“The effect of interest rates on credit access for small and medium-sized enterprises: A South African perspective”

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THE EFFECT OF INTEREST RATES ON CREDIT ACCESS FOR SMALL AND MEDIUM-SIZED ENTERPRISES: A SOUTH AFRICAN PERSPECTIVE

Abstract

This study investigates the effect of interest rates on credit access for small and medium-sized enterprises (SMEs) in South Africa. The study employs a quantitative research design, using data collected from 200 SMEs in South Africa. The data was analyzed using descriptive statistics, Pearson's correlation coefficient analysis, and multiple regression analysis. An inverse relationship between interest rate and credit accessibility was found using the Pearson correlation coefficient ($r = -.199$, $p < 0.05$). The results show that interest rates have a significant negative effect on credit access for SMEs in South Africa. Moreover, the study finds that SMEs experience considerable obstacles in obtaining affordable credit, and that interest rates play a crucial role in this. The study recommends that policymakers in South Africa should consider reducing interest rates and relaxing collateral requirements to improve credit access in SMEs. Furthermore, the study suggests that SMEs should focus on building a good credit history to improve their creditworthiness and increase their chances of accessing credit. Overall, the findings of this study contribute to the existing literature on the effect of interest rates on credit access for SMEs and provide insights for policymakers and SME owners in South Africa.

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INTRODUCTION

Small and Medium-Sized Enterprises (SMEs) play a crucial role in driving economic growth and employment opportunities, particularly in emerging economies like South Africa. The significance of SMEs in the country's economy cannot be overstated, as they contribute to more than half of the nation's total employment and Gross Domestic Product (GDP) (National Treasury, 2021). Moreover, they have been known to exhibit resilience even in the face of economic shocks, such as the COVID-19 outbreak, by adapting their business models and leveraging technology to remain competitive (Fubah & Moos, 2022). Despite their vital contributions, South African SMEs encounter significant challenges in accessing adequate financing, particularly when it comes to credit access (Fatoki & Smit, 2011; Fubah & Moos, 2022; Msomi & Olarewaju, 2022). Securing loans with reasonable terms to support their growth and development has been an ongoing struggle for many SMEs (Msomi & Nzama, 2022). One of the major hindrances to credit access for SMEs in South Africa is the relatively high cost of credit, with interest rates on SME loans ranging from 10% to 30% per annum (OECD, 2020), compared to other emerging markets (Bwembya, 2022). The interest rate plays a pivotal role in determining the cost of credit, impacting SMEs' ability to borrow, invest, and ultimately grow (Tran et al., 2020).

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In South Africa, the interest rate is set by the South African Reserve Bank (SARB), and its monetary policy decisions significantly influence credit access for SMEs (Baaziz et al., 2013). Unfortunately, many SMEs are perceived as high-risk borrowers, lacking credit history, collateral, or sufficient financial statements, leading to lenders charging higher interest rates to compensate for the perceived risk (Msomi & Maharaj, 2022). Moreover, the economic environment plays a crucial role in determining the demand for credit and lenders' willingness to lend (Dell'Ariccia, et al., 2012). In times of economic prosperity, the demand for credit rises, making lenders more open to extending loans. However, during economic downturns, credit demand decreases, and lenders become more cautious in their lending practices. South Africa's struggling economy has posed additional challenges for SMEs seeking credit access.

Addressing these issues is of paramount importance, as access to credit enables SMEs to enhance flexibility, allocate resources efficiently, and overcome cash flow constraints (Malhotra et al., 2007). Unfortunately, SMEs often encounter internal restrictions within financial institutions that limit their access to external funding. Moreover, previous research in other countries has shown that high-interest rates can significantly hinder SMEs' ability to secure finance (Hossain et al., 2020; Gunasagar et al., 2022).

1. LITERATURE REVIEW

The interest rate is the proportion of the loan's principal amount that the lender collects from the borrower each year (Conard, 2021). For the lender, interest rate it is the opportunity cost of lending money (Del Negro et al., 2019). Simply put, interest is the cost associated with borrowing money from another party. Inflation, monetary policy, money demand and supply, the borrower's creditworthiness, and the duration of the loan period are only a few of the variables that go into establishing the interest rate (Conard, 2021). Loans like mortgages, credit cards, consumer lending, and business loans have interest rates that are either fixed or variable (Del Negro et al., 2019). The interest rate on SMEs loans is determined by several variables and important consideration is the SME's risk profile (Goto & Wilbur, 2019). SMEs are more precarious than big corporations owing to their lower stability, lower financial reserves, and worse credit records (Bwembya, 2022). This results in smaller businesses having to pay greater loan rates than their larger counterparts. The market circumstances under which financial institutions function also have an impact on interest rates for SMEs. Interest rates for SMEs may be cheaper in nations with a robust financial sector owing to greater competition among financial institutions (Maudos & De Guevara, 2004). Yet, SMEs in countries with less established financial sectors may be subject to higher interest rates owing to a lack of competitive lending options. There is also the possibility that government policies and laws would affect the interest rates on SME loans. Financial institutions that lend to SMEs may be eligible for government subsidies or other incentives under new laws designed to encourage SMEs. The borrowing rates paid by SMEs may be lowered with the aid of these initiatives (Baaziz et al., 2013). Crowdfunding and peer-to-peer lending are two examples of the newer forms of SME finance that have gained popularity in recent years. As these non-bank lenders do not have the same regulatory burdens as banks, they may be able to provide more competitive interest rates on their loans (Msomi & Maharaj, 2022).

Credit access is the accessibility and availability of financial resources to individuals, companies, or organizations through financial institutions or other sources (Razzaq et al., 2019). These resources may come from a variety of different places. Since people and companies alike need credit to launch, grow, and continue their operations, it is an essential component of the finance requirements that must be met. Borrowers need to be able to get loans, credit cards, mortgages, and other forms of financing on fair terms to have access to credit (Adhiambo et al., 2022). These terms should include reasonable interest rates and time periods for repayment. It is impacted by a number of variables, including creditworthiness, the availability of collateral, and legislation governing the financial industry (Cheong et al., 2020). Since it influences people's and enterprises' opportunities to invest, develop, and expand, the degree of credit availability in a nation or area has a substantial influence on the economy of that country or region. Access to credit facilities is one of the most significant obstacles that SMEs must overcome (Beltrame et al., 2023). SMEs need finance to launch, grow, and sustain their operations, this is an essential part of the funding they need. Several factors affect the ease with which SMEs get loans. An important consideration is the SME's risk profile. Owing to their smaller size, lower financial resources, and worse credit records, SMEs are seen as higher risk than larger corporations (Cheong et al., 2020). Thus, SMEs are often subjected to stricter borrowing criteria and higher interest rates. The state of the global economy is another element that modifies the availability of finance for SMEs (Moulick et al., 2021). SMEs face challenges gaining access to financing depending on macroeconomic factors such as the pace of economic growth, interest and inflation, and the security of the financial system (Ma et al., 2019). For instance, banks are less reluctant to provide credit to SMEs amid times of economic uncertainty (Moro & Fink, 2013). Access to loans for SMEs is impacted by government policies and laws as well. The government must institute pro-SME policies, such as offering loan guarantees or financial incentives to banks that lend to SMEs (Aliero & Yusuf, 2017). This has the potential to expand SMEs' access to loans. Crowdfunding and peer-to-peer lending are two examples of the newer forms of SME finance that have gained popularity in recent years (Pierrakis, 2019). SMEs benefit from increased access to credit and a new, diverse source of finance made possible by these alternative financing solutions.

Several studies have examined the relationship between interest rates and credit access in SMEs. For instance, Aliero and Yusuf (2017) explored the barriers that prevent small and medium-sized enterprises in Nigeria from gaining access to credit. The study makes use of primary data that was obtained from 294 respondents out of a population of 1,710 registered SMEs in the Sokoto metropolitan using the availability sampling approach. To analyze the data, regression analysis was carried out. The findings showed that there is no significant connection between the volume of formal credit extended to SMEs and the age of SMEs, size of SMEs, ownership structure of SMEs, size of SMEs collateral, level of education of the entrepreneur, or number of trainings the entrepreneur has participated in. On the other hand, the finding demonstrates a substantial association between the amount of credit extended to SMEs and the interest rate, which indicates that the only factor that limited access to credit in the research region was the interest rate.

Ndungu (2016) evaluated the determinants of SMEs' access to credit in Kenya. This study was conducted with the intention of greatly benefiting aspiring business owners, possible financial backers, financial organizations, the county administration of Murang'a, and other researchers interested in developing credit policies that are conducive to business growth. The target audience consisted of 1,020 SMEs currently functioning in the region of Murang'a. In this study, 102 participants were recruited using a stratified random selection technique followed by a basic random sample technique. The use of questionnaires allowed for the collection of data. A factor and regression analysis were carried out on the data that was obtained to determine the nature of the connection that existed between the identified components and the use of credit. The research found that the most important determinants affecting SMEs' access to credit in Murang'a are the volume of lending institutions, the interest rate on loans, the availability of collateral, and the literacy rate.

Magembe (2017) looked at the variables that influence small and medium-sized enterprise owners' access to credit. Due to the exploratory character of the study, the researchers decided to use the survey approach. As a result, the research aimed to gather information from 300 business owners in Dar es Salaam, Tanzania, by means of questionnaires. According to the findings, the most significant obstacles that financial institutions face when extending credit to small and medium-sized enterprises are high interest rates and the demand of collateral as the deciding factor for loan acceptance. In addition, the primary causes of non-performing loans are held by SMEs.

Based on an original database compiled by the Union Industrial Argentina in 1999, Bebczuk (2004) explores the factors that determine the availability of credit for a sample of around 140 Argentine SMEs. The results suggests that the

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provision of collateral does not impact the likelihood of securing a bank loan, but rather accepting overdraft lines at high interest rates and extremely short duration is a significant effect. While in South Africa, Msomi and Maharaj (2022) investigate the connection between the availability of credit and finance and the effect that this has on the viability of SMEs. A quantitative approach to research was included in the process. The methodology of the study was descriptive as well as cross-sectional in nature. The study was conducted with 105 SMEs based in KwaZulu-Natal, South Africa. According to the data, 75.73 percent of SMEs who are successful in obtaining financing for their businesses have seen a favorable association between that financing and the profitability and longevity of those enterprises.

There is a reasonable amount of agreement, despite the contradictory results in the research that has been done so far, that interest rates do influence the amount of credit that is available to SMEs. For instance, research conducted by the World Bank in 2018 discovered that SMEs in developing nations had higher interest rates than big corporations, which made it more difficult for them to get access to finance. In a similar vein, research that was carried out by the Tyson (2021) unearthed that the high interest rates that were pervasive in Sub-Saharan Africa were a significant obstacle for the connectivity that SMEs had to monetary resources. This was found to be the case.

The Loanable Funds Theory served as a foundation for this investigation of the relationship between prevailing interest rates and availability of credit. Choi (2021) proposed this hypothesis to explain the relationship between the availability and demand for loanable money, which in turn affects borrowers' easy access to credit. This idea influenced the research because it shows that the supply and demand for loanable money follows the same rules as any other market. The genesis of loanable money may be traced back to companies and groups that have an excess of income and are willing to save and lend it out, either immediately (by investing in a bond) or in the foreseeable (by depositing it in a bank) (Tsiang, 1989). As a result, people can get loans from their savings. SMEs value chain have increased their borrowing needs for investment purposes. Interest rates are the cost that borrowers must pay to use a bank's loan services, whereas the profit that banks make off of lenders comes directly from their savings.

2. METHODOLOGY

The positivist paradigm was employed since this investigation was conducted using a quantitative research approach. The data collection process included a closed-ended questionnaire using a Likert scale of five points. The owners and managers of all SMEs in the eThekwini area that fall under the jurisdiction of the Durban Chamber of Commerce and Industry (DCCI) were the target. SMEs include a very wide variety of businesses, including those in manufacturing and the retail sector. Since there are so many SMEs in KwaZulu-Natal, the manufacturing and retail sectors made up the population that was targeted. More than 700 SMEs in the province of KwaZulu-Natal are members of the DCCI and SEDA. Both agencies work with Durban's small businesses (Olarewaju & Msomi, 2021). This study concentrated on SMEs in the Central Business District (CBD) of KwaZulu-Natal in Durban. SMEs that employ between 10 and 200 employees were chosen to examine the effect of interest rates on credit access for small and medium-sized enterprises. A population of 700 people served as the basis for the study's intended sample size of 220. Yamane offered a more straightforward formula for calculating sample size that was applied. A sample size of around 200 people was chosen using a strategy known as purposive sampling, which has been determined to be acceptable since it enables the researcher to exercise his or her own discretion in selecting an appropriate representation of the company owner. Since some SMEs are run by their owners while others are run by managers, respondents were owners or managers. Questionnaires were used to gather the primary data for this study. These questions were sent out to respondents who were found in the DCCI database using the QuestionPro software. Emails were sent out, and each email had a link to the questionnaire that could be accessed online. It was requested of the responders that they finish the survey by clicking on the link that was supplied. The researcher wrote letters of reminder which was to be sent in the event of an unsatisfactory answer or after a week had passed after the delivery of the questionnaire with no response being received. A total of 220 individuals filled out the questionnaire provided to them. There were 213 respondents who filled out and returned the questionnaire. Out of them, 5 of the surveys were invalid because they were not correctly filled out. For the purpose of this research, the remaining 208, which accounted for 94% of the response rate, were assigned codes and evaluated. Since a questionnaire was used to collect primary data for this investigation, the information was initially entered into a spreadsheet created with Microsoft Excel, and then it was transferred to a computer running Statistical Package for the Social Sciences (SPSS) to be coded and analyzed. The use of SPSS was permissible since it made it simple to comprehend how changes in interest rates affected the credit available to small and medium-sized enterprises.

3. RESULTS

A descriptive assessment of survey participants' replies on the effect of interest rate on credit access for South African SMEs was conducted.

Table 1 shows that interest rates and credit access are important issues for SMEs. The majority of respondents feel that interest rates charged by financial institutions for SME loans are too high and that high interest rates make it difficult for SMEs to access credit. Additionally, interest rates are considered a key factor in deciding where to borrow money for SMEs. However, a significant number of respondents are willing to pay higher interest rates to obtain credit for their SME. Access to credit is also considered important for the growth and success of SMEs, but many respondents have experienced challenges in accessing credit or have been declined for credit in the past. The reasons given for declined credit applications were often related to interest rates. Alternative sources of funding, such as crowdfunding or peer-to-peer lending, are seen as viable options for some SMEs. Overall, the data suggests that SMEs face significant challenges in accessing affordable credit, and that interest rates are a major factor in this. Alternative sources of funding may be helpful for some SMEs, but it remains to be seen if they can fully address the issue of high-interest rates for SME loans.

Table 1. Responses on analysis of survey responses

Statements	SD	D	N	SA	A
Interest Rates					
Interest rates charged by financial institutions for SME loans are too high	15 (07%)	11 (05%)	07 (03%)	70 (34%)	105 (50%)
High-interest rates make it difficult for SMEs to access credit	10 (05%)	14 (07%)	16 (08%)	57 (27%)	111 (53%)
Interest rates are a key factor in deciding where to borrow money for my SME	61 (29%)	21 (10%)	12 (06%)	31 (15%)	83 (40%)
I am willing to pay higher interest rates to obtain credit for my SME	101 (49%)	38 (18%)	10 (05%)	18 (09%)	41 (20%)
Credit Access					
Access to credit is important for the growth and success of my SME	17 (08%)	25 (12%)	12 (06%)	31 (15%)	123 (59%)
I have experienced challenges in accessing credit for my SME	36 (17%)	15 (07%)	15 (07%)	24 (12%)	118 (57%)
I have been declined for credit for my SME in the past	19 (09%)	11 (05%)	07 (03%)	41 (20%)	130 (63%)
The reasons given for declined credit applications were related to interest rates	97 (47%)	22 (11%)	08 (04%)	11 (05%)	70 (34%)
Alternative sources of funding, such as crowdfunding or peer-to-peer lending, are viable options for my SME	51 (25%)	33 (16%)	24 (12%)	59 (28%)	41 (20%)

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Table 2. Correlation between Interest rate and SME Credit access

Construct A	Construct B	Pearson's correlation (r)	p-value
Interest rate	Credit access	–.199*	< .05

Note: * Correlation is significant at the 0.05 level (2-tailed).

Table 3. Linear regression between Interest rate and SMEs Credit access

Variables in the equation	B	Beta	t	p-value	R^2	F	Df	p-value
Constant	16.003	–	14.232	< .05	.039	5.008	1; 122	< .05
Interest rate	–.228	–.199	–2.238	< .05				

Note: DV – Credit access.

The Pearson correlation coefficient was used to determine the link between the interest rate and access to credit for SMEs. Table 2 displays the conclusion of Pearson's correlation coefficient.

The Pearson correlation coefficient shown in Table 2 establishes a statistically significant association between Interest rate and SMEs Credit accessibility at ($r = .199$, $p < 0.05$). The negative correlation implies an inverse relationship between the two constructs. These results are congruent with the findings of a study conducted in Ghana by Asiedu et al. (2022), which indicated that high interest rates in emerging nations were a major barrier to SMEs accessing credit. A study conducted in South Africa by Msomi and Olarewaju (2022) revealed that SMEs often subjected to interest rates that were higher than those paid to bigger firms. This posed a challenge for SMEs to compete and acquire the capital they need to build their operations. Aghion et al. (2019) in France discovered that interest rates had an inverse relationship on credit accessibility. In Kenya, Adhiambo et al. (2022) showed that higher interest rates resulted in decreased credit access. A study in Garissa County by Maalim and Gikandi (2016) demonstrated that high interest rates made it hard for SMEs to get loans.

A regression analysis was further carried out to show the level of influence between the two constructs. The results of linear regression are showcased in Table 3.

The results of the regression analysis summarized in Table 3 indicate an R^2 value of 0.039, which suggests that Interest rate accounts for 3.9% of the variance in Credit access and there is a significant linear relationship between Interest rate and Credit access, $F(1, 122) = 5.008$, $p < .05$. The independent variable, Interest rate, is a significant predictor of Credit access, $B = -0.199$, $p < 0.05$. There is a possibility that the bank fees and interest rate fees levied on borrowers by micro financial institutions and commercial banks might constitute a significant portion of the overall cost of borrowing. The high overall cost of borrowing is consistently regarded as the single most significant barrier that prevents the vast majority of prospective borrowers from approaching financial institutions for loans. Just a select few small and medium-sized enterprises were able to apply for and be approved for loans to sustain their activities when commercial banks raised their internal fees. When interest rates are high, it is more difficult for small and medium-sized businesses to receive credit. On the other hand, when interest rates are low, loan availability will improve, which can encourage economic development. In addition, since they have fewer financial resources and less of a credit history, small and medium-sized enterprises are more susceptible to shifts in interest rates.

CONCLUSION AND RECOMMENDATIONS

In conclusion, the purpose of this investigation was to examine the relationship between interest rates and credit availability for Small and Medium-sized Enterprises in the Durban Central Business District (CBD). The results of this study clearly indicate a negative correlation between interest rates and SMEs' credit availability. Specifically, a decrease in the number of SMEs seeking loans from financial institutions in the Durban CBD was observed as interest rates increased. This negative correlation was substantiated through both linear regression analysis and the Pearson correlation coefficient ($r = -0.199$, $p < 0.05$). The study also revealed that financial institutions imposed greater internal fees, making loans less accessible to SMEs. These findings align with prior research in the field, highlighting the adverse effects of increasing interest rates on borrowers' ability to access credit. Notably, this study has underlined the significance of the Loanable Funds theory in explaining how interest rates impact the availability of credit to borrowers.

As a result of these findings, several recommendations can be made to enhance SMEs' access to credit. Policymakers at microfinance institutions and commercial banks should explore cost-cutting measures to reduce overall interest rate charges. The integration of artificial intelligence and online application systems for automated loan processing could streamline the borrowing process and enable borrowers to evaluate various financial institutions more efficiently. Furthermore, governments should consider implementing regulations that incentivize financial institutions to offer lower interest rates on small business loans. Initiatives like credit guarantee systems, tax breaks, and regulatory frameworks could be employed to achieve this goal. Additionally, it is essential to empower businesses with knowledge about how interest rates affect lending availability and how to manage their financial affairs effectively. Seminars, workshops, and online resources can be valuable tools in this regard.

SMEs should also explore alternative funding options, such as equity finance, crowdsourcing, or peer-to-peer lending, to reduce their reliance on bank loans and mitigate the impact of interest rate fluctuations. Lastly, SMEs can enhance their creditworthiness by increasing their debt-to-equity ratio, developing robust business strategies, and maintaining positive credit histories. This study recommends that similar research be conducted on the practices of other lending institutions and their implications on credit availability, including commercial banks. Comparative studies in different locations can provide valuable insights for a more comprehensive understanding of the relationship between interest rates and SMEs' access to credit.

AUTHOR CONTRIBUTIONS

Conceptualization: Thabiso Sthembiso Msomi.
Data curation: Thabiso Sthembiso Msomi.
Formal analysis: Thabiso Sthembiso Msomi.
Funding acquisition: Thabiso Sthembiso Msomi.
Investigation: Thabiso Sthembiso Msomi.
Methodology: Thabiso Sthembiso Msomi.
Project administration: Thabiso Sthembiso Msomi.
Resources: Thabiso Sthembiso Msomi.
Software: Thabiso Sthembiso Msomi.
Supervision: Thabiso Sthembiso Msomi.
Validation: Thabiso Sthembiso Msomi.
Visualization: Thabiso Sthembiso Msomi.
Writing – original draft: Thabiso Sthembiso Msomi.
Writing – reviewing & editing: Thabiso Sthembiso Msomi.

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