

MSME Finance in Uganda – Status and Opportunities for Financial Institutions

Anup Singh

March 2017

Key Points:

1. *MSMEs contribute to 75% to the gross domestic product in Uganda.*
2. *Nearly 70% of MSMEs in Uganda have unfulfilled credit needs.*
3. *To adequately support MSMEs, financial institutions need to rethink pricing strategies, enhance efficiency, innovate on delivery options, and design customer centric products/services.*

Introduction¹

Uganda has an extensive MSME² sector that accounts for approximately 90% of the private sector, over 80% of manufactured output and contributes about 75% to the GDP. Out of an estimated 980,000 enterprises, an estimated 84% fall under micro category. The sector employs over 3.0 million people, which makes it one of the largest employers in the country.

Given the role MSME's in Uganda play in generating employment and in enhancing GDP, it is imperative to understand the growth drivers of MSMEs particularly access to finance and the role that the private sector can play to support the growth of MSMEs.

This note features MSMEs' access to finance in Uganda and charts a potential roadmap for banks and other financial institutions in Uganda as they expand and downscale to serve the MSME market. The note is based on our assessment of Ugandan MSME sector, their financial needs and consequent product development opportunities for financial service providers. *MicroSave* conducted a research to assess the state of finance to MSMEs in Uganda. The research centred on evaluating three main areas, namely, current functioning of MSMEs; their role in the economy; and their financial needs. The analysis revealed unique patterns and issues of MSMEs in Uganda. The following sections detail the status of Ugandan MSME finance and highlight the areas where financial institutions can strengthen finance delivery to tap the opportunities that MSMEs present.

Profile of Ugandan Enterprises

MSMEs in Uganda are predominantly informal and young; about 50% of them are less than five years' old. Given the infancy of enterprises in the sector (many entrepreneurs in Uganda have multiple small enterprises and then over time may decide to focus on one or the other), the mortality rate of businesses is high and for every new business being established, another is closed within one year of its operation. Only about 8% of the MSME

enterprises have been around for 15 years or more.

Ugandan MSMEs are largely concentrated in urban areas, mainly in Kampala and the central region. They are predominantly engaged in trade, construction, hospitality, manufacturing, finance and insurance.

Ownership of the enterprises is almost equally distributed between male and female entrepreneurs at 49% and 51% respectively, with a high number of female entrepreneurs engaged in micro enterprises.

Most of the MSMEs (about 45%) are sole proprietorships, followed by private limited liability companies (around 30%). Others include partnerships (20%), associations (2%), cooperatives (2%) and NGOs (1%). The majority of micro and small businesses are not registered, as registration requirements are cumbersome; whilst taxation implications for registered enterprises discourage registration. In the research, it was found that two-thirds Ugandan entrepreneurs do not pay taxes.

Financing Needs of MSMEs in Uganda

There are over 25 banks and other formal financial institutions in Uganda having presence across the country. Intense competition among these banks has ensured deep penetration of formal finance (in terms of savings/current accounts) among MSMEs. 93% of the enterprises surveyed had bank accounts with formal financial institutions.

Around 3% of the respondents used semi-formal institutions such as SACCOs and MFIs to save money and borrow. Most of the enterprises that used semi-formal financial institutions were micro enterprises. They expressed higher comfort levels in dealing with semi-formal institutions. Only about 4% of the sample population had never used banks or any other formal / semi-formal institution for any financial purpose.

Nearly 70% of the respondents had unfulfilled credit needs. While 41% of the respondents need working capital loans, 29% expressed the need for investment (capital assets) and vehicle

¹Statistics source: Uganda Bureau of Statistics, 2015.

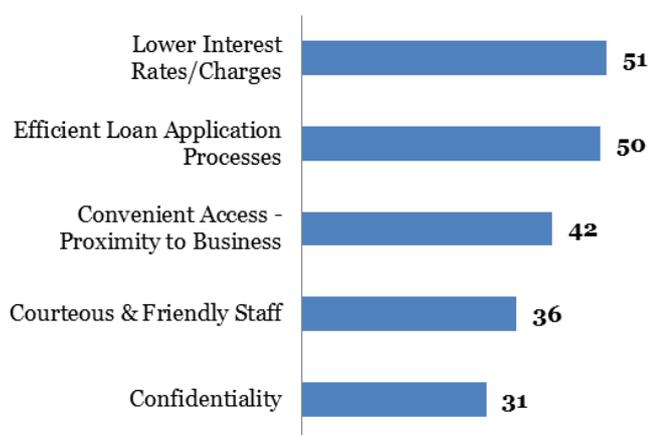
²Refer to the definition of MSMEs as per Ministry of Finance Planning and Economic Development (MoFPED) and Uganda Investment Authority (UIA)

finance to expand their businesses. Around 17% of the respondents opined the need for savings products such as cash management, collection and payroll services. Some 57% respondents expressed the need for mobile money to be able to pay and receive funds electronically.

Financial products attributes that Ugandan enterprises value the most

MSME owners were asked for their suggestions to financial institutions in Uganda so that products and services can better meet the needs of MSMEs. The top five suggestions were:

Product/Service Attributes Preferred by Enterprises - % of Enterprises



Way Forward for Financial Institutions

Considering the huge number of MSMEs in Uganda and the potential market/profitability it presents, financial institutions must re-strategise their approach to cater to this segment. Some of the quick wins may be:

- **Offer Differentially Priced Loans Based on the Profile:** Banks and financial institutions must develop a dynamic pricing tool so as to align the interest rate to the profile of the borrower. It should consider the borrower's profile such as loan demand (higher loan amount means lower transaction cost per unit of currency), term (longer loan term means additional task of monitoring loan and less churn of capital) and the risk grading of the borrower. Also, banks must focus on product wise costing to assess the need for revising interest rates and passing on the benefits to the customers.
- **Enhance Efficiency:** To enhance efficiency, banks must look at their operational processes, introduce technology and tools such as credit scoring, and

review the workflows to ascertain smooth and efficient flow of services to the customers.

- **Design and Rollout Customised Product:** There is an immediate need to design and implement new products based on the market needs. Financial institutions should profile SMEs on parameters such as industry/clusters they operate in, need for finance, geography /region, employment provided, assets size, turnover etc. and determine the key segments that they will like to service. Accordingly, financial institutions should develop product concepts and prototype tailored offerings for MSMEs, for both assets and liabilities offerings, as per the needs of key segments.
- **Innovate through Technology-Enabled Cost Effective Delivery Channels:** In order to enhance accessibility of services as well as ensure operational efficiency with delivery and costs optimisation, the financial institutions must look at non-traditional delivery channels and distribution arrangements such as relationship manager, agent, electronic and mobile banking. As the entrepreneurs are willing to pay for such services, introducing these will certainly help in providing a competitive edge to the financial institutions.
- **Design Appropriate Non-financial Services Package to Build Capacities of MSMEs:** Given the profile of Ugandan enterprises, there is a definite need for quality business development services for Ugandan entrepreneurs. The government has to play a key role to create an enabling support network in terms of building capacities of training institutions to provide customised training/mentorship programmes for MSME sector. Besides the government, financial institutions have to play an equally important role in designing appropriate non-financial service packages. While this will help the financial service providers to secure their portfolio by building capacities of their clients, the provision of such packages will also be an important marketing exercise for their financial products targeted at MSMEs.

