit accessibility is the most significant determinant of the performance of agricultural cooperatives. To attain a higher performance level of

agricultural cooperatives, better mechanism for accessing credit must be put in place and credit terms/lending policies must be simplified/revised.

*Summary Literature Review*

Article	Writers and (Date of Publications)	Objectives	Methodology	Findings
Supply chain finance and innovation efficiency: An empirical analysis based on manufacturing SMEs	Wang et al; (2023)	To analyze the positive and negative effects of supply chain finance on the innovation efficiency of China's small and medium-sized enterprises (SMEs) in the manufacturing industry	Based on the data of 267 manufacturing companies in China Growth Enterprise Market from 2015 to 2019, the DEASBM method was used to measure the comprehensive innovation efficiency of different companies.	The study found that supply chain financial services have a strong positive impact on the comprehensive innovation efficiency and organizational innovation efficiency of manufacturing SMEs. Further, supply chain finance has the most significant improvement on the technological innovation efficiency of the sample of private traditional enterprises, but it has a significant inhibitory effect on the organizational innovation efficiency of the sample of state-owned high-tech enterprises.
The Impact of Government Policies and Small Scale Enterprise Development	Onyedika chi, et al., (2022)	To analyze how government policies, SSE advancement, expansion, and promotion affect SSE performance and economic growth in Nigeria.	The study used survey based research approach. The study sampled a valid respondents of 250 to make a generalization using Yaro Yamane formulae. The	The study agree that good government policy for SMEs is vital to most economies' long-term growth and prosperity. Effective government policies affect SSEs' long-term viability. The correlation analysis connected all variables positively. These issues may affect SSE's performance and economic growth. Effective government policies, SSE advancement, expansion, and promotion are combined efforts

<p>Activities on Economic Growth Evidence from Nigeria</p>	<p>study used Cronbach's Alpha, Pearson's Correlation, Durbin-Watson, ANOVA, and OLS Regression.</p>	<p>between the government and entrepreneurs. It will help firms or organizations to expand, find new possibilities, and improve. Besides, the ability of entrepreneurs to continue to develop and offer services depend on having access to financial resources to expand their businesses is a means to contribute to economic growth and development because the continual function of these SSEs will create employment, reduced unemployment and generate revenue through taxes for development intervention.</p>		
<p>Access to formal credit and enterprise performance in Nigeria</p>	<p>Nwosu and Orji (2021) To evaluate the impact of access to formal credit on enterprise performance.</p>	<p>The study used Nigerian Enterprise Surveys data for 2010 to construct a direct measure of credit constraint.</p>	<p>The study found that that access to formal credit matters and has a significant impact on enterprise performance indicators. Firms that are credit constrained have significantly lower output per worker, capital per worker, employment of labor and investment in fixed assets for expansion compared to firms that are not credit constrained. This is more pronounced for women-owned enterprises after adjusting for bias in the estimations and controlling for sampling weights. This study suggested that one way to support the growth of enterprises in Nigeria is to make access to formal credit less stringent. Also, government and monetary authorities should support credit expansion policies for medium and small enterprises in Nigeria.</p>	
<p>Factors</p>	<p>Mole and</p>	<p>To find out how</p>	<p>A descriptive</p>	<p>The study found that among the</p>

affecting access to credit by small and medium enterprises: A case of Kitale town.	Namusonge (2020)	lending procedures affect access to credit by small and medium scale enterprises; to find out how collateral requirements influence access to credit by SMEs; to establish the relationship between the credit bureau referencing policies and access to credit by SMEs; and to find out the influence of education and entrepreneur training and access to credit by SMEs.	survey design method was used to collect data. The target population was made up of the 726 SME's registered with Kitale Municipal Council. Stratified random sampling technique was used to determine the sample size.	factors that lending procedures, collateral requirement, credit bureau referencing policies and training offered by finance Institutions significantly influence access to credit facility by SME from financial institutions. The key recommendation was that information symmetry should be enhanced between CRBs and financial institutions on one hand and SMEs on the other hand.
Access to finance by Saudi SMEs: Constraints and the impact on their performance	Waked (2019)	To identify the types of finance available to SMEs in Saudi Arabia by identifying internal and external sources of capital.	The used descriptive analyses, chi-square tests, t-tests, correlation tests and analysis of variance and then used to address the hypotheses and to meet the objectives of the study.	The study found that difficulties most Saudi entrepreneurs faced when they applied for loans from Saudi banks included high collateral requirements, high interest rates, long time-lags to receive insufficient finance, and rather challenging loan criteria and application conditions. This indicates the need to improve the availability of credit conditions that offered to SMEs by Saudi banks in order to enhance their access to banks' credit. The findings of the study also demonstrate internal and external obstacles such as availability of capital, competition, customer satisfaction and marketing as the

				most significant obstacles affecting business performance.
Financial execution of the ten commercial banks working in Pakistan	Amornkit vikai and Harvie (2016)	To examine the key factors enhancing SME access to external finance.	The study used quantitative data. Descriptive research design was used. The study used statistical tools.	The study found that that larger SMEs have superior performance as measured by export performance and technological innovation performance. The results also revealed that financial institutions in Thailand still rely on collateral-based lending and SME financial transparency through audited financial statements to reduce asymmetric information and adverse selection costs.
Why do SMEs not borrow more from banks?: Evidence from the People's Republic of China and Southeast Asia	Winnarja and Jinjarak (2015)	To investigate the relationship between firm characteristics and SME finance for the People's Republic of China, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam.	Descriptive and analytical research designs were used.	The study found that SMEs in sampled countries rely heavily on internal funds due to a lower level of financial and capital market development. In addition, they found that firm characteristics are likely to be correlated with bank borrowing; line of credit availability; and collateral, credit, and lender type. Smaller SMEs are likely to have a significant and negative association with bank borrowing and line of credit availability. Finally, export market participation, firm age, and financial audit make a significant and positive contribution to SME finance.
Effects of micro-finance on the performance of small and medium	Kibet, Dennis, Achesa and Gedion (2015)	To highlight the effects of microfinance credit on the performance of Small and Medium enterprises in Uasin Gishu	Descriptive and analytical research designs were used. The study employed an ex-post facto design. The	The findings showed that in order to enhance a sustained and accelerated growth in the operations of SMEs credits should be client-oriented and not product-oriented. It's concluded that MFIs are concerned with provision of financial services to people who are economically poor

enterpris es in Uasin Ghisu county, Kenya	County, Kenya	instruments used in this study were open and closed ended Questionnaires, observation and interview guide. The study used simple random sampling of 47SMEs	and who therefore experience financial exclusion in that they do not have ready access to mainstream, commercial financial services. It is concerned with provision of financial services to poor people using means which are just, fair and sustainable for example they accept social collateral rather than financial collateral, access to larger amounts of loan if repayment is performance is positive, easy way to access finance in not much paper work, and easy and short procedures..	
The effect of bank financing on the financial performa nce of SMEs in Nairobi county.	Irene (2014)	To evaluate the effect of bank financing on the financial performance of SMEs in Nairobi County, Kenya.	This research was conducted through a descriptive research design. This study used quantitative, secondary data. The secondary data sources were obtained from the KPMG Top 100 SMEs survey in Kenya over a period of 5 years (2009- 2013)	The study provides information to policy makers, scholars, academicians and investors on the effect of bank financing on the financial performance of SMEs. From the findings, the study established that bank financing and SMEs' size positively affected the SMEs' financial performance while SMEs' tangibility had an inverse relationship with the SMEs' financial performance. The study concluded that there exists a significant positive relationship between bank financing and the financial performance of SMEs based in Nairobi County, Kenya.

### 2.3 Research Gap

In the International context, a number of studies have been undertaken on the issue related to the credit accessibility and performance of the small and Medium Enterprises (SMEs). Different kinds of variables were considered like growth, sustainability, productivity, liquidity, profitability etc to measure the performance

of the SMES. In the context of country Nepal, the studies were just undertaken to find out just only the problems and challenges faced by the SMES of Nepal but of none of them had addressed the issue related to the credit accessibility and performance of SMEs. The forgone studies failed to show the relationship between the credit term and the performance of SMEs. They even failed to show the relationship between the access to credit and the performance of SMEs. Not only that, also the previous studies failed to determine the effect of credit term and the access to credit on the performance of the SMEs. Therefore, this study takes the mentioned weakness above as a one of the research gap found in this study that triggered the researcher to undertake this study by carrying out a survey to find out the impact on the performance of entrepreneurs in SMEs as result of the credit term and access to credit provided by the financial Institutions in the Kathmandu of Kathmandu district.

## **CHAPTER-III**

### **RESEARCH METHODOLOGY**

This chapter discusses the method by which this study was undertaken. It includes identifying a research design that is used, population and size, sources of data, data collection procedure, data processing procedure, data analysis tools and techniques.

#### **3.1 Research Design**

Research design refers to how data collection and analysis are structured in order to meet the research objectives through empirical evidence. Since, the study focuses on more than one small and medium enterprises, the study adopted descriptive and causal comparative research design because it is the fact-finding operation searching for adequate information. It generally helps to assess the opinions, behaviours, or characteristics of a given population and helps to describe the situation and events occurring at the present. It simply portray an accurate profile of organizations, events, or situation.

#### **3.2 Population and Sample**

A population is an entire group of individuals or events or objects having common observable characteristics that conform to a given specification. For this study, the population consisted of all the registered small and medium enterprises in the Kathmandu district basically involving in the manufacturing and trade sectors, which are registered in the Department of Cottage and Small Industries of Nepal (DCSIN) and having the facilities of credit from the financial institutions like commercial banks, micro finance etc. The study used sample of 70 respondents i.e. 70 entrepreneurs (owners/managers) out of 225 small and medium enterprises who are operating small and medium enterprises (SMEs) within the Kathmandu district and having the facilities of credit scheme or loan facilities of the financial institutions basically commercial banks in Kathmandu district.

The sample size for this study has been determined as per Cochran (1977) for calculating representative sample size when the population is finite having maximum variability with following formula:

$$n = \frac{N}{1 + N(e)^2}$$

Where, n = sample size

N = Population with given characteristic

e = Error margin

For the known population by considering the confidence level of 90%, with sampling error e=10%

$$n = \frac{225}{1 + 225(0.1)^2} = 69.23$$

So, the optimal sample size for this study is 69.23. However, this study has considered 70 samples for conducting the study through convenience sampling method.

The study also employed purposive sampling technique based on the position hold respondents during the survey. Moreover, respondents are chosen based on the researcher's judgment that they have desirable characteristics and can provide the required information. Furthermore, purposive sampling technique is used to select the entrepreneurs who are having the facility of credit/ loan from the commercial banks. Owners or managers of small and medium enterprises are selected purposefully because of key positions, knowledge and experienced hold in their job position.

### **3.3 Nature and Sources of Data**

Quantitative data has been used in this study. Primary data is used. It is gathered from the respondents through administering the questionnaires. Questionnaire is at first pre-tested to a small number of respondents to check if the instrument can measure what claimed to be measured. Thereafter, 70 questionnaires were distributed by the researcher to the respondents for collection of raw data.

### **3.4 Data Collection Technique**

The researcher used self-structured questionnaires covering all the variables in the study. In these questionnaires, a five point Likert Scale is used to ease data processing and analysis. The scale is marked 1-5 where 1 represented strongly disagree and 5 strongly agree.

### **Measurement of Study Variables**

Access to credit is measured by amount borrowed/volume and frequency of access/number of times credit has been received in a given period (Nakiyingi, 2007 and CGAP, 2009). Credit terms are measured in terms of interest rate, collateral and repayment period using measures developed by (Agarwal, 2006). Performance of SMEs is measured by productivity, sales, profit, saving, number of employees and number of customers).

### **3.5 Data Processing and Presentation**

The data collected is computerized, sorted, edited, classified and coded. The resultant data was entered using Statistical Package for analysis. This generated frequency tables for demographic and descriptive data. The relationship between the study variables is established by using correlation. Regression analysis is used to determine the prediction potential of the model.

The qualitative data collected is analyzed by using statistical and qualitative approaches in order to make meaningful presentations and conclusions. Data collected from the 70 respondents are examined and arranged basing on the research objectives. The data collected are arranged into a more workable framework that enabled the researcher to classify and organize them. In order to make meaningful presentation of the data collected and to match it with the study objectives and research questions, the data is subjected to various steps including; editing in order to identify missing gaps, spelling mistakes, incomplete answers and to eliminate unwanted data; coding, classification of data with common characteristics. In the statistical method, analysis of clearing and forwarding data focused on various process and procedures involved by the port and other agents activities and this was done at three levels.

The researcher describes the study population by background characteristics purposely relating to the establishment of relationship between the credit term and the performance of the SMEs, establishment of the relationship between access to credit and the performance of SMES, and the effect of credit term and the access to

credit on the performance of entrepreneurs in the SMES which are in operation within the Kathmandu of Kathmandu district.

### 3.6 Validity and Reliability of the Instrument

Cronbach's alpha (Cronbach, 1951) reliability coefficient of 0.6 points and above was used to measure the internal consistency or average correlation of items in a survey instruments to gauge its reliability. The higher the score, the more reliable the generated scale is. For instance, Nunnally (1978) argues that 0.7 alpha coefficient is an acceptable reliability coefficient.

*Validity and reliability of the instrument*

Study variables	Reliability coefficient Cronbach's Alpha
Access to credit	0.727
Credit term	0.659
Performance of SMEs	0.702

*Source: Primary data, SPSS Output*

The instrument is also checked for accuracy, reliability, consistency and completeness using Alpha Cronbach test (Cronbach, 1951). The acceptable reliability results were those of 0.6 points as shown in the table 3.1.

### 3.7 Data Analysis Tools and Technique

#### Mean

A simple arithmetic average is used to summarize the data as a representation of mean data. A simple arithmetic average is a value obtained by dividing the sum of the values by their numbers. Thus, the average is expressed as:

$$\bar{X} = \frac{\sum X}{n}$$

Where:

- $\bar{X}$  = Arithmetic mean
- n = Number of observations
- $\sum X$  = Sum of observations

## Standard Deviation

The standard deviation is commonly used tool to measure risk. It shows the deviation of actual mean with average mean. The standard deviation measures the absolute variability or dispersion, greater the standard deviation or vice versa. The standard deviation is found from the following formula.

$$\text{Standard Deviation } (\sigma) = \sqrt{\frac{\sum(X - \bar{X})^2}{n}}$$

Where,

$(\sigma)$  = Standard deviation

X = Variables

$\bar{X}$  = mean value

n = Number of observation

## Correlation Analysis

Correlation is a measure of the relation between two or more variables. The measurement scales range from -1.00 to +1.00. The value of -1.00 represents a perfect negative correlation, while a value of +1.00 represents a perfect positive correlation. A value of 0.00 or close to zero represents a lack of correlation.

Here, correlation coefficient of access to credit and credit term with performance of SMEs has been calculated. Correlation coefficient of access of credit with major variables like performance of SMEs has also been carried out. The formula for correlation coefficient is:

$$\text{Coefficient of Correlation, } r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{N\sum X^2 - (\sum X)^2} \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

Where,

N = Number of pairs of observation.

X = Variable

Y = Variable

r = coefficient of correlation

## Regression Analysis

The data are analyzed using regression analysis. Regression is to determine the effect or variation in the dependent variable due to the independent variables. The regression equation that has been used is as shown below:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + e$$

Where, Y= Performance of SMEs

$\beta_0$  = Regression constant

$\beta_1, \beta_2$  =Regression constant

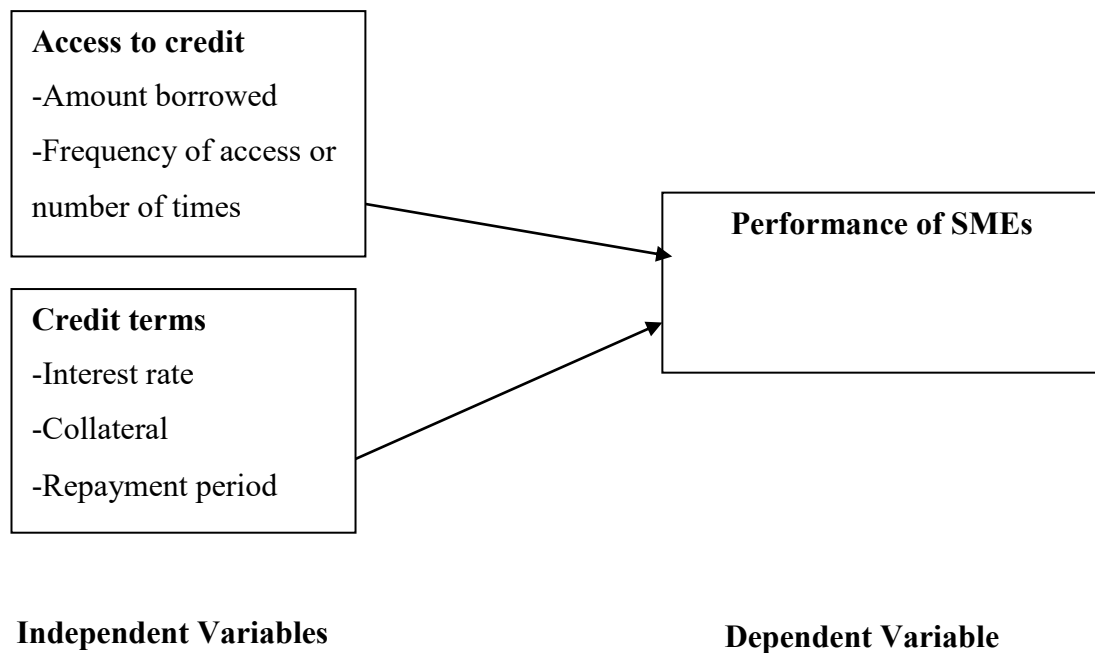
$X_1$ =Access to credit

$X_2$ = Credit terms

e = Error term

### 3.8 Research Framework and Definition of Variables

The conceptual framework is developed as per the requirement of the objectives of the study with aim to make the study convenient.



Source: Nwosu, & Orji, 2021.

Figure 1: *Conceptual framework for the study on the impact of access to credit and credit term on the performance of the SMEs.*

The figure 1 depicts the conceptual framework which shows independent variable (credit terms and access to credit) and dependent variable (SME's performance). Also the relationship between them is shown. According to Agarwal (2006), credit terms are measured in terms of interest rate, collateral and repayment period. Access to finance is measured by amount borrowed/volume and frequency of access which is the number of times one can access credit (Nakiyingi, 2010). Performance is defined as the measurement of firm's financial ability which

includes the level of profit, investment level with both growth in sales and profit and the performance of SMEs depends a lot on a financial institutions' support (Kamyabi & Devi, 2012). Performance of SMEs is measured by the increased sales volume, profit, saving, productivity, employees and customers. Credit terms are conditions set by commercial banks in advancement of credit to meet working capital and short-term liquidity management. Access to credit depends on the ability of the business to meet credit set of commercial banks. Therefore, ability of the business to meet credit terms set by commercial banks. Therefore, improved access to more financial capital can help firms expand more and maintain financial stability, leading to improved financial stability (Claessens, 2006).

### **Definition of the key term**

This section will deals with definition of some scholars regarding the variables (i.e credit term, access to credit and financial performance) of the study.

#### **1 Access to credit**

Access to credit' refers to the availability of a supply of a reasonable quality financial services at reasonable cost. Credit accessibility refers to the ease or difficulty of acquiring credit by borrowers for purposes such as to enhance business performance .In order to ensure continuity and realized success, SMEs, need to acquire the necessary financial resources /credit to allow them to invest now so that they will obtain in the future.

Access to credit is defined as an absence of price and non-price barriers in the financial services. Financial access is measured by number of loans in a given period/frequency and average loan amount/volume relative to per capita income. There is growing consensus in the literature that small businesses as opposed to larger firms face specific constraints in raising external finance as observed by (Berger, 1998).

SMEs do not have access to public capital markets and hence depend on banks for funding. When there is a difference between the demand for funds by SMEs and the supply of funds, a financing gap is said to occur. A clear distinction must, however, be made between "actual gaps" and "perceived gaps". An actual financing gap is said to exist if firms that merit financing cannot obtain it due to the existence of market imperfections (OECD, 2006). The fact that some

enterprises experience difficulties in accessing financing is not an indication of the existence of an “actual gap”.

Access to credit also reduces the opportunity costs of capital-intensive assets relative to family labor, thus increasing labor-profitability and raising labor productivity, a crucial factor for development, especially in many African countries (Zeller, 2001). Acquisition of such credit is difficult for the SMEs because of high rates of interest on lending, and this has constrained private sector demand for the credit and limited their progress.

## **2 Credit terms**

‘Credit terms’ are the minimum conditions set by lending institutions to which borrower must adhere in order to qualify for loan. Credit terms are the standards applied by commercial banks in determining the ability to repay loan. Enforcing credit terms involves the screening of customers so that only those who are credit-worthy are allowed to do business. These terms help in assessing credit worthiness of borrowers and hedge against the risk of loss in case of non repayment. They include collateral, interest rate and repayment period (Agarwal, 2006).

Credit terms have been the key in the determination of capital requirements of SMEs as set by bank. Normally, due to the possibility of default and lack of effective contract enforcement mechanisms, lenders have additional incentives to restrict the supply of credit, even if they have more enough to meet a given demand and the borrower is willing to pay a high interest rate (Stiglitz & Weiss 1981).

Credit terms refer to standards or negotiated terms (offered by a seller to a buyer) that control the monthly and total credit amount, maximum time allowed for repayment, discount for cash or early payment, and the amount or rate of late payment penalty . According to Agarwal (2006), credit terms include factors such as interest rate, collateral and loan repayment periods.

Collateral required by commercial banks in developing countries has been a contentious issue in SME financing. However, real-estate collateral provides an incentive and a justification to lend and repay, as well as a means to offset losses in case of default (Aryeetey, 1994). Stiglitz and Weiss (1981) in their credit rationing theory argue that in an equilibrium market with problems that are commonly found

in financial markets, it would be rational for banks to engage in credit rationing. Due to problems of asymmetric information and agency, banks have difficulty distinguishing good risks from bad risks and in monitoring borrowers once funds have been advanced (Organization of Economic Cooperation and Development, 2006).

It has, however, been found that large long-term loans have a comparative advantage over small loans because long term loans not only increase an enterprise's capital base considerably but also give the enterprise longer grace and repayment (credit) periods, which have been found to support business growth (Myers, 1997).

### **3 Performance of SMEs**

Performance is the outcome derived from efficiency and effectiveness in optimum utilization of resources and productivity. Kamyabi and Devi (2012) performance defined as the measurement of firm's financial ability which includes the level of profit, investment level with both growth in sales and profit and the performance of SMEs depends a lot on a financial institutions' support. Business performance is the ability to contribute to job and wealth creation through business start up, survival and growth. Improved access to credit helps business grow and advance their financial performance. On the other hand acquisition of such credit has proved to be difficult due to the credit terms that are perceived to be unfavorable. Whereas access to credit improves economic activities, most SMEs 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. The practice of financial rationing by financial institutions using Interest rates has hindered most SME from accessing credit as only high income large scale borrowers who expect higher returns can bear the high cost of borrowing (Stiglitz & Weiss, 1981).

An organization's financial performance can be measured by total sales, liquidity, and profitability (Miller, Wilson and Adams 1988; Birley and Westhead 1994). The performance of SMEs is their ability to contribute to job and wealth creation through business start up, survival and growth. Maintaining optimal liquidity demonstrates that there are economies of scale associated with the cash levels required to confront the normal transactions of the firm. Sales growth is often used

as a measure of performance. Thomas and Mason (2008) have argued that if sales increase, profits will eventually follow. Information on financial performance is useful in predicting the capacity of the enterprise (Levassar, 2002).

## CHAPTER IV

### RESULTS AND DISCUSSION

This chapter contains the results and the interpretation relating to the sample characteristics of the survey respondents. The presentation is guided by the research objectives and statistics were generated with the aim of generating responses from the research questions.

#### 4.1 Socio-demographic Profile of the Respondents

Socio- demographic profile represents the typical characteristics of the respondent like the gender of the owner, age of the owner, ownership of the business, number of employees in the firm, kind of the business the firm engaged in, length of the existence in the business, owner/manager's level of education, single largest amount ever borrowed by the firm, total amount borrowed by the firm and the number of the times that the firm has borrowed from the bank which are crucial for interpreting and discussing research findings. The study sampled 70 respondents and all the questionnaires are collected from them. Therefore, the study analysis is based on the 100% response rate.

##### 4.1.1 Gender Distribution of the Respondents

As the study employed respondent of both gender, the table 1 represents the distribution of the respondents on the basis of the gender.

Table 1

*Gender profile of the respondents*

Gender	Number	Percent
Male	68	97.1
Female	2	2.9
Total	70	100

*Source: Field Survey, 2024*

Table 1 reveals that the majority of the respondents are male constituting 97.1% compared to their female counterparts representing 2.9% in the sample. The result implies that most of the SMEs are owned by the male population in the Kathmandu of Kathmandu district.

#### 4.1.2 Number of Employees

The total number of the employees in the firm are also considered for the study to find out the size of the business hence, the table 2 represents the total number of employees of the sampled SMEs.

Table 2

*Number of employees*

Number of employees	Number	Percent
2 to 7	24	34.3
7 to 15	20	28.6
15 to 30	10	14.3
More than 30	16	22.9
Total	70	100

*Source: Field Survey, 2024*

Table 2 depicts that most of the employees are between 2 to 7 representing 34.3%, between 7 to 15 constituting 28.6%, the least are between 15 to 30 comprising of 14.3% and more than 30 representing 22.9% respectively in the entire sample. This implies that the majority of the businesses are small sized enterprises as per the sample.

#### 4.1.3 Age of the Owner/Manager

The study employed respondents of different age group from the field which is presented by the table 3.

Table 3

*Age of the owners/managers*

Age of the owner/manager	Number	Percent
18-27	1	1.4
28-37	22	31.4
38-47	26	37.1
48-57	14	20.0
58+	7	10.0
Total	70	100

*Source: Field Survey, 2024*

The result of the table 3 reveals the that majority of the respondents were in the age group of 38-47 years representing 37.1%, followed by 28-37 years constituting 31.4% and 48-57 years comprising 20% and the least were in the age bracket above 58 years and 18-27 years constituting 10% and 1.4% respectively. This implies that most owner/managers of the SMEs in the Kathmandu of Kathmandu district fall under the age group of 38-47.

#### 4.1.4 Ownership of the Business

Ownership of the business has also been considered by the study which is shown by the table 4.

Table 4

*Ownership of the business*

Ownership	Number	Percent
Sole Proprietorship	45	64.3
Partnership	24	34.3
Limited Liability Companies	1	1.4
Total	70	100

*Source: Field Survey, 2024*

Table 4 reveals that ownership of the most businesses is sole proprietorship representing 64.3% followed by partnership 34.3% and least is limited liability company comprising 1.4% in the entire sample.

#### 4.1.5 Kind of Business the Firm Engaged in

Generally, the study has considered two categories of the SMEs, they are manufacturing and trade which is represented by the table 5.

Table 5

*Kind of business the firm engaged in*

Business Types	Number	Percent
Manufacturing	46	65.7
Trade	24	34.3
Total	100	100

*Source: Field Survey, 2024*

Table 5 reveals that the most of the respondents are engaged in the manufacturing kind of the business constituting 65.7% and the least are observed to be in the trade

kind of business comprising of 34.3% in the entire sample. This implies that the manufacturing is the most dominant business activity carried out by SMEs in comparison to trade.

#### 4.1.6 Length of Existence in Business

Table 6 presents the duration of the SMEs that have been in the existence to the till date.

Table 6

*Length of existence in business*

Duration	Number	Percent
1-less than 5 years	21	30.0
5-less than 10 years	16	22.9
10 and above	33	47.1
Total	70	100

*Source: Field Survey, 2024*

Table 6 reveals that the most of the organizations have been in the existence for a period more than 10 years constituting 47.1%, followed by less than 5 years representing 30% and the least have been in existence for a period less than 5 years representing 22.9% in the entire sample. This signifies higher levels in businesses that have existed longer and therefore stand a better age to access credit than those existing for shorter periods and therefore improve the performance of the business.

#### 4.1.7 Owner/Manager's Level of Education

Education level of the respondents is also taken into the account in order to find out the levels of education of the owners/ manager of the SMEs surveyed in the Kathmandu district which is presented by the table 7

Table 7

*Owner/manager's level of education*

Owner/manager's level of education	Number	Percent
SEE(SLC)	11	15.7
+2	16	22.9
Bachelor	35	50.0
Masters	8	11.4
Total	70	100

*Source: Field Survey, 2024*

Table 7 reveals that out of the 70 owners/managers, 50% had qualification of bachelor level, 22.9% qualified with +2 level, 15.7% qualified with SEE(SLC) level and least of the owners/managers qualified with masters degree constituting 11.4%. This implies that the majority of the respondents have qualification of bachelor level, meaning that the population sample is made up of learned and experienced owner/managers.

#### **4.1.8 Single Largest amount Ever Borrowed by the Firm**

Single largest amount ever borrowed by the owner of the SMEs is also taken into the account with the aim to find out the credit accessibility of the SMEs to support for the objective of the study. It is presented by the table 8.

Table 8

*Single largest amount ever borrowed by the firm*

Single largest amount ever borrowed	Number	Percent
Less than 10 lakhs	19	27.1
10-30 lakhs	35	50.0
30-50 lakhs	9	12.9
50 lakhs- 1 crore	6	8.6
More than 1 crore	1	1.4
Total	70	100

*Source: Field Survey, 2024*

Table 8 indicates that the majority of the respondents' single largest amount ever borrowed is 10 to 30 lakhs representing 50%, followed with less than 10 lakhs constituting 27.1%. Similarly, respondents' single largest amount ever borrowed is 30 to 50 lakhs representing 12.9% and the least of the respondents, single largest amount ever borrowed is 50 lakhs to 1 crore and more than 1 crore representing

8.65 and 1.4% respectively. This implies that the SMEs of the Kathmandu of Kathmandu district are having the loan facilities from the financial institutions.

#### **4.1.9 Total Amount Borrowed by the Firm**

Total amount ever borrowed by the owner of the SMEs is also taken into the account with the aim to find out the credit accessibility of the SMEs. It is represented by the table 9.

Table 9

*Total amount borrowed by the firm*

Total amount borrowed	Number	Percent
Less than 10 lakhs	3	4.3
10-30 lakhs	14	20.0
30-50 lakhs	18	25.7
50 lakhs -1 crore	23	32.9
More than 1 crore	12	17.1
Total	70	100

*Source: Field Survey, 2024*

Table 9 reveals that the majority of the respondents' total amount borrowed is 50 lakhs to 1 crore representing 32.9% followed by the 30 to 50 lakhs, 10 to 30 lakhs and more than 1 crore comprising 25.7%, 20% and 17.1% respectively and the least of the respondents' total amount borrowed is less than 10 lakhs representing 4.3% of the entire sample.

#### **4.1.10 Number of Times the Firm has Borrowed**

The study has taken into account even the number of times that the firm has borrowed from the commercial banks or any other financial institutions with the aim to know the frequency of borrowing as it also supports for the objective of the study and it is presented in the table 10.

Table 10

*Number of times firm has borrowed money from financial institutions*

No. of times firm has borrowed	Number	Percent
1-less than 3 times	28	40.0
3-less than 5 times	27	38.6
5- less than 10 times	10	14.3
10 or more than 10 times	5	7.1
Total	70	100

*Source: Field Survey, 2024*

Table 10 reveals that the number of times the majority of the firms has borrowed money from financial institutions (commercial banks) is for 1 to less than 3 times comprising 40% followed by 3 to less than 5 times constituting 38.6% and the least is 5 to less than 10 times and 10 or more than 10 times comprising 14.3% and 7.15 respectively. It implies that the borrowing rate of the SMEs from the financial institution is low.

## **4.2 Descriptive Statistics**

Descriptive statistics summarizes the sample and the observations that has been made. In this study, descriptive analysis incorporates the calculation of statistical measures such as mean, standard deviation, minimum and maximum.

### **4.2.1 Descriptive Statistics of Access to Credit**

Access to credit is important independent variable of this research. Access to credit is measured by the amount of the borrowing and the number of times the SMEs borrows from the financial institutions. Descriptive study of the research questions drafted and overall descriptive study on these variables is shown in the table 11.

Table 11

*Descriptive Statistics of Access to credit*

Code	Opinion Statement	N	Mean	Standard Deviation
ACT1	The firm can easily get credit from commercial banks.	70	3.91	0.65
ACT2	Frequency of access to loans helps in the growth of firm's business.	70	4.13	0.51
ACT3	The firm can get loan size it requires.	70	3.60	0.71
ACT4	The firm has enough information on the credit availability.	70	3.41	0.75
ACT5	The firm can get loan any time it is needed.	70	3.66	0.70
ACT6	Credit policies of commercials banks influence the firm's decision to get credit.	70	4.10	0.59
ACT7	The Security required to get loans limits the firm's ability to borrow from commercial banks.	70	3.77	0.42
ACT8	The firm has reliability security guaranteed to access credit.	70	3.89	0.40
ACT9	Access to loans helps in growth of the firm's business.	70	4.06	0.61
ACT10	Length of relationship between this firm and suppliers of credit is important in accessing credit.	70	4.16	0.47
ACT11	The amount credit the firm has been getting from bank is on the increasing trend.	70	3.84	0.50
ACT12	The firm's ability to repay loan is always satisfactory.	70	4.03	0.29
	Access to credit	70	3.88	0.55

*Source: SPSS Output, Appendix 3*

Table 11 shows the descriptive statistics of an individual item and as a whole of access to credit sub factor. It indicates the mean and the standard deviation (variation around the mean) of each of the 12 assertions representing the extent to

which these factor affect the accessibility of credit. Five-point Likert Scale type questions (1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree and 5= Strongly Agree) were asked and each of the 70 respondents submitted their responses in the five-point Likert scale. Low numbers specified agreement with the assertion to a lesser extent, while high numbers indicated that respondents are in higher agreement with the declaration.

Table 11 shows that the items have a mean ranging from 3.41 to 4.16 i.e. response is positive toward access to credit. Length of the relationship between the firm and suppliers of credit is the most important factor for accessibility of credit from the financial institutions because respondents indicate very highest mean of 4.16 for this declaration/ statement. Higher mean implies to the higher agreement regarding the given statement. Similarly, other statements like Frequency of access to loans helps in the growth of the firm's business (mean of 4.13), Credit policies of commercial banks influence the firm's decision to get credit (mean of 4.10), Access to loans helps in the growth of the firm's business (mean of 4.06), The firm's ability to repay loans is always satisfactory( mean of 4.0286) and The firm has reliable security guaranteed to access credit(3.89) has also obtained high levels of agreement respectively. This indicates that respondents are in agreement with these declarations.

Similarly, statements that obtained low mean are like the amount of credit the firm has been getting from the bank is on the increasing trend (mean of 3.84), The security required to get loans limits the firm's ability to borrow from commercial banks (mean of 3.77), The firm can get loan at any time( mean of 3.66), The firm can gets loan size it requires (mean of 3.60) and The firm has enough information on the credit availability ( lowest mean of 3.41). The low mean indicates that the respondents are in lesser agreement with the declarations.

Table 11 shows that code ACT10 has the highest score of mean 4.16 with the standard deviation of 0.47 and code ACT4 has lowest score of mean 3.41 with the standard deviation of 0.75 among the twelve statements of access to credit. The aggregate mean of access to credit is 3.88 with the standard deviation of 0.55.

#### 4.2.2 Descriptive Statistics of Credit Term

Credit term is also another important independent variable of this research which includes the factors like interest rate, collateral, loan repayment period. Descriptive study of the research questions drafted and overall descriptive study on these variables is presented in table 12

Table 12

*Descriptive statistics of credit term*

Code	Opinion Statement	N	Mean	Standard Deviation
CT1	The firm can afford the interest rates charged by commercial banks.	70	3.96	0.32
CT2	The loan repayment period given to this firm is convenient.	70	3.77	0.46
CT3	The firm feels collateral required by commercial banks favorable.	70	3.47	0.76
CT4	The interest rates paid remain fixed for the whole repayment period.	70	2.06	0.74
CT5	This firm has sufficient collateral to get credit from commercial banks.	70	3.84	0.50
CT6	Presence of collateralizable assets in this firm helps in business growth.	70	3.86	0.64
CT7	The firm's credit history helps in access to credit.	70	4.21	0.48
CT8	The firm always uses loan according to its original purpose.	70	3.79	0.54
CT9	Most loan obtained by the firm have to be paid back within one year.	70	2.00	0.54
CT10	This firm gets incentive from banks after paying back loan in terms of increase in loan amount.	70	2.01	0.67
CT11	This firm has never defaulted on any loan obligation.	70	4.01	0.12
CT12	This firm can acquire a bigger loan amount as long as its collateral can be increased.	70	3.97	0.51
CT13	This firm's repayment period varies according to the loan size.	70	2.79	0.83
CT14	The interest rates offered to this firm's short repayment periods are fixed compared to those of longer repayment periods.	70	3.70	0.71
CT15	The firm has reliable security guaranteed to access credit.	70	3.94	0.34
	Credit term	70	3.43	0.54

*Source: SPSS Output, Appendix 3*

Table 12 shows the descriptive statistics of an individual item and as a whole of credit term sub factor. It indicates the mean and the standard deviation (variation around the mean) of each of the 15 assertions representing the extent to which these factor affect the credit term. Five-point Likert Scale type questions (1= Strongly Disagree,2= Disagree, 3=Neutral, 4=Agree and 5= Strongly Agree) were asked and each of the 70 respondents submitted their responses in the five-point Likert scale. Low numbers specified agreement with the assertion to a lesser extent, while high numbers indicated that respondents were in higher agreement with the declaration.

Table 12 shows that the items have a mean ranging from 3.41 to 4.16 i.e. response is positive toward credit term. The firm's credit history helps in access to credit is the most important factor of credit term because respondents indicate a very highest mean of 4.21 for this declaration/statement. Higher mean implies to the higher degree of agreement regarding the given statement. Similarly, other statements like the firm has never defaulted on any loan obligation (mean of 4.01), the firm can acquire a bigger loan amount as long as its collateral can be increased ( mean of 3.97), the firm can afford the interest rates charged by commercial banks (mean of 3.96),the firm has reliable security guaranteed to access credit (mean of 3.94),presence of collateralizable assets in the firm helps in the business growth(mean of 3.86),the firm has sufficient collateral to get credit from commercial banks (mean of 3.84), the firm always uses loan according to the original purpose ( mean of 3.79),The loan repayment period given to the firm is convenient (mean of 3.77),the interest rates offered to the firm's short repayment periods are fixed compared to those of longer repayment periods(mean of 3.70) and the firm feels collateral required by the commercial bank is favorable(mean of 3.47) has also obtained high levels of agreement respectively. This indicates that respondents are in agreement with these declarations.

Similarly, statements that obtained low mean are like the firm's repayment varies according to the loan size (mean of 2.79), the interest rates paid remain fixed for the whole repayment period (mean of 2.06), the firm gets incentive from the banks after paying back loan in terms of increase in loan amount) and most loans obtained by the firm have to be paid back within one year (lowest mean of 2.00).

The low mean indicates that the respondents are in lesser agreement with the declarations.

Table 12 shows that code CT7 has the highest score of mean 4.12 with the standard deviation of 0.48 and code CT9 has lowest score of mean 2.00 with the standard deviation of 0.54 among the fifteen statements of credit term. The aggregate mean of access to credit is 3.43 with the standard deviation of 0.54.

#### 4.2.3 Descriptive Statistics of Performance of SMEs

Performance of SMEs is important dependent variable of this research. In the study, performance of SMEs is measured on the basis of increased productivity, sales, profit, saving, employees and the customers. Descriptive study of the research questions has drafted and overall descriptive study on these variables is presented in the table 13.

Table 13

*Descriptive statistic of performance of SMEs*

Code	Opinion Statement	N	Mean	Standard Deviation
PSME1	Productivity has been increased after getting credit facility.	70	4.03	0.48
PSME2	Sales volume has been increased than before.	70	3.97	0.38
PSME3	Firm's profit has been increased.	70	3.64	0.51
PSME4	Firm's saving is in the increasing trend.	70	3.69	0.50
PSME5	Number of staffs or employees has been increased.	70	3.87	0.41
PSME6	Number of customers are increasing than before.	70	3.97	0.29
	Performance of SMEs	70	3.86	0.43

*Source: SPSS Output, Appendix 2*

Table 13 indicates the mean and the standard deviation (variation around the mean) of each of the 6 assertions representing the extent to which these factor affect the credit term. Five-point Likert Scale type questions (1= Strongly Disagree, 2= Disagree, 3=Neutral, 4=Agree and 5= Strongly Agree) were asked

and each of the 70 respondents submitted their responses in the five-point Likert scale. Low numbers specified agreement with the assertion to a lesser extent, while high numbers indicate that respondents are in higher agreement with the declaration.

The statement, productivity has been increased is rated as the highest changed experienced by the respondents after acquiring/having accessibility of credit from the financial institutions (commercial banks), with a highest mean of 4.03. It indicates that the high level of agreement of 70 respondents were with this statement/ declarations. Additional declarations that also obtained high levels of agreement are increased sales volume and increased number of customers, both of having mean of 3.97 which is even followed by the increased number of employees with a mean 3.87. This implies that the respondents are in agreement with these declarations too.

Statements that has obtained a low mean are firm's saving is in the increasing trend with ( mean 3.69). The least prominent change experienced by the owner/manager of SMEs is firm's profit has been increased( mean of 3.64). The low mean indicates that the respondents are in lesser agreement with the declarations.

Table 13 shows that code PSME1 has the highest score of mean 4.03 with the standard deviation of 0.48 and code PSME3 has lowest score of mean 3.64 with the standard deviation of 0.51 among the six statements of performance of SMEs. The aggregate mean of performance of SMEs is 3.86 with the standard deviation of 0.43.

### 4.3 Correlation Analysis

Pearson correlation test is employed to establish the relationships among the independent variables (access to credit and credit term) and the dependent variable (performance of SMEs) of the study at 1% and 5% level of significance. Table 14 presents the correlation matrix for the sample observations.

Table 14

*Pearson's correlation analysis*

	Access to credit	Credit term	Performance of SMEs
Access to credit	1		

Credit terms		.191 (0.003)	1	
Performance of SMEs	of	.271* (0.002)	.373** (0.0016)	1

---

\*Correlation is significant at the 0.05 level (2-tailed)

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

*Source: SPSS Output, Appendix 4*

There is low positive correlation between access to credit and credit terms and productivity of small and medium enterprises and credit term. Table 14 shows that all the variables are positive correlated to each other. It means that the independent variables (access to credit and credit terms) are correlated with the dependent variable (Performance of small and medium enterprises).

#### **Relationship between access to credit and performance of SMEs**

Table 14 reveals that, the correlation between the access to credit and performance of SMEs is 0.271. It shows that access to credit is positively correlated with the performance of SMEs at 0.05 level of significance (2-tailed).It indicates that when the access to credit increase then the performance of the SMEs will also increase and vice versa. From this it can be concluded that there is a significant positive association between access to credit and performance of SMEs ( $r=0.271$ ,  $p<0.05$ ) which is contributing positively in the enhancement of the performance of SMEs.

#### **Relationship between credit terms and performance of SMEs**

Table 14 shows that, the correlation between the credit term and performance of SMEs is 0.373 which indicates that there is also a significant positive correlation between credit terms and performance of SMEs at 0.01 level of significance (2-tailed).From this it can be concluded, that improved credit terms are associated with enhanced performance of SMEs ( $r = 0.373$ ,  $p<0.01$ ).

Therefore, the tables 14 signifies that the accessibility of the credit and the credit terms are positively and significantly related with the performance of the SMEs. It implies that if the credit terms are favorable along with the increment in the facility of the accessibility of the credit then the performance of the small and the medium enterprises can be enhanced.

#### **4.4 Regression Analysis**

The regression analysis is carried out to determine whether the dependent variable is influenced by the given independent variables or not. Regression is used to determine the level of prediction of the independent variables (access to credit: amount borrowed and frequency of borrowing and credit terms: interest rate, collateral and repayment) on the dependent variable (performance of the SMEs: productivity, sales, profit, saving, employees and customers). Multiple regression is used to determine the extent to which the combination of independent variables (credit term and access to credit) explain the dependent variable (performance of SMEs).

#### 4.4.1 Model Summary Statistics

The study sought to establish the nature if the relationship (strength and the direction of the relationship) that exists between the study variables.

Table 15  
*Regression analysis model summary*

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.425 <sup>a</sup>	.180	.156	.25405

a. Predictors: (Constant), Credit terms, Access to credit

b. Dependent Variable: Performance of SMEs

*Source: SPSS Output, Appendix 5*

Correlation can be considered as one of the measure of the quality of the prediction of the dependent variable. Table 15 shows the value of  $R$  is 0.425 which indicates a medium level of prediction that means the explanatory variables have associated up to 42.5% with the explained variable.

R-square is known as the coefficient of determination, which explains the extent to which changes in the dependent variable can be explained by the changes in the independent variables. It is the proportion/percentage of variation in the dependent variable that is explained by the independent variables. It helps in explaining the variance. Here, the value of R-square as evident Table 15 is 0.180 which means that 18% variation in performance of small and medium enterprises( dependent variable) is explained by the access to credit and credit terms (independent variables) and remaining 82% is explained by other factors.

In other words, the R-square is also a measure of the overall goodness of fit of the entire model which indicates that the model is capable of explaining about 18% variation in the dependent variable by variation in the independent variables. This means that the model explains about 18% of the systematic variation in the performance of SMEs and remaining 82% of the variations in the performance of sampled SMEs are accounted for by the other factors which have not been captured by this model. Therefore, further research should be conducted to investigate the other factors that affect the performance of small and medium enterprises (SMEs).

The result is complimented by the adjusted R-square of about 15.6% which in essence, is the proportion of the total variance. The value of adjusted R-square at 15.6% implies that the minimum explanatory ability of the model. Adjusted R-square attempts to correct R-square to more closely reflect the goodness of fit of the model in the population. It is superior to R-square because it is sensitive to addition of irrelevant variables.

Model summary also indicates the standard error of the estimate of model 1 which is 0.25405, which shows the variability of the observed value of factors influencing performance of entrepreneurs in SMEs in Kathmandu from regression line is 0.25405 units.

#### 4.4.2 ANOVA

Analysis of Variance (ANOVA) consists of calculations that provide information about levels of variability within the regression model and form a basis for tests of significance. ANOVA is used for testing hypothesis. Following ANOVA table shows the results of analysis of variance, sum of squares, degree of freedom (df), mean square, regression and residual values obtained from regression analysis. The “F” column provides a statistic for testing the hypothesis that all  $B \neq 0$  against the null hypothesis that  $B=0$  (Weisberg, 2005).

Table 16  
*ANOVA analysis*

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.*
1	Regression	.952	2	.476	7.373	.001 <sup>a</sup>

Residual	4.324	67	.065
Total	5.276	69	

a. Predictors: (Constant ), Credit terms, Access to credit

b. Dependent variable: Performance of SMEs, \*Significant at the 0.05 level

Source: SPSS Output, Appendix 5

Findings from the Fishers ratio (i.e. the F-Statistics which is the proof of the validity of the estimated model) as reflected in the ANOVA table 16 indicates that F is about 7.373 and P-value that is almost equal to 0.001. This invariably suggests clearly that simultaneously the explanatory variables are significantly associated with the explained variable. That is they strongly determine the performance of SMEs. The significance value (P-value) is 0.001, which is less than alpha value 0.05, this shows that the independent variables (access to credit and credit terms) statistically predict the dependent variable (performance of SMEs). Therefore, the model is a good predictor of the relationship between the dependent and independent variable. As a result, the independents variables are significant in explaining the variance in the performance of SMEs.

Table 17

*Regressions coefficients*

Coefficients					
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.*
	B	Std. Error	Beta		
1 (Constant)	1.582	.598		2.643	.010
Access to credit	.208	.113	.207	1.839	.002
Credit term	.430	.145	.333	2.958	.004

a. Dependent Variable: Performance of SMEs, \*Significant at the 0.05 level

Source: SPSS Output, Appendix 5

Table 17 shows the standardized coefficient which indicates how much the dependent variable varies with an independent variable when all other independent variables is held constant. According to the linear equation, taking all the factors (access to credit and credit terms) constant at 0.010, performance will be 1.582 for all the SMEs. Under the study of overall SMEs, the regression coefficient of access to credit and credit term is denoted by  $b_1$  (0.207) and  $b_2$  (0.333) respectively. From this finding, it is revealed that a unit increase in access to credit will leads to

a 0.207 (20.7%) increment in the performance of SMEs. Similarly, a unit increase in credit terms leads to a 0.333 (33%) increment in the performance of SMEs.

Similarly, considering the effect of access to credit in the unstandardized coefficient of B is equal to 0.208 which means that there is a positive relationship between access to credit and performance of SMEs and for a unit increase in access a unit increase in access to credit will lead to a 0.208 (20.8%) increment in the performance of SMEs. Similarly, considering the effect of credit term in the Unstandardized coefficient of B is equal to 0.430 which means that there is also a positive relationship between credit term and performance of SMEs and a unit increase in credit terms also lead to a 0.430 (43%) increment in the performance of SMEs. This result implies that the credit term was observed to be the most significant predictor of performance of SMES.

Each of these Beta values has an associated standard error indicating to what extent these values would vary across different sample. Standard error of access to credit and credit term are 1.839 and 2.958 respectively.

The estimated relationship for the model is:

$$\text{Performance of SMEs} = 1.528 + 0.208 (\text{ACT}) + 0.430 (\text{CT})$$

Table 17 reveals the regression model which shows the effect of access to credit and credit term on the performance of small and medium enterprises. The result indicates P-value is less than 5% which indicates that the coefficient of independent variables are not zero. The coefficient shows that both the access to credit and credit terms have a positive and significant effect on the performance of SMEs. Access to credit is measure of amount borrowed and frequency of access (number of times one can access the credit). At 5% level of significance and 95% of confidence, access to credit had a 0.002 level of significance, access to credit has significant effect on the performance of SMEs as its P- value is less than 5%. Similarly, at 5% level of significance and 95% of confidence, credit term has a 0.004 level of significance which implies that the credit terms has a significant impact on the performance of SMEs. From this, it can be concluded that among two independent variables, the most significant factor is credit term in comparison to the access to credit.

#### **4.5 Major Findings**

Based on the study following are the major findings of the study.

- a. Among the total 70 respondents, majority of the respondents are male constituting 97.1% and female representing only 2.95% which shows that most of the SMEs are owned by the male in the Kathmandu of Kathmandu district.
- b. As per the ownership basis, most of the SMEs are Sole proprietorship representing 64.3%.
- c. Most of the SMEs are engaged in the manufacturing kind of business dominating the trade sector comprising 65.7%
- d. Most of the SMEs have been in the existence for a period more than 10 years constituting 47.1%. Among the 70 respondents, 50% of the respondents have the qualification of Bachelor level.
- e. The single largest amount ever borrowed by the SMEs is in between of 10-30 Lakhs constituting 50% and most of them had borrowed 1-3 times mostly which means that most of the SMEs are having the access to finance.
- f. Descriptive static table reports the descriptive statistics comprises mean, standard deviation, minimum and maximum of the sampled registered SMEs in Kathmandu.
- g. Among twelve statement related to the factors of access to credit, Length of the relationship between the firm and suppliers of credit is the most important factor for accessibility of credit from the financial institutions because respondents indicated a very highest mean of 4.1571 for this declaration/ statement and the statement that the firm has enough information on the credit availability has the lowest mean of 3.4143 which indicate that the respondents are in lesser agreement with the declarations. The aggregate mean of access to credit is 3.88 with the standard deviation of 0.55.
- h. Among fifteen statements related term, the firm's credit history helps in access to credit is the most important factor of credit term because respondents indicated a very highest mean of 4.2143 for this declaration/statement. Higher mean implies to the higher degree of agreement regarding the given statement. Similarly, the most loans

obtained by the firm has to be paid back within one year has the lowest mean of 2.000. The low mean indicates that the respondents are in lesser agreement with the declarations. The aggregate mean of access to credit is 3.43 with the standard deviation of 0.54.

- i. Among six statements regarding the improved performance of SMEs after having credit facilities from the financial institutions, respondents are highly agreed with the statement that performance of SMEs has been increased after getting credit facilities from the bank with the highest mean of 4.0286. And the respondents have shown less agreement regarding the statement that profit has been increased with lowest mean of 3.6429. The aggregate mean of performance of SMEs is 3.86 with the standard deviation of 0.43.
- j. The correlation between the access to credit and performance of SMEs is 0.271. It shows that access to credit is significantly positively correlated with the performance of SMEs at 0.05 level of significance (2-tailed). It indicates that when the access to credit increases then the performance of the SMEs will also increase and vice versa. The correlation between the credit term and performance of SMEs is 0.373 which indicates that there is also a significant positive correlation between credit terms and performance of SMEs at 0.01 level of significance (2-tailed). The correlation analysis shows there is a moderate degree of positive relationship among the independent and dependent variables.
- k. In multiple regression of overall sampled SMEs, the coefficient of multiple regression shows that performance of SMEs is least influenced by the joint effect of access to credit and credit term because  $R^2$  is only 0.180, which means that the dependent variable (performance of SMEs) is less predicted with more error from the independent variable (access to credit and credit term) of individual sample SMEs. That is about 82% of the variations in the performance of SMEs are accounted for by the other factors not captured by the model. Moreover,  $R^2$  of all individual SMEs are higher than overall's  $R^2$ .
- l. In overall of Multiple Regression, the F is about 7.373 and P-value that is almost equal to 0.001. This invariably suggests clearly that simultaneously the explanatory variables are significantly associated with the explained

variable. That is they strongly determine the performance of SMEs. The significance value (P-value) is 0.001, which is less than alpha value 0.05, this shows that the independent variables (access to credit and credit terms) statistically predict the dependent variable (performance of SMEs). Therefore, the model is a good predictor of the relationship between the dependent and independent variable.

#### **4.6 Discussions**

In this section, the overall findings of the research are discussed with the aim to find out whether the result of the research is consistent or not with literature review done in the chapter II.

Findings revealed that there is a significant positive association between access to credit and performance of SMEs. The results are consistent with the existing literature that easy accessibility by SMEs' facilities further growth and expansion of their business (Mole & Namusonge, 2020). They even asserted that SMEs, reliable access to short term and small amounts of credit are more valuable and emphasizing it may be more appropriate in credit programs aimed at such enterprises success. This means that in the presence of improved access to credit, performance of SMEs will be enhanced. This was even in the line with Muguchu (2013) who argued that improved access of credit by SMEs leads to the survival, increased sales, higher profitability and low cost of doing business.

Result indicates that there is a significant positive association between credit terms and performance of SMEs. This finding is consistent with Nwosu, & Orji (2021); Onyedikachi, Clement, & Funmilayo (2022), who affirm that in the presence of favorable credit terms, access to finance is enhanced with the improved liquidity to finance their capital investment and daily operational needs. Hence, a firm can invest in more in its business like in manufacturing activities and increased its performance and sales volume. Higher productivity and sales volume will lead to increased in firm's profitability as well as saving of the firm. Similarly, it also lead to the increment in the number of employees as well as customers too which is the indication of the improved performance of the firm (SMEs). This implies that in the

presence of favorable and attractive credit term, performance of the SMEs will be enhanced with the ease acquisition of loans.

Similarly, stringent or less attractive credit terms make it difficult for the firms to access loans and it may even lower the performance of SMEs. Poor credit terms may also limit the size of SMEs as well as their growth, liquidation and other activities too. When credit terms are favorable, they encourage borrowing and therefore the expansion of the capital base, leading to increased business activity, this finding is consistent with Wang., Shichao., Dragana, & Liu jun (2023). In contrast, unfavorable credit terms not only discourage borrowing but also decrease the business growth of burrowing enterprises because they become huge direct expenses without cash discount, which reduces revenue.

The regression analysis addressed relationship between independent variables and the dependent variable. The analysis indicates that there is a reliable combined effect of the independent variables on the dependent variable, 18% of the variance was explained. This means the credit term and credit accessibility influences in the performance of entrepreneurs in small and medium enterprises of Triyuga Municipality of Udayapur district in a significant positive way. It is revealed that favorable credit terms facilitated ease access to credit by SMEs and therefore improved the performance of SMEs in terms of productivity, sales, profit, saving, employees and customers. This position is supported by Nwosu, & Orji, (2021), who argued that if credit accessible and reasonably priced, firms can address their liquidity constraints in turn it aiding profitability.

## CHAPTER V

### SUMMARY AND CONCLUSION

This chapter summarizes the whole study. This chapter presents the summary, conclusion and implications drawn from the study findings of the chapter four. In this chapter, the study objectives are discussed and conclusions and implications are made. Areas for further study are also suggested.

#### **5.1 Summary**

The study has focused on the “impact of government policies on access to credit for small business in Kathmandu. The research has followed these objectives: (i) To establish the relationship between access to credit and performance of SMEs in Kathmandu District. (ii) To establish the relationship between the credit terms and performance of SMEs in Kathmandu District (iii) To examine the effect of access to credit and credit term on the performance of the SMEs in Kathmandu District. A descriptive and analytical research design is used to attain these objectives. The target population is all the registered SMEs in Kathmandu. A purposive sampling method is carried out and 70 registered SMEs are taken as sample out of 225 SMEs for the study. Data from 70 SMEs collected is representing the 100% response rate. Descriptive statistics such as frequency distribution, percentage, variations and measures of central tendency are used to summarize the basic features of the data in the study. Pearson Correlation analysis is used to determine the relationships among the independent variables (access to credit and credit term) and dependent variable (performance of SMEs). Similarly, Regression analysis is used to examine the effect of independent variables on the dependent variable.

As per the Pearson zero order correlation, the correlation between the access to credit and performance of SMEs is 0.271. It shows that access to credit is significantly positively correlated with the performance of SMEs at 5% level of significance (2-tailed). From this it can be concluded that there is a significant positive association between access to credit and performance of SMEs ( $r=0.271$ ,  $p<0.05$ ) which is contributing positively in the enhancement of the performance of SMEs. Similarly, the correlation between the credit term and performance of SMEs is 0.373 which indicated that there is also a significant positive correlation

between credit terms and performance of SMEs at 1% level of significance (2-tailed). From this it concluded, that improved credit terms are associated with enhanced performance of SMEs ( $r = 0.373$ ,  $p < 0.01$ ).

In the estimated model coefficients of this study, the R-values were less than 0.05 (i.e.  $R < 0.05$ ). The value of R is 0.425 which indicates a medium level of prediction that means the explanatory variables (access to credit and credit term) have associated up to 42.5% with the explained variable (performance of SMEs). Further, R-square is 0.180 which means that 18% variation in the dependent variable (performance of small and medium enterprises) is explained by combined effect of independent variables (the access to credit and credit terms and remaining 82% is explained by other factors. The value of the adjusted R-square is 0.156 which implies the 15.6% the minimum explanatory ability of the model.

The regression coefficient model indicates that P-value is less than 5% which implies that the coefficient of independent variables are not zero. The coefficient shows that both the access to credit and credit terms have a positive and significant effect on the performance of SMEs. Access to credit is measure of amount borrowed and frequency of access (number of times one can access the credit). At 5% level of significance and 95% of confidence, access to credit has a 0.002 level of significance which means that access to credit has significant effect on the performance of SMEs as its P- value is less than 5%. Similarly, at 5% level of significance and 95% of confidence, credit term has a 0.004 level of significance which implies that the credit terms also has a significant impact on the performance of SMEs. From this, it can be concluded that both the independent variables have a significant positive relationship with the dependent variable.

The study found that for SMEs to perform as expected they need to access external finances for example loan or credit facilities from the financial institutions. It can be concluded that financial constraints affect the SMEs adversely and that an incremental improvement in the lending facilities by the financial institutions will encourage the SMEs to borrow from the financial institutions which will help to boost up the capital level of SMEs and will positively impact on the improvement of the performance of SMEs.

## **5.2 Conclusions**

In general, the study looked at access to credit, credit terms and performance of small and medium enterprises. In conclusion, it is observed that there is a positive significant association among the study variables which includes credit terms, access to credit and performance of SMEs. Discussion of the findings indicate that the favorable credit terms including interest rates, collateral and repayment periods enables businesses to access required amounts of credit thus leading to the improved the performance of the SMEs that means there is increment in terms of productivity, sales volume, profit, saving, number of employees and customers. However, unfavorable credit terms such as high interest rates, lack of collateral security and short repayment periods deprived some enterprises from accessing credit therefore leading to failure of business.

Furthermore, there are other factors that are found to influence performance of SMEs not limited to this study such as information gap regarding credit availability between lenders and borrowers which involves transaction costs. When there is information gap, SMEs are unable to know which , how and where to obtain this finance on acceptable terms, and the risk associated to pay back funds leads to stringent credit terms and therefore difficult in accessing finance and high transaction costs also influence to finance and eventually affect the performance of the firm negatively. The amount of the loan size is quite low, it means that SMEs in Kathmandu are not getting the required amount of credit facilities as per their requirement. The security required to get the loans has been hindering the the firm's ability to borrow from the commercial banks. Similarly, the interest rates charged by the financial institutions keeps fluctuating time to time which also affect on the decision whether to have credit facilities from the financial institutions or not. Similarly, financial institutions do not have a provision of providing the incentive to the SMEs after they pay back the loan taken. This fact has also discourage the borrower (SMEs) to borrow and slightly affect on the performance of SMEs.

In conclusion, this study has brought up new insights into SMEs financing field to the extent that better SMEs performance depends on the credit financing by the financial institutions and the credit term charged against the credit financing. Hence, SMEs must properly align themselves on how to easily access the credit

facility offered by banks. Because having loan facilities will help to increase the capital of the SMEs which can be utilized in the different activities of the firm. As a result, it will help in the growth of the firm as well as helps to enhance the overall performance of the SMEs too.

### **5.3 Implications**

Based on the major findings of the study of the sampled small and medium enterprises, the following implications can be carried out:

- Since the practice of credit rationing by financial institutions using interest rates has locked out most SMEs as only large scale borrowers who expect higher returns can bear the high cost of borrowing, so the financial institutions should have special lending structures for this category of customers.
- SMEs do not have adequate credit to meet the needs at different levels of growth. That is why the government needs to urgently come in new ways of financing SMEs as SMEs is regarded as the driving force of economy of the nation.
- The findings of the study imply that the government should formulate policies that will compel commercial banks' restrictive regulations and operations to be quite flexible so they will offer more credit facilities for SMEs which will enhance the performance of SMEs.
- Mostly the government should empower that SMEs to access and get credits from commercial banks through formal and informal entrepreneurship education for SMEs to develop their managerial capabilities, accounting skills and overall, so that owners of the SMEs could be more creditworthy and have easy access of the credit facilities from the financial institutions.
- Furthermore, initiatives to support emerging businesses should be intensified in order to achieve sustainable socio-economic growth. Initiatives such as giving entrepreneurs incentives in form of capital from the government and more business associations should be encouraged.
- Business entrepreneurs should be encouraged to upgrade their managerial competencies by going for training courses and attending business

development services that will improve their skills and knowledge. This will enable them compete favorably in the competitive environment.

- In order to improve the performance of small and medium enterprises, there is need by the owners to fulfill the set credit terms in order to maintain a good relationship with the commercial banks. This will help to receive favorable terms when they wish to borrow again because of the good track record. This in turn will help them to maintain adequate liquidity because they can always access cash resources when need arises.

### **5.3.1 Suggestions for Further Study**

- This study focused on SMEs in Kathmandu and therefore generalizations cannot adequately extend to other SMEs outside Kathmandu. On the basis of this fact, it is therefore recommended that a broad study covering all SMEs of countrywide be done to find out the effect of access to credit and credit term on the performance of SMES.
- It is important to carry out similar study among large enterprises in order to find out the effect of access to credit and credit term on the performance of SMEs.
- Further research can be done on the effect of managerial competence, information availability and other factors has affect the general performance of SMEs.
- Further research can be carried out on the criteria that have been followed by the financial institutions or commercial banks in the issuance of loans to the SMEs.
- There is need to research further on the external factors that have an impact on the access to credit by the small and medium enterprises in the economy among others.

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driving force behind this study. The purpose of the study is to ascertain, evaluate, and investigate several elements that impact the performance of business owners in the district of Kathmandu's small and medium-sized enterprises (SMEs). The following goals are being pursued by the study: (i) To determine the connection between the performance of SMEs in the Kathmandu District and their ability to obtain loans. (ii) To determine how the performance of SMEs in the Kathmandu District relates to the terms of their loans. (iii) To investigate how the performance of SMEs in the Kathmandu District is impacted by credit availability and terms. The descriptive and analytical survey design forms the basis of the investigation.

**Self-administered questionnaires given to respondents who were owners or managers of the**

registered SMEs in the Kathmandu district were used to gather primary data. Using convenience and purposive sampling, a sample size of 70 respondents out of 225 population members were considered for the study. To determine whether the variables are related, correlation and multiple regression analysis are used. The variables of lending terms and SME performance showed a substantial positive correlation, according to the data. Similarly, there is a strong positive correlation between SMEs' success and their ability to obtain finance. According to regression research, the combination of credit term and availability accounted for 18% of the variation in SMEs' performance. Commercial banks and other lending organizations must modify credit terms to reflect what borrowers can afford in order to increase SMEs' access to credit. The general performance of SMEs can be improved if finance is easily accessible and offered on conditions that are advantageous to them. **Keywords:** Entrepreneurs, small and medium enterprises, credit terms, access to credit, productivity and performance of SMEs. **CHAPTER I INTRODUCTION**

**1.1 Background of the Study** Small and medium-sized businesses, or SMEs, are known to be the main contributors to economic expansion in any country. Support for the expansion and development of SMEs has grown recently in both industrialized and developing nations. Small and medium-sized businesses contribute significantly to the economy and social fabric of both industrialized and developing nations. SMEs are crucial to the country as well as the individual. They improve both businesses' and employees' standards of living and offer jobs to the individual. They serve closed or limited markets that only allow for small-

