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Short-Term Debt and Financial Performance of Small and Medium Scale Enterprises in Buganda Region, Uganda*

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Abstract

Short-term debt is regarded as an important source of financing for Small and Medium-sized enterprises (SMEs). This is because it can be easily accessed and useful during times of emergent working capital shortage. However, short-term debt is the least researched among the components of capital structure, which explains why its contribution to the financial performance of small and medium-sized businesses still lacks empirical validation especially in the Ugandan context. This paper sought to determine the effect of short-term debt on financial performance of Small and Medium Enterprises in Uganda. The study adopted a descriptive cross-sectional research design to collect and analyse the data. Stratified random sampling technique was used to select SMEs while purposive sampling technique was used to select one key respondent from each of the sampled 453 SMEs in Uganda. Primary data was collected using survey questionnaire. Data was analysed using descriptive statistics and simple linear regression analysis. The findings indicated that short-term debt had a negative and significant effect on financial performance of SMEs as measured by return on assets. The study provides empirical evidence to support the propositions in the extant literature that short-term debt significantly hampers financial performance of SMEs. The study recommends that SMEs should adopt low cost operation procedures to improve profitability. This would lead to accumulated profits that can be used for investment purposes as a means of driving growth among the SMEs without resorting to borrowing. This paper suggests that further research should be conducted to establish the justification for the negative and significant effect of short-term debt on financial performance using qualitative approaches.

Keywords: Short-term debt; Financial performance; Small and Medium scale Enterprises

JEL Classifications: G11; G32; M41

* This paper is extracted from the corresponding author's thesis entitled 'Capital structure and financial performance of Small and Medium scale Enterprises in Buganda region, Uganda'

Introduction

Small and Medium scale Enterprises (SMEs) have been credited as drivers of economic growth across nations because of their contribution to revenue mobilization, employment creation and contribution to GDP (Rossi, 2014). The importance of SMEs is evidenced by their contribution to the economic growth of the developed and emerging economies alike. Extant literature indicates that SMEs contribute over 60% of the Gross Domestic Product and about 70% of the total jobs in the high income countries (Zafar & Mustafa, 2017; World Trade Organisation, 2016). In Africa, SMEs account for over 90% of the businesses, contributing over 50% of the GDP (Muriithi, 2017). In Uganda, SMEs contribute up to 20% of the Gross Domestic Product (GDP) and employ up to 90% of the active work force (Ministry of Trade, Industry and Cooperatives, Uganda, 2015; Uganda Investment Authority, 2016).

In order to deliver sustainable economic development, SMEs must ensure that they maintain high levels of financial performance. According to Naz, Ijaz and Naqvi (2016), financial performance is a measure of how well a firm realizes the results of its short-term and long-term objectives from its operations over a given period of time expressed in monetary terms. Existing literature indicates that financial performance is undoubtedly core to the growth and long term survival of Small and medium-sized enterprises (Gibson, 2004; Karadağ, 2016). Gibson maintains that short-term debt forms the largest proportion of financing in the capital structure of small and medium enterprises in emerging and developed economies alike. This attribute is linked to lack of access to long-term debt and equity capital from the equity markets due to lack of collateralisable assets as well as information scarcity characteristic of SMEs (Forte, Barros & Nakamura, 2013). Studies indicate that there have been a persistent decline in the financial performance of SMEs in most of the developed and emerging economies alike in recent past (Belas et al., 2015; Palacios et al. 2016). However, the extent to which short-term debt affects financial performance of SMEs in the developing country context is not well known, especially so in Uganda where empirical literature is scanty and incipient.

Empirical literature about the relationship between short-term debt and financial performance of small and medium scale firms is still incipient in the developed and less developed economies alike (Abor & Biekpe, 2009; Dawar, 2014). Plesko (2000) in agreement with Rai and Danilevskaia (2005) observe that short-term debt remains the least studied among the major components of capital structure. This notwithstanding, empirical findings about the effect of short-term debt and financial performance have been contradictory and inconsistent. For instance, studies have indicated that Short-term debt has a significant and negative impact on financial performance measured by return on assets (Nwude, Itiri, Agbadua & Udeh, 2016; Aziz & Abbas, 2019). Baum et al. (2006) and Eton et al. (2017) reported a positive relationship between short-term debt and financial performance. Ebaid (2009) on his part, short-term debt, long-term debt and total debt were found to have no significant impact on financial performance measured by Return on Equity and Gross Profit Margin.

In the context of Uganda, SMEs' access to short-term debt has been linked to information asymmetry between the finance providers and the borrowers. According to Competitive Industries and Innovation Program, (2016) the formal financial sector had been reluctant to extend credit to SMEs citing issues of a dysfunctional credit market characterised by weak or lack of complete financial information about the SMEs. Attempts to enable SMEs access financing through the Uganda Securities Exchange market had been constrained by the capital market inefficiencies and high levels of information asymmetry, characteristic of capital markets in emerging economies, Uganda inclusive (Abor & Biekpe, 2009). Additionally, the lack of information about the business operations of SMEs and the high cost associated with long-term borrowing continue to affect the capital structure decisions of Small businesses in Uganda (Kagame, 2014).

Empirical evidence has strongly indicated that Small and Medium scale Enterprises are key players in delivering inclusive sustainable global, regional and national economic development through promoting innovation, local industries and reduction in income inequalities (OECD, 2017). However, empirical studies indicate that financial performance of Small and Medium Enterprises has been intermittent over the years. Palacios et al. (2016) found that the growth of SMEs in Mexico had fallen by 1.3% in the 2015/2016 accounting period as compared to an average growth rate of 1.4% to 5.4% in the preceding year 2013/2015. The Kenya National Bureau of Statistics (2016), reports that 2.2 million SMEs representing 73.5% discontinued their operations in the last five years including 2016. In Uganda, the survival rate of SMEs fell from 50% as documented in 2004 (Walter et al., 2004; Abaho et al., 2017) to 30% in 2018. While a plethora of studies indicate a negative effect of short-term debt on financial performance of firms, Benmelech and Dvir (2013) assert that it is more of an indicator of financial performance failure than a cause. Accordingly, the extent to which the documented decline in SME performance is attributed to the short-term debt component

in the capital structure remains a research challenge especially in Uganda where the credit market is still undeveloped.

Empirical studies examining the relationship between debt finance and financial performance of Small and Medium scale Enterprises have mainly focused on the level of debt in explaining its effect on financial performance (Wahba, 2013). Wahba, contends that it is the debt maturity structure (short-term or long-term debt) that affects financial performance rather than the level of debt. Kwenda and Holden (2014) observe that short-term debt serves as an important financing option especially in times of financial crises as a source of emergency funding. Although short-term debt increases refinancing risks, it is known to reduce the cost of debt associated with long-term debt (Chen, Ganum, Liu, Martinez & Peria, 2019). This notwithstanding, the effect of short-term debt on financial performance of Small and Medium scale Enterprises has received limited attention from empirical researchers (Plesko, 2000).

Prior studies linking short-term debt to financial performance of SMEs have remained scanty and contradictory, more so in Uganda where only 47% of them are registered (Sekabira, 2013; Abaho et al., 2017; Olutayo et al., 2015; Obuya, 2017). The persistent performance decline, inconsistencies in the empirical findings on the link between short-term debt and financial performance of SMEs, as well as limited empirical literature in the Ugandan context present a good justification to assess the relationship between short-term debt and financial performance of SMEs in Buganda region, Uganda. Accordingly, the specific objective the study was to determine the effect of short-term debt on the financial performance of Small and Medium scale Enterprises in Buganda region, Uganda.

This paper is significant in various ways. First, it contributes to the existing body of knowledge by documenting empirical support to prior studies that have established the effect of the finance theories underpinning this study, on the capital structure decisions made by the SMEs practitioners. The study provides insights on how finance theories explain the effect of short-term debt on financial performance by documenting empirical evidence to support the theoretical propositions. Empirically, the study extends the scope of extant research by establishing the extent and significance of the effect of short-term debt on financial performance of SMEs. This paper makes a practical contribution by documenting useful information to providers of finance whether individuals or institutions in developing appropriate financial products suitable for small and medium-sized businesses regardless of their stage of development. The findings should enable government policy makers and business practitioners in formulating policies that will make credit finance not only accessible but also less costly so as to reverse its current adverse effects on financial performance. The findings are also informative to the academic fraternity as well as researchers interested in the same field of study.

The remaining part of the paper is organised as follows: part two presents the theoretical as well as the empirical literature upon which the study is premised. Part three describes the methodology and presents the hypothesis guiding the study as well as the population and sample. The fourth section presents the empirical model and the data collection and analysis procedure. Part five presents the results and the discussion thereon based on the major mode of analysis. The sixth part presents the major conclusions, recommendations and suggested areas for further research.

Literature Review

Theoretical Review

This theory was advanced by Modigliani-Miller in 1958. The theory holds that based on the perfect market assumptions concerning the behavior of the capital markets and investors, the worth of an entity is not defined by the composition of its capital structure (Korzh, 2015). The Modigliani and Miller (1958) theory predicted that under conditions of free markets, investor's uniform access to market information and absence of taxes as well as transaction charges, the capital structure remains immaterial in determining the worth of the firm. This theory was more based on assumptions that there were no bankruptcy costs, no information asymmetry among all the firm stakeholders (Abeywardhana, 2017). The same author argues that individual investors can equally access financial markets, as the firm can enable individual investors to create any leverage that was wanted but not offered or get rid of any leverage that the firm took on but was not wanted. This could lead to the irrelevance of leverage in determining the firm value. Given this argument, the firm's value is determined by its real assets, not by the securities it issues (Modigliani & Miller, 1958).

The capital structure irrelevance theory is relevant in this study because it provides a strong base upon which most of the capital structure theories are built (Ahmad et al., 2012). The capital structure irrelevance theory was based on conditions that had limited applicability in the real world and more so in the context of Small and Medium Scale Enterprises (Campello, 2006; Romano, Tanewski & Smyrnios, 2001). However, it stimulated finance research gaining support from other researchers (Sidiki, Kabiraj and Joghee, 2015; Stiglitz, 1974; Taani, 2013; Ebaid, 2009) in the attempt to explain the capital structure-financial performance relationship.

Advanced by Modigliani and Miller (1963), trade-off theory presents a modified position of the Modigliani and Miller 1958 proposition. According to the authors, the trade-off theory postulates that the optimal level of debt is attained at a point where the marginal benefit of debt finance is equal to the marginal cost of debt finance. They argued that a firm's capital structure may be optimized by employing as much debt as capital in order to take advantage of the tax shield conditioned by interest expenses associated to debt (Korzh, 2015; Edet, Uma, & Udo, 2017). In agreement with Modigliani and Miller (1963), Myers (1984) argued that there exists a tradeoff between a firm's capital structure and the effects of taxation, financing costs and agency costs. Firms seek debt levels that balance the tax advantages of additional debt against the costs of possible financial distress (Myers, 2001; Wen-Chien, 2017).

The tradeoff theory is relevant in this study because it enables firms to exploit the advantages of the debt interest that is deducted from profits before computation of taxes. According to (Mac an Bhaired and Brian (2011), managers have to weigh the advantages and disadvantages accruing from debt so as to realize an ideal capital structure using the interest charges. This helps to reduce the tax burden, leading to a reduction in the cost of debt compared to equity financing. Accordingly, a raise in the amount of debt leads to a fall in the weighted average cost of capital of a firm until the firm obtains the debt-equity ratio that maximizes its value. Abeywardhana (2017) posits that the problems of financial distress increase proportionately with the amount of debt, resulting into an optimal capital structure that shows the highest possible tax shield the firm can achieve.

Stakeholder theory was advanced by Freeman in 1984. The theory holds that business enterprises have stakeholders and that they should pay attention to them (Freeman, 1984) cited in (Harrison & Wicks, 2013). According to Freeman (1984), the firm's stakeholders are those individuals, groups of individuals and institutions among which the firm is deployed without which it would cease to exist, including suppliers, consumers, employees, government institutions and the surrounding communities. The proponents of the stakeholder theory argue that while financial performance is of interest to all company stakeholders, it is not the only valuable benefit that matters to the company beneficiaries (Harrison & Wicks, 2013). They redefine a company's performance in terms of its total value arising from its operations and the subsequent utility that accrues to its legitimate stakeholders and not necessarily the shareholders. The principle focus of the stakeholder theory therefore is performance and firm growth arising from its concern to the overall societal good leading to long term profitability and survival (Ali & Abdelfettah, 2016).

In this paper, the stakeholder theory was discussed in support of the response variable of financial performance. According to this theory, performance of firms will achieve long term profitability not only by focusing on the short term financial returns but by addressing the broader perspective of stakeholder value accruing from their activities (Narbel & Muff, 2017). The theory therefore provides a prediction about the stakeholder influence in determining the benefits that obtain from the corporate social responsibility initiatives of the firm (Ali & Abdelfettah, 2016).

Empirical Review

Empirical studies examining the relationship between debt and firm performance have yielded inconsistent and mixed findings. For instance, Saeed, Gull and Rasheed (2013) examined the effect of capital structure on bank performance in Pakistan. Using data for a period of five years from the stock exchange, regression results indicated a strong and significant positive association between all the considered constructs of capital structure (short-term debt, long-term debt and total debt) and financial performance measured by return on assets. The study focused only on listed banks. This study used a representative sample of SMEs from all sectors regardless of their listing status.

Lixin and Lin (2008) studied debt financing and firm value in China. Using data for a period of five years from listed firms on the Shanghai stock exchange, the correlation results indicated a negative association between short-term debt and firm performance measured by return on equity. The study used return on equity which is restricted to equity capital and therefore does not provide a comprehensive assessment of the firm's

performance. The current study used return on assets which examines firm performance based on the total assets of the firm.

Aziz and Abbas (2019) studied debt financing and company performance in Pakistan. The authors aimed at examining the relationship between different sources of finance and performance of firms in the non-financial sector. Secondary data from 14 listed firms indicated that short-term debt had a negative and significant effect on firm performance measured by return on assets. The study focused on listed companies on the Pakistan Stock Exchange whose operation characteristics as well as economic environment differ from the Ugandan SMEs.

Yazdanfar and Ohman (2015) studied Debt finance and business performance in Sweden. The study sought to assess the linkage between debt and performance of small businesses. Using the three-Stage Least Squares and fixed effects models, the authors analyzed data from 15,896 SMEs operating in five industry sectors in Sweden. The findings indicated that short-term debt and long-term debt negatively affected firm performance in terms of profitability. Contextually, the study was conducted in a developed economy where small and medium scale firms maintain financial records that can be accessed in an official database. This study was conducted in a developing country context, Uganda where authentic financial data bases were unavailable.

Lee and Dalbor (2013) studied short-term debt and performance of restaurant firms in USA. The study was motivated by the need to establish the influence of short-term debt on the financial performance of listed firms in the restaurant industry. Using data for a period of ten years, pooled regression analysis results indicated that short-term debt had a negative impact on the performance of restaurant companies in the USA. The study was based in the developed market context in which firm characteristics significantly differs from emerging context firms. The current study was conducted in an emerging market context, Uganda.

Prempeh and Nsiah Asare (2016) examined debt policy and firm performance in Ghana. The main objective was to assess the impact of debt policy on the performance of manufacturing firms. Debt policy was represented by short-term debt, long-term debt and total debt while performance was measured by return on assets, gross profit margin and Tobin's q. Data for a period of ten years was used and the panel regression results indicated a negative impact of all the considered constructs of debt policy on the performance of manufacturing companies in Ghana.

Jones and Edwin (2019) studied debt finance and corporate performance. The motivation of the study was to examine the effect of debt measured by short-term debt, long-term debt and total debt on firm performance. Using data from 15 listed companies, the panel regression results indicated that short-term debt, long-term debt and total debt had a positive impact on performance in Nigerian consumer based corporations. The study focused on the listed companies and left out the SMEs most of which are not listed on the stock exchange. The current study focused on all small and medium sized firms regardless of their listing status. Narang (2018) studied the impact of capital structure on firm performance in India. The motivation of the study was to examine the influence of capital structure represented by short-term debt, long-term debt and total debt on the profitability of publicly traded firms in India. Using five years data from twenty firms, the regression results indicated a positive relationship between short-term debt and firm performance as measured by return on assets.

In their study about capital structure and firm performance in Sri Lanka, Sivalingam and Kengatharan (2018) aimed at evaluating the link between capital structure and company performance. Capital structure was measured by short-term debt, long-term debt and total debt while performance was represented by return on assets and return on equity. Panel data from ten banks was used and the regression results did not indicate that short-term debt as well as long-term debt had a relationship with return on assets as a measure for performance.

In Uganda, studies that have attempted to explain the short-term debt-financial performance relationship were scanty and conspicuously missing in the empirical literature, rendering research in this area inconclusive (Sekabira, 2013). Sekabira assessed the role of capital structure on profitability of SMEs focusing on Micro-finance Institutions (MFIs) in Uganda. The study sought to ascertain the role played by the various financing options on the performance of MFIs. Using panel data from 14 MFIs, regression results indicated that short-term debt had a significant negative effect on MFI performance. The study used a sample of 14 MFIs. This study used a large sample of 453 SMEs from across the sectors of the economy in Buganda region, Uganda.

Methodology

The data analysis procedure of the study was guided by one research hypothesis. Literature indicates that short-term debt is an important aspect of the capital structure of SMEs because of the ease of access (Saeed, Gull & Rasheed, 2013; Jones & Edwin, 2019). However, most studies have largely focused on the effect of debt finance and limited attention has been given to the individual effect of short-term debt on firm performance (Plesko, 2000; Rai & Danilevskaia, 2005). Although short-term debt is faulted for potentially exposing borrowing firms to the bankruptcy risk, Baum et al. (2006) assert that high level of short-term debt is linked to high level of profitability. Accordingly, the following hypothesis was tested in the current study:
H0: Short-term debt does not have a significant effect on Financial Performance of Small and Medium scale Enterprises in Buganda region, Uganda.

Methodologically, the study adopted a cross-sectional research design collect the data used to test the research hypothesis. The approach followed the work of Moorman, Rindfleisch, Malter & Ganesan (2008). The approach permits the testing and consequently confirming the hypothesis using well developed empirical model that specifies the relationship between the independent and dependent variables under study (Zikmund et al., 2013). The quantitative data used in the study was collected using a questionnaire as has been done in other studies of a similar nature (Zabri, 2013; Kwiecinski, 2017).

The target population comprised of the SMEs in Buganda region, Uganda. Specifically, the sample population comprised of SMEs operating from the designated business industrial zones in Kampala metropolitan area in Buganda region. This area was chosen because 61.1% of the SMEs in Buganda region are located in Kampala metropolitan (Abaho et al., 2017).

The study adopted two-stage sampling approach to select the SMEs who participated in the study. In the first stage, stratified sampling was employed to select SMEs from the study population, while purposive sampling was employed to select one key respondent from each of the chosen SMEs at the second stage. The sample size for this study was calculated using the Yamane (1967) formula for sample size determination as cited in (Singh & Masuku, 2014).

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

Where: n = the required sample
N = the study population
e = margin of error

$$n = \frac{133,454}{1 + 133,454(0.05)^2}$$

n = 398.804 ≈ 399 respondents.

The fact that most business studies are affected by non-response problem, the sample size was adjusted (Wagner & Kemmerling, 2010; Mellahi & Haris, 2016). Therefore, the final sample size of 453 SMEs was determined for the study.

Findings and Discussion

Data was collected using a questionnaire considered to be the most widely used tool for collecting quantifiable data where secondary data bases are unavailable (Kwiecinski, 2017; Tomaskova, 2009). The questionnaire was designed with question items on each of the variables under investigation based on studies that have used a similar approach notably (Zabri, 2013; Tomaskova, 2009; Kwiecinski, 2017). The authors postulate that likert scale questionnaire is the most widely used tool for survey studies and hence the most effective in measuring attitudes as well as allowing for quantification of responses to permit statistical analysis.

Data was analyzed using descriptive (mean, percentages, and standard deviation) and inferential (simple linear regression) analyses. The key method of analysis was simple linear regression analysis. Thus, the

general regression model is based on the empirical studies of Akintoye (2008), Arulvel and Ajanthan (2013), and Nassar (2016). The functional form of the model is expressed as follows:

$$FP = \beta_0 + \beta_1 (STD) + \varepsilon$$

Where: FP = Financial performance (Measured by Return on Assets)

STD = Short-term debt

β_0 = A constant

β_1 = regression Coefficient

ε = Error term

The descriptive analyses of the SMEs' characteristics are presented separately in Table 1.

Table 1: Characteristics of Small and Medium Scale Enterprises

Characteristic	Freq.	Percent
Ownership structure	73	17.3
Sole proprietorship		
Partnership	110	26.0
Private limited company	240	56.7
Sector of business operation		
Services	156	36.9
Manufacturing	177	41.8
Agribusiness	80	18.9
Others	10	2.4

Source: Survey data, 2019

In view of Table 1, it is evident that the major classifications of the ownership structure in SMEs were sole proprietorship, partnership and private limited companies. Findings in Table 1 indicate that limited companies formed the majority of the SMEs at 56.7 percent; partnerships were 26 percent while sole proprietors constituted 17.3 percent. The results are in contrast with The World Bank Group (2013) which established that sole proprietorship businesses were the majority with 65 percent; while partnerships were 23.7 percent and limited companies constituted 11 percent of the SMEs in Uganda. However, the deviation is explained by the contribution of Micro enterprises and large firms which were included in the World Bank study, but were excluded by the current study because its scope was limited to SMEs.

The findings further indicate that most of the SMEs were largely involved in manufacturing operations with 41.8 percent; services with 36.9 percent while agribusiness constituted 18.9 percent. This finding is consistent with related studies such as Muzaki (2015) who established that most small and medium scale enterprises in Uganda largely engage in manufacturing activities. The growing contribution of the service sector among SMEs is also evident among the firms that participated in the study standing at approximately 37%. This is consistent with the Uganda Bureau of Statistics (2017) whose findings established that services sector contribution was 47.1 percent. The deviation is explained by the contribution of the large service firms that were outside the scope of the current study.

The analysis of the data and its interpretation were guided by the research hypothesis: Short-term debt does not have a significant effect on financial performance of SMEs in Buganda region, Uganda. The study hypothesis was tested using regression analysis technique. Simple linear regression analysis was used to assess the significance of the hypothesized relationship between short-term debt and financial performance. Interpretation of the hypothesis test results was based on the p-values at the significance level of 0.05 as well as the R-squared. Furthermore short-term debt was regressed on financial performance as well as the firm-specific factors (firm age and firm size) as the control variables in the study. The findings are presented in Table 2.

Table 2: Regression Results

VARIABLES	Model 1	Model 2
	FP_ROA	FP_ROA
Short-term debt	-0.271*** (-0.057)	-0.255*** (-0.0599)
Years_business		-0.0419** (-0.0213)
Size_employees		0.0243*** (-0.00894)
Partnership (Base: Sole proprietorship)		0.0831 (-0.797)
Private limited company		0.844 (-0.631)
Manufacturing (Base: services)		-0.195 (-0.441)
Agribusiness		-0.802 (-0.574)
Others		-3.250* (-1.843)
Constant	19.70*** -0.952	19.38*** (-1.172)
Observations	423	423
F-statistics	F(3,419)=18.9 (P-value=0.000)	F(10, 412)=8.11 (P-value=0.000)
R-squared	0.172	0.213

Notes: *** p<0.01, ** p<0.05, * p<0.1; Robust standard errors in parentheses

Source: Survey data, 2019

From Table 2, the findings represent the regression results of the effect of short-term debt on financial performance:

$$FP = 19.70 - 0.271STD + \varepsilon$$

Where: FP = Financial performance (Measured by Return on Assets)

STD = Short-term debt

ε = Error term

The results in Table 2 indicate that the models' F-statistics is statistically significant with p-values = 0.000 for both short-term debt and the firm specific characteristics. This indicates that the overall goodness of fit of the model was appropriate in predicting financial performance of SMEs in Uganda. The R-squared of the model of 0.17 and 0.21 for model 1 and 2 respectively indicate that short-term debt singly explains 17 percent of the variation in the financial performance of SMEs, while the 83 percent is explained by other factors not captured in the model. The increase of the R2 to 21 percent after controlling for firm characteristics demonstrates the effect of control variables in refining the prediction power of the model.

Results in Table 2 indicate a negative and significant effect of short-term debt $\beta = -0.271$ and corresponding p-values of -0.057 at a significance level of 0.01. This indicates that short-term debt has a statistically significant and negative effect on the financial performance of SMEs. Therefore, the null hypothesis that short-term debt does not have a significant effect on the financial performance of SMEs in the Buganda region, Uganda is not supported.

The finding is consistent with studies in literature which have documented a significant and negative effect of short-term debt on financial performance of firms (Riaz, 2015; Nassar, 2016; Anarfo, 2015; Wahba, 2013;

Bokhari & Khan; 2013). The finding suggests that firms employing short-term debt are more likely to experience higher levels of losses accruing from debt financed investments.

In the context of Uganda, the finding is consistent with Guloba, Ssewanyana and Birabwa (2017) who investigated the hindrances to entrepreneurship and inclusion of the SMEs into the formal socio-economic development sector of the rural communities in Uganda. The authors maintain that SMEs in Uganda rely on informal sources of finance usually associated with high interest rates that make debt repayment difficult leading to poor financial performance.

Theoretically, the findings are consistent with the tradeoff theory which posits that by employing as much debt as capital in the capital structure, firms take advantage of the tax shield conditioned by debt interest expenses associated with debt (Korzh, 2015; Edet, Uma, & Udo, 2017). For instance, short-term debt is associated with interest payment which results in reduced profit. However, since the return on assets is the ratio of earnings after interest and taxes to total assets, short-term debt has implications on profit that reduce the ROA (Saputra, Achsani & Anggraeni, 2015).

The control factors included in the model indicate that firm characteristics had a positive effect on the relationship between short-term debt and financial performance of SMEs. For example, the increase of the R² after controlling for age and size of SMEs illustrates the positive impact of attributable to firm factors in the short-term debt-financial performance relationship. This can be attributed to growth of the asset base over time and the improved efficiency of the employees in utilizing the asset base. This is consistent with Chandrapala and Knápková (2013) who recorded a positive and significant effect of firm size on firm financial performance. Bigliardi (2013) established that an increase in the size of the firm as measured by number of employees has a positive effect on the relationship between short-term debt and firm performance.

Conclusions

This study found that short-term debt has a negative and statistically significant effect on financial performance of SMEs. This suggests that as the amount of short-term debt increases in the firm's capital structure, financial performance levels decline. It can therefore be concluded that the variations in short-term debt significantly explain the changes in the financial performance of SMEs. The study findings indicate that even after controlling for firm characteristics, the effect of short-term debt on the financial performance remains negative and significant. This demonstrates that short-term debt is a significant predictor of financial performance. This implies that in order to heighten financial performance among SMEs, management of short-term debt becomes a critical financing decision.

Based on study conclusions, the study draws some policy recommendations to help SMEs make financing decisions regarding short-term debt and financial performance. Firstly, the study demonstrated that short-term debt has a negative effect on the financial performance of SMEs. Therefore, it is recommended that SMEs should adopt low cost operation strategies that limit short term borrowing. This will enable the SMEs to avoid over dependence on debt but to use the retained earnings and other forms of low cost financing options for investment purposes. Secondly, it is recommended that government and/ or lending institutions should design financing options suitable for SMEs such as credit and equity guarantees as well as industry-based credit facilities that will make credit not only available but also affordable.

The study makes a contribution to theory by documenting empirical evidence to support the finance theories that informed this research endeavor. For instance, the study indicated that short-term debt has significant negative effect on the performance. This is consistent with the tradeoff theory which posits that by employing as much debt as capital in the capital structure, firms take advantage of the tax shield conditioned by debt interest expenses associated with debt. From the empirical perspective, the findings of the current research provide evidence in support of the extant literature which postulates that short-term debt has a negative effect on the financial performance of SMEs.

Based on the findings of this study, suggestions for further research can be made. For instance, using the quantitative approach the study established a negative and significant relationship between short-term debt and financial performance. Further research can be conducted to establish the justification for the negative effect of short-term debt on financial performance of SMEs using qualitative approaches. Additionally, the regression results indicate that the effect of short-term debt on financial performance controlling for firm age was negative and significant while it was positive for firm size. Research should be conducted to establish the justification for the difference in the direction of the relationship.

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