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**COMMERCIAL BANKS AND THEIR EFFECT ON SMALL AND
MEDIUM ENTERPRISES FINANCING IN RWANDA: A CASE
STUDY OF KIGALI CITY AND SOUTHERN PROVINCE**

Mutamuliza EULARIE*, Giramata AURORE

College of Agriculture, Animal Sciences and Veterinary Medicine, University of Rwanda,
Musanze, Rwanda

*Corresponding author: emutamuliza@yahoo.fr

ABSTRACT

Commercial Banks worldwide are identified to be one of the key players in the financial industry that have positively affected individuals involved in business, and the economy at large, through the functions they perform in the economy. However, inadequate financing in the activities of Small and Medium Enterprises (SMEs) is still the major constraint faced by people involved in business activities. Even though the Government of Rwanda has made effort to improve the accessibility to credit, entrepreneurs still have some challenges to access financial services in order to improve their businesses. The purpose of this research was to assess the contribution of commercial banks in financing SMEs in Rwanda. A sample of 60 SMEs was selected in Kigali and Southern Province of Rwanda. Data was collected from the respondents through a structured questionnaire. The collected data were analyzed using descriptive statistics such as frequencies and percentage distributions. A Pearson Chi-Square Test was used to analyze the relationship between commercial banks and SMEs in Rwanda. The results indicated that the main purposes of loan application were start-up capital, working capital and expansion of businesses. The results also revealed that there was positive relationship between commercial banks and SMEs in Rwanda. The results revealed as well, that commercial banks in Rwanda played a crucial role in contribution to SME's economic development and small and medium entrepreneurs who got credit from commercial banks expanded their businesses and increased their income.

Keywords: *Commercial Banks, Small and Medium Enterprises, Entrepreneurs, Chi-square Test, Rwanda.*

INTRODUCTION

Commercial banks are the most important savings mobilization and financial resources allocation institutions and their roles make them an important phenomenon in economic growth and development (Olusanya et al., 2012). Commercial banks are considered as financial institutions that provide services,

such as accepting deposits, giving business loans and auto loans, mortgage lending, and basic investment products like savings accounts and certificates of deposit (Gockel and Akoena, 2002).

In Rwanda, commercial banks had focused on the improvement of communities' livelihoods. This is to be achieved by contributing to effective economic development activities for sustainable financial empowerment especially through small and medium businesses. Commercial banks constitute the anchor of the growth of other sectors by providing them access to credit facilities in the form of loans (Asantey & Tengey, 2014). Small and Medium Enterprises (SMEs) have been recognized as driving force for economic growth in developing countries. SMEs play a significant role in economic development and emerging markets. For SMEs to perform their role in the economy, they need adequate funds in terms of short and long-term loans (Ohachosim et al., 2013).

The Rwandan Small and Medium Enterprises policy is designed to complement a set of existing strategies with the aim to increase non-farm employment, develop business and technical skills in the Rwandan workforce, strengthen the financial sector and facilitate investment finance to generate industrial growth. The Government of Rwanda through its regulatory authorities, commercial banks will be able to increase entrepreneurship development. The recent poverty eradication program in Rwanda is focused on sustainable development through small business development, as the Government of Rwanda placed much interest on the development of the private sector, being the pillar of poverty eradication at all levels in the society (MINECOFIN, 2013).

The Government of Rwanda has concentrated efforts on implementing policies and programs targeted at enhancing the ability of SMEs and their entrepreneurs to access funding. Financial institutions, especially commercial banks, in Rwanda are one of the ways of reaching people who are involved in Small and Medium Enterprises (SMEs) for increasing their income and other self-employment activities by providing them credit. Commercial banks have been considered valuable if they provide credit facility to people. Banks financing SMEs face difficult financial constraints due to the lack of accurate reliable information on financial conditions of small firms. Banks hesitate to finance start-up and young firms, those with insufficient collateral, which demonstrate the possibilities of high returns but at significant risk of loss (Berger and Scott, 2005). However, inadequate financing in SMEs activities is still the major constraint faced by people involved in business activities.

Although the Government of Rwanda made effort to improve the accessibility to credit, entrepreneurs still have some challenges to access financial services in order to improve their businesses including financial credit accessibility. Commercial banks perceive SMEs as high risk and are therefore inflexible in terms of collateral accepted and repayment terms. This compound by the fact that most small borrowers lack experience and understanding of financial organizations and do not have the necessary skills to make successful applications. Despite this, there are funds, available for SMEs to assist in lending including funds for export

promotion, agricultural development and SMEs development, which are managed by National Bank of Rwanda (NBR) and the Rwandan Development Bank (BRD). The rapid development of accessing financial services has been a potential key to fight against poverty and build productive capacity, to compete to create job opportunities. Commercial banks can become truly sustainable for economic growth in the country. Despite increasingly important roles of commercial banks in poverty reduction, there have been relatively few studies that examine the role of commercial banks on small and medium enterprises in Rwanda. Therefore, this study seeks to assess the impact of commercial banks on SMEs financing in Rwanda.

MATERIAL AND METHODS

Study area

The study was carried out in March 2018 in Kigali City, Huye and Muhanga Districts of Southern province and where sixty Small and Medium Enterprises were clustered in production or manufacturing. Those SMEs were producing different productions. They were in production of foods, beer, iron sheet, organic pesticide, clothes, footwear, ceramics, and mining.

Data collection

The study used both qualitative and quantitative data from primary data sources to get information needed. Primary data were collected using structured questionnaires via SMEs manager's interviews and focus group discussion. Data were obtained using questionnaire to get the real information from Small and Medium Entrepreneurs and from commercial banks. The research design has been used to investigate how SMEs are affected by loans from commercial banks. Secondary data were obtained from different sources such as books, Government reports, RCA (Rwanda Cooperative Agency Report), theses and other documents relevant to the study.

Sampling methods

The sample used purposive sampling techniques to select 60 Small and Medium Enterprises in Kigali city and Southern Province of Rwanda. The study used the convenience sampling method to collect the relevant required data for analysis from the respondents.

Data analysis

The study used descriptive and correlation analyses to investigate the economic impact of the commercial banks on small and medium enterprises. The Chi-Square test method was used in this study to assess and investigate if there is relationship between the independent and dependent variable. The data were analyzed by using SPSS software and are presented in tables as frequencies and percentages.

RESULTS AND DISCUSSION***Description of different activities offered by SMEs in Rwanda***

The table 1 presents the products and services provided by the SMEs assessed in the study area. Some of the SMEs are among manufacturing SMEs and others are among agro-based SMEs.

Table 1. Products and Services provided by SMEs in the study areas.

Products and Services provided by SMEs	Frequency	Percent
Agricultural products	8	13.3
Food products	12	20
Cement products	9	15
Brewery products	5	8.3
Metal products	4	6.7
Hygiene products	7	11.7
Organic pesticides products	3	5
Mining products	2	3.3
Clothing and footwear products	10	16.7
Total	60	100

**Source: Computed from field survey, 2018.*

The table 1 shows that food products have a highest percentage of 20 percent than other products while clothing and footwear products represent 16.7 percent. The remaining products and services provided by SMEs are still very few in the study areas.

Different source of the finance to Small and Medium Enterprises' start-up

Figure 1 presents different source of funds to finance the Small and Medium enterprises start-up in Rwanda.

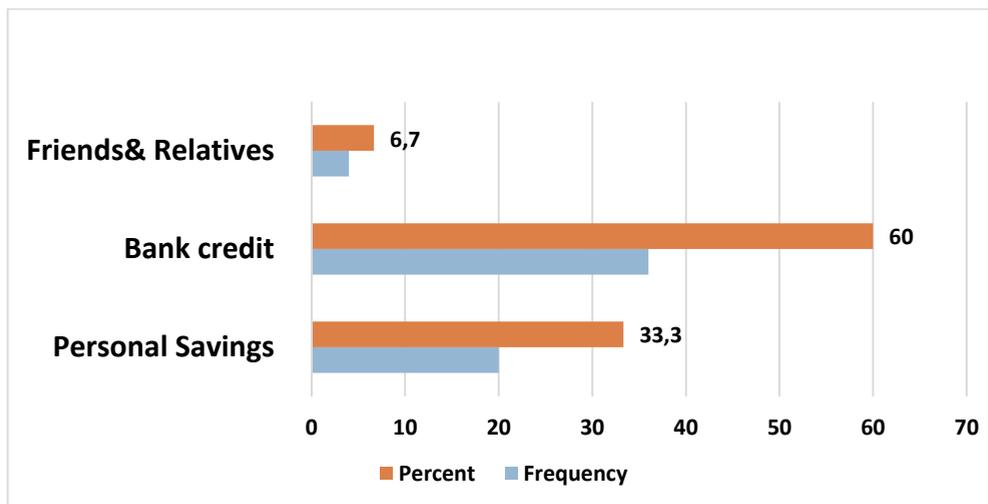


Figure 1: Source of finance to SMEs' start-ups.

*Sources: Computed by Author from field Survey, 2018

Figure 1 above shows that 33.3 percent of small and medium entrepreneurs reported that they have used their personal savings to finance SMEs start-up while the majority of them 60 percent reported that they have financed their SMEs start-up from bank credits and only 6.7 percent of respondents that they have financed their SMEs from friends and relatives. From this result, we can indicate that the commercial banks in Rwanda have played a crucial role in financing SMEs especially in their start-up and their economic development.

Ranking of the relationship between SMEs and commercial banks in the study areas

The table 2 presents the ranking of the relationship between SMEs and commercial banks.

Table 2. Ranking of the relationship between SMEs' and Commercial banks.

Rank	Frequency	Percent
Excellent	22	36.7
Good	18	30
Average	12	20
Poor	8	13.3
Total	60	100

*Source: Computed by Authors from field Survey, 2018.

The results indicate that 36.7 percent of SMEs entrepreneurs ranked the relationship they have with commercial banks as excellent while 30 percent of SMEs ranked the relationship they have with commercial banks as good.

However, SMEs have a positive and good relationship with commercial banks, it means that commercial banks are working adequately with SMEs in Rwanda.

Main purposes of loan application

The figure 2 shows the main purposes for loan application by SMEs managers.

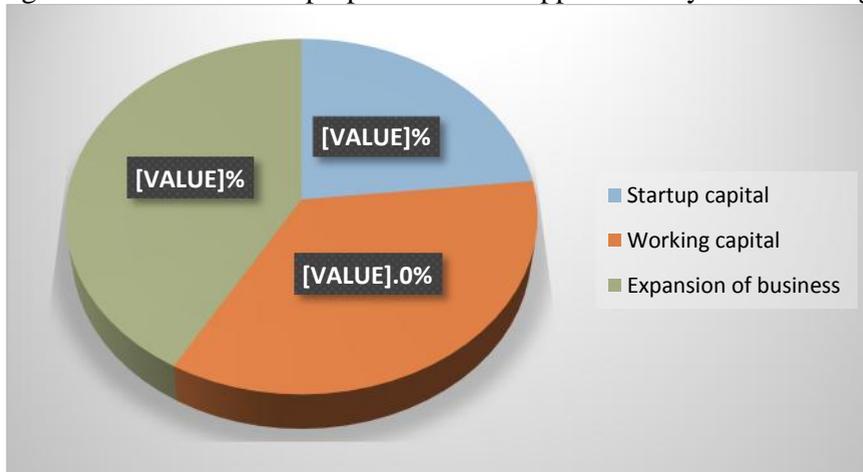


Figure 2. Description of the purpose of the loan application.

*Source: Computed by Author from field Survey, 2018.

The results indicate that the main purposes of loan application were start-up capital, working capital and expansion of businesses. According to this figure 2, majority of entrepreneurs applied for loan to expand their businesses. However, the result show that 23.3% of respondents reported that they have applied for a loan for their start-up capital whereas 35% have applied loans for working capital and 41.7% have applied loan for expanding their businesses. According to the findings of this study, the majority of respondents applied for loan to increase their livelihood.

Major constraints to the growth of SMEs in the study areas

The table 4 shows the major constraints faced by households involved in SMEs activities. According to this table, the respondents showed their anxiety by giving constraints they face in the growth of their SMEs. However, 25 percent of the respondents reported lack of finance and credit as the main constraint to the growth of SMEs in Rwanda, whereas 15 percent declared market competition; 15 percent of the respondents stated that higher interest rate is a constraint to the growth of the SMEs especially those in agricultural and food production sector, 20 percent reported high taxes, 10 percent reported that raw materials are very expensive and 8.3 percent reported lack of markets of their products. However, in the study areas, the majority of the respondents reported lack of markets completion for their products. So, it is suggested that the Government and NGOs support small and medium entrepreneurs for improving their standards of living.

Table 3. Major constraints to the growth of the SMEs.

Major Constraints	Frequency	Percent
Lack of finance and credit	13	21.7
Market competition	15	25.0
Higher interest rate	9	15.0
Higher taxes	12	20.0
Expensive raw materials	6	10.0
Lack of market for our products	5	8.3
Total	60	100.0

*Source: Computed by Author from field Survey, 2018.

Business experience after receiving loan from commercial banks

The results from figure 3 shows that 44% of the respondents reported that after receiving loan, their business has been improved in a positive way while 25% reported that receiving loan from the bank increased profitability in the company and their business has expanded, 19% of respondents reported that the income increased after getting loans as they gained more profit in the company and only 12% percent reported that there was no improvement in their companies after getting loan from the bank because they spent more time working for the repayment of the loan rather than working for the development of the business. As seen in the figure above, the majority affirmed that after receiving loan their companies improved.

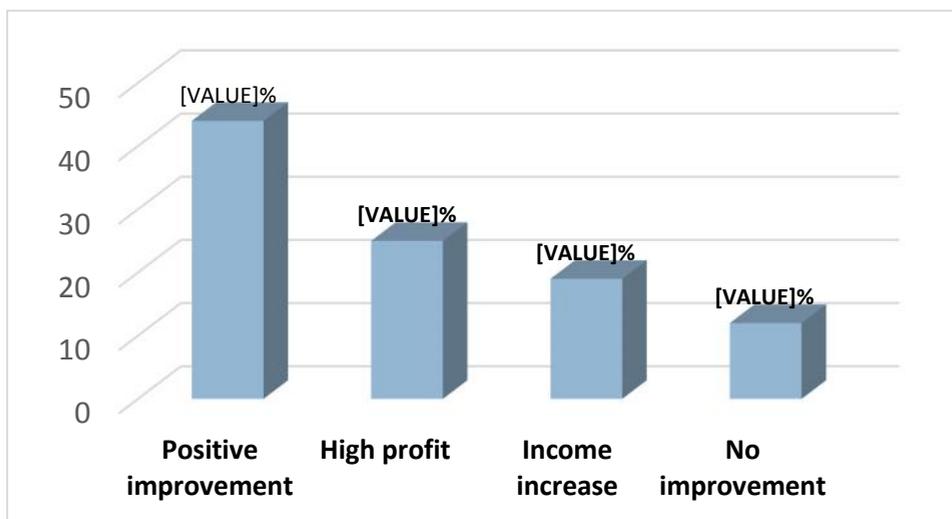


Figure 3. Impact of loan on business

*Source: Computed by Author from field Survey, 2018.

Results from Pearson Chi-Square test

The Pearson Chi-Square was used to evaluate the relationship between commercial banks and monthly income, annual interest rate and repayment period of the credit got from commercial banks.

Table 4. Relationship between access to credit and annual interest rate.

Access to credit from commercial Banks	Annual interest rate			Overall
	Less than 15 %	15-20%	20-25%	
Yes	15 (25%)	11(18.3%)	8 (13.3%)	34 (56.7%)
No	10 (16.7%)	9 (15%)	7 (11.6%)	26 (43.3%)
Total	25 (41.7%)	20 (33.3%)	15 (25%)	60 (100%)
Chi-Square= 2= 0.013				

*Source: Computed by Author from field Survey, 2018.

The results from table 4 shows that 25% of respondents who have applied for credit reported that the annual interest were less than 15 percent while 18.3% of respondents reported that the annual interest rate was in the range of 15-20 percent and only 13.3% of respondents reported that the annual interest rate was in the range of 20-25 percent. The results shown after the calculation of the P-value revealed that it is equal to 0.013, which is less than 0.05. In this case, we accept the alternative hypothesis (H1) and reject the null hypothesis. This mean there is a significant relationship between access to credit and annual interest rate.

Table 5. Description of how SMEs rate their relationship with commercial banks according to the repayment period.

SMEs relationship with commercial Banks	Repayment Period				Overall
	Up to 1 year	Up to 2 Years	Up to 3 Years	Above 3 Years	
Excellent	13 (21.7%)	10 (16.6%)	2 (3.3%)	2 (3.3%)	27 (45%)
Good	5 (8.3%)	8 (13.3%)	7 (11.6)	1 (0.6%)	21 (35%)
Average	2(3.3%)	4(6.6%)	5 (8.3%)	1 (0.6%)	12 (20%)
Total	20 (33.3%)	22 (36.6%)	14 (23.3%)	4 (6.6%)	60 (100%)
Chi-Square= 2= 0.050					

*Source: Computed by Author from field Survey, 2018

Results from table 5 shows that for households who applied for loans with a maturity period of up to 1 year, 21.7% of them declared that the relationship with commercial banks is excellent while 8.3 % and 3.3 % declared that relationship

with commercial banks was good and average, respectively. As for households who applied for loans with a maturity period of up to 2 years, 16.6% of them declared that their relationship with commercial banks was excellent; 13.3% declared that their relationship was good and 6.6% reported that their relationship is average. Regarding households who applied for loan with a maturity period of up to 3 years, 3.3% of them declared that their relationship with commercial banks was excellent and only 0.6% and 0.6% declared that their relationship with commercial banks was good and average, respectively. The results also show that there is a positive relationship between commercial banks and SMEs. The table 5 shows also that the P-value is equal to 0.05, which is equal to 5 percent level of significance. This means that we accept the alternative hypothesis (H1) and reject the null hypothesis. In our case, the results indicate that there is relationship between commercial banks and the repayment period for loans. We can conclude that commercial banks have a significant impact on SMEs in Rwanda.

CONCLUSIONS

Small and Medium Enterprises (SMEs) in Rwanda have been recognized as driving force for economic growth and have been seen as very important way to escape poverty. This study analyzed the impact of commercial banks on SMEs in Rwanda and identified the relationship between commercial banks and SMEs. The results revealed that the commercial banks have played an important contribution to SMEs' economic development in Rwanda. However, the majority of the SMEs' Owners have reported that after getting loans from commercial banks, they have improved their businesses and their increased their income.

Therefore, the rapid development of accessing financial services has been a potential key to fight against poverty and build productive capacity, to compete to create job opportunity.

The study concludes that commercial banks have played a crucial role in financing SMEs especially in their start-up costs and their economic development and have a significant impact on SMEs in Rwanda. However, the major constraints to the growth of SMEs are markets completion, lack of finance and credit, higher interest rate in agricultural and food production sector, high taxes, raw materials which are very expensive.

With reference to the results of the study, the following policy implications have been given:

- Government should implement several programs to support the SMEs sectors in Rwanda.
- Government should support and help SMEs in various ways such as in accessing credit from different financial institutions, in organizing training programs for SMEs employees and promoting technological innovation for increasing their competitiveness at the market.
- Both public and private sectors should work together in order to develop SMEs sectors because of their contribution to the economic development and poverty reduction in Rwanda.

- Ministry of Commerce should facilitate business support services targeted especially at access to credit facilities for manufacturing firms and SMEs.
- The Government should implement policies in order to promote Made in Rwanda and market facilities of its products especially at regional and international level.

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