

THE IMPACT OF MICROFINANCE SERVICE DELIVERY ON THE GROWTH OF SMEs IN UGANDA

Nahamya K. Wilfred 

Department of Economics and Statistics, Kyambogo University, Kampala, Uganda

wnahamya@yahoo.com

Ajanga Max

Department of Economics and Statistics, Kyambogo University, Kampala, Uganda

Michael Omeke

Department of Economics and Statistics, Kyambogo University, Kampala, Uganda

Tumwine Norman

Department of Economics and Statistics, Kyambogo University, Kampala, Uganda

Nasinyama Moses

Department of Economics and Statistics, Kyambogo University, Kampala, Uganda

Abstract

This paper arises from the study to establish the impact of microfinance services on the growth of Small and Medium Enterprises (SMEs) in eastern Uganda. This was done by; establishing whether MFIs service delivery led to growth of business capital, stock accumulation and growth of employment in SMEs. It further sought influence of socioeconomic characteristics on growth of SMEs and factors constraining access to MFIs services by SMEs. The Analysis used multiple regressions and the Logit models. The findings reveal that; first, there is a positive relationship between micro-credit and the growth of SMEs business capital and stock accumulation, secondly, the socio-economic characteristics like the location, gender of the owner, education levels, age of the business and default history of SMEs affected the growth of SMEs and lastly,

access to MFIs products was constrained by levels of education of the business owners, age of business, initial capital, assets owned before the loan, liabilities before the loan, the availability of collateral, location and default history. The study recommends establishment of an SME authority as powerful single-point administrative institution to address challenges affecting SMEs and formulate strategic plan on SMEs and MFIs operations. This can be done through public-private partnership.

Keywords: SMEs, Growth of Micro finance, Financial And Non-Financial Services, Employment

INTRODUCTION

The major challenge facing many developing countries, especially in Africa, is devising appropriate development strategies that will capture the financial services instruments of small and medium entrepreneurs (SMEs) which constitute about 70 percent of the business sector. Delivery of micro credit to operators of SMEs in developing countries is increasingly being viewed as a strategic means of assisting the so-called “working poor”. In the last twenty five years the delivery of financial services to the SMEs has been considered an important tool for poverty reduction through provision of job opportunities. This is part of the Millennium Development Goal (MDGs) to alleviate poverty where MFIs can contribute tremendously as argued by Hiderink et al (2009). Moreover, the main challenge facing the poor is to gain financial power to enable them boost their income generating activities since accessing finance is pivotal in the struggle to reduce poverty (Yunus, 2003; Kasekende and Opondo 2003).

The Microfinance industry worldwide has been recognized as an instrumental tool for poverty alleviation and economic growth. Socio-economic transformation efforts of low-income and poor community have been possible through accessing semi-formal and informal financial products/ services and so they play a key role in determining the size of the firms (MFPED 2008). They indeed help in providing start-up and business expansion capital among other financial services. The industry is thus seen as paramount in augmenting private sector-led growth through supporting the SME sector.

In Uganda, the microfinance industry is meant to play a critical role in providing a range of small financial and non-financial products to its clients such as loans, financial education and wide spectrum of cross-cutting issues like fight against HIV/AIDS and environmental protection. Such provision of a range of services is envisaged to contribute to SMEs growth. For a number of years, SMEs have gained support from the MFIs, but it still remains unclear whether their administrative practices and services rendered support their efforts or create additional hurdles for firms in need of financing for the development of their businesses. Over the past decades, a

considerable amount of multi- and bilateral aid has been channeled into microfinance programs in Uganda with varying degrees of success. Like all development interventions evaluations studies to ascertain the achievements and failures of these programs would help a lot for future program design. This study is intended to clearly establish the impact of microfinance service delivery on the growth and development of SMEs in Uganda.

METHODOLOGY

The paper focused on establishing the impact of microfinance service delivery on growth of SME in the eastern region of Uganda. A sample of 228 SMEs was selected using a combination of area, stratified and simple random sampling techniques. Both quantitative and qualitative data analytical methods based on objectives suggested were employed. Multiple regressions and the logistic regression model were employed to achieve the overall objective of establishing the impact of microfinance service delivery on the growth of Small and Medium Enterprises.

The study design adopted a triangulation of methodological approaches that combines relevant aspects of quantitative, qualitative, and participatory techniques that included key informant interviews. This was within the broad framework of evaluating the impact of microfinance service delivery to the growth of Small and Medium Enterprises. Thus a cross-sectional data was collected from SMEs that had borrowed from MFIs in eastern Uganda. The conceptual scope of the study concentrated on the impact of microfinance services on SMEs growth in terms of growth of business capital, stock accumulation, asset and employment growth. For this study stock accumulation was got by getting the difference between the size of stock before the loan and the size of the stock after the loan.

EMPIRICAL RESULTS

The amount of business loans borrowed and other MFIs services greatly influence the growth of Small and Medium Enterprises. This is in addition to other intervening household characteristics like the level of education, gender, type of ownership and location of the business.

Microfinance services and SMEs business capital and stock accumulation growth

The results, in model 1 in table 1, show that the growth of stock accumulation is positively associated with amount of the loan borrowed, adequacy of the loan, interest rate paid and the number of times the SME has borrowed. The relationship between the stock accumulation and the amount of loan borrowed is highly significant at 99 percent level of confidence interval. Others have positive association but are not statistically significant. This is supported by the finding that 91percent of the SMEs borrowed money from MFIs to buy raw materials for their

businesses. The result further show that an increase in the amount borrowed by one million leads to stock accumulation by about 141.5 percent. The type of collateral be it car log book or buildings and length of time it takes to process the loan are negatively associated with SMEs' stock accumulation. This could be explained by the fact that SMEs owners in Eastern Uganda do not have cars and buildings to stake as collateral security. The length of time it takes to process a loan has a negative association with stock accumulation (as shown in model 2), implying that the longer the time to get a loan; the less is stock accumulation because the borrowers will not have finances to expand on their stock.

Table 1: Regression Results on determinants of MFIs Services and SMEs Stock Growth

	Model 1			Model 2		
	coeff	Std err	T	Coeff	Std err	t
Amount of capital that was borrowed	1.4146 ***	0.2273	6.22	-	-	-
Adequacy of the borrowed amount	0.2042	3.2977	0.06	0.1750	3.5990	0.05
Loan repayment period	-	-	-	-1.6104	2.8098	-0.57
Interest rate paid	0.0174	0.2661	0.07	0.2597	0.2837	0.92
Number of times SME has ever borrowed	0.0898	2.0146	0.04	1.3308	2.1663	0.61
Type of collateral (car log book)	-0.6484	8.4901	-0.08	2.5254	9.1277	0.28
Type of collateral (building)	-1.9797	4.5031	-0.44	-2.4707	4.8481	-0.51
Time it takes to process the loan	-0.3159	1.1067	-0.29	-0.0274	1.1971	-0.02
_cons	2.2705	8.5495	0.27	0.3871	9.5288	0.04
Number of observations		250			250	
F(8, 241)		5.09			0.26	
Prob.>F		0.0000			0.9788	
R ²		0.1446			0.0085	
Adj R ²		0.1162			-0.0245	

*** 1 percent level of significance, ** 5 percent level of significance and * 10 percent level of significance.

Microfinance Services and SMEs Employment Growth

The SMEs' non-financial activities are measured by change in level of employment. The results show that 34 percent of respondents from SMEs used part of the loan from the MFIs for operational cost by hiring additional units of labor to help in the running of Small and Medium Enterprises. In table 2, it can be seen that in model 1 the amount of the loan borrowed is positively associated with increase in employment. It shows that an increase of a loan by UGX 1million will increase employment level of SMEs by 1.33 percent. This finding is significant at 99 percent level of confidence.

Similarly, amount of interest rate charged on the loan has a negatively impacts on the ability of SMEs to hire new units of labor. This means that as interest rate charged increases the

labor hired by SMEs significantly falls. Evidently, from model 1 at 90 percent confidence level, a percent increase in interest rate lowers employment level of SMEs by about 0.54 percent.

The variables like adequacy of the loan borrowed and time it takes to process the loan are also negatively associated with the SMEs' employment generation abilities. In essence indicating that if the loan is inadequate then less of it will be used to hire extra units of labor. Likewise, if the time for process the loan increases then less of it is used to hire extra labor because the borrowers will be de-motivated to borrow with a long due diligence process based on theoretical understanding.

In model 2, the findings show that, loan repayment period and adequacy of the loan significantly influence the decision by SMEs to hire extra labor. The loan repayment period is positively associated with employment generation and is significant at 99 percent level of significance. The findings shows that if the loan repayment period is raised by one year, SMEs can raise the level of employment by about 26.4 percent. The adequacy of the loan borrowed is negatively associated with employment in model 2 just as it is in model1 and is significant at 95 percent level of significance. It means that inadequate loans restrict employment generation by about 12.8 percent because the loan will be allocated to other cooperate factors of production than the labor.

Table 2: MFIs services and SMEs Non-Financial Activities /Employment Growth

Variable	Model 1			Model 2		
	Coef	Std err	T	Coef	Std err	t
Amount of capital that was borrowed	0.0133***	0.0045	2.92	-	-	-
Adequacy of the borrowed amount	-0.0761	0.0644	-1.18	-0.1277**	0.0618	-2.06
Loan repayment period	-	-	-	0.2643***	0.0461	5.72
Interest rate paid	-0.0054*	0.0052	-1.05	-0.0047	0.0049	-0.96
Time it takes to process the loan	-0.0109	0.0209	-0.52	-0.0154	0.0199	-0.77
Nonfinancial services provided by Mfi(advisory)	-0.1663	0.2133	-0.78	-0.0781	0.2042	-0.38
Nonfinancial services provided by MFIs(training)	-0.1102	0.2174	-0.51	-0.0286	0.2081	-0.14
Nonfinancial services provided by MFIs(counseling)	-0.2347	0.2231	-1.05	-0.1251	0.2138	-0.59
Nonfinancial services provided by MFIs(Corporate Social Responsibility)	-0.1367	0.2380	-0.57	0.0264	0.2292	0.12
_cons	0.5556**	0.2629	2.11	0.1834	0.2603	0.70
Number of observations			245			245
F(8, 236)			1.67			4.75
Prob.>F			0.0176			0.0000
R ²			0.0535			0.1387
Adj R ²			0.0214			0.1096

The Effects of Socio Economic Characteristics on the growth of SMEs.

Table 3 shows the effects of socio Economic Characteristic on SMEs growth. Model 1 its shown that, ownership is significant at 1percent level of significance. This implies that if ownership changed from sole proprietorship to other forms, such as, partnerships, then employment growth (as a measure of growth of SMEs) will increase by about 20.7 percent (from 1 to 3persons). Likewise, a change in location from say rural setting to urban center will increase employment level by 18.7 percent (from 1 to 2 persons). Other socio economic characteristics like, being uneducated is negatively associated with growth of SMEs. The time period of business existence and default history is positively associated with the growth of SMEs, that is, the longer the business existence, the more likely that it will grow more than those businesses which are just beginning and the lower the default level the more likely that the business can access the loan employ more labor because of a good repayment history or portfolio. However, these factors are not significant according to the findings.

In model 2, ownership remains significant at 1percent level of significance. The percentage influence in growth also remains the same (20.7 percent). Major source of business capital and no education negatively impact on level of employment but are not significant. The other social economic characteristics like highest educational attainment (primary, secondary, tertiary and university), time period business has existed and default history is all positively associated with growth of SMEs.

Table 3: Effects of socio-economic characteristics of on the growth of SMEs

Variable	Model 1			Model 2		
	Coef	Std err	t	Coef	Std err	t
Location	-0.1866	0.0999	-1.87	-	-	-
Ownership	-0.2069***	0.0615	-3.36	-0.2071***	0.0621	-3.34
Major source of business capital	-0.1018	0.0735	-1.39	-0.1068	0.0746	-1.43
Highest level of education (none)	-0.4173	0.2726	-1.53	-0.0363	0.5393	-0.07
Highest level of education (primary)	-0.1363	0.0778	-1.75	0.2093	0.4723	0.44
Highest level of education (secondary)	-0.1042	0.0681	-1.53	0.2221	0.4710	0.47
Highest level of education (university)	-	-	-	0.3515	0.4730	0.74
Highest level of education (tertiary)	-	-	-	0.3114	0.4787	0.65
Time period business existed	0.0421	0.0352	1.18	0.0289	0.0357	0.81
Default history	0.0427	0.0863	0.50	0.0289	0.0875	0.33
-cons	0.6494***	0.1339	4.85	0.1782	0.4693	0.38
Number of observations		269			261	
F(8, 252)		2.95			2.27	
Prob.>F		0.0036			0.0185	
R ²		0.0856			0.0752	
Adj R ²		0.0569			0.0421	

Constraints to SMEs' access to MFI services

Table 4 shows constraints to SMEs access to MFI services. It is very clear the the level of education influenced access to MFIs services significantly.

Table 4. Logit Model results

Model 1			
Independent variables	Odds ratio	Z values	p> z
Location	0.0166*	-1.83	0.068
Ownership	0.5042*	-1.92	0.055
Highest level of education(primary)	3.71e+10***	10.10	0.000
Highest level of education(secondary)	1.33e+10***	9.74	0.000
Highest level of education(tertiary)	4.98e+09***	9.11	0.000
Highest level of education(university)	8.19e+09***	9.51	0.000
Time period business existed	0.7379	-1.53	0.126
Amount of business capital	0.9939	-1.25	0.211
Quantity of output before loan (per month)	0.9904	-1.49	0.136
Assets owned before the loan (land)	1.3852	0.41	0.685
Assets owned before the loan (buildings)	1.0015	0.00	0.997
Liabilities before the loan	0.8712	-0.81	0.421
Default history	3.4141*	2.02	0.043
Number of observation		242	
Chi2(15)		52.26	
Prob		0.0000	
Pseudo R2		0.1726	
Model 2			
Purpose of the loan (merchandise)	0.9066	-0.21	0.834
Purpose of the loan (machinery)	1.0513	0.11	0.915
Interest charged on the loan	1.0105	0.46	0.647
Number of times borrowed	1.2478	1.25	0.213
Whether loan needs security	3.4428**	2.34	0.019
Time it takes to process the loan	.83965*	-1.82	0.068
Number of observation		260	
LR chi2(6)		11.29	
Prob > chi2		0.0797	
Pseudo R2		0.0345	

Note * and ** signify levels of significance at 0.1 and 0.05 respectively
Model 1 and model 2 represent borrower and loan characteristics

In the above table, it could be seen that the clients of SMEs who had completed primary education had 3.7 chances of accessing MFIs compared to their counterparts that did not and the results were highly significant at 5 percent level of significance. The results also indicate that schooling increases the probability of accessing a loan. All the coefficients of education are highly significant at 5 percent level of significance. Consequently the borrowers with higher

levels of education have higher chances of accessing loans compared to their counterparts. Clients whose level of education was secondary had 1.3 chances of accessing MFIs services compared to their counterparts that did not and this factor was also highly significant. Clients whose level of education was tertiary including those with diplomas and certificates had 5.0 chances of accessing MFIs services compared to their counterparts that did not and this factor was also highly significant. Clients of SMEs whose owners had completed university education had 8.2 chances of accessing MFIs services compared to their counterparts that had not completed that level of education. Therefore the results indicate that education levels have considerable influence on the probability of obtaining a loan from a micro finance institution.

CONCLUSION

Microfinance plays a central role in the growth of micro enterprise but this is only possible if it is accessible and reasonably priced. Small and Medium Enterprises are increasingly seen as playing a strategic role in economic growth, despite experiencing difficulties in accessing financial and non-financial products from MFIs to finance their working capital. Some of the reasons include limited levels of education to provide management and technical skills, lack of collateral, poor technology, poorly located enterprises and sometimes limited market. In cases where SMEs succeed in accessing financial resources, the interest rate is high, which sometimes lead to high default rates or non-performing loans. This calls for a need to overcome constraints that impede SMEs access to financial resources. Uganda, therefore, needs to create the necessary institutional and regulatory framework environment for both SMEs and MFIs to overcome access problems and constraints.

POLICY RECOMMENDATIONS

The study recommends for; i) Establishment of an SME Authority and ii) enhancing SME competitiveness in Uganda focusing on institutionalizing public-private partnership.

Establishing the SME Authority and Inter-institutional Coordination

Existence of supporting institutions like in Uganda like Microfinance outreach Plan and Association of Microfinance Institution of Uganda (AMFIU) does not guarantee the effectiveness of the whole support system. Evidence from the field survey shows where there is a range of support institutions, effective financial and non-financial support is often not available. In view of the aforementioned, certain strategies are needed to enhance the quality of institutional support for SME growth. Establishment of the SME Authority would create a powerful single-point administrative structure which cuts across administrative and financial barriers and fully

implement policy and other actions affecting Small and Medium Enterprises. The Authority should have powers to formulate policy, expedite approvals from other government agencies and resolve issues encountered during implementation of agreed actions. In operational terms, the Authority should be an independent body and should function as a “one stop shop” which could coordinate and facilitate information delivery to Small and Medium Enterprises. This recommendation is in line with two successful organizations in Serbia and the United States set up by law to support the development of Small and Medium Enterprises. Thus need for the creation of a body to act as a ‘one-stop shop’ for addressing challenges of SMES in accessing MFIS services.

Inter-Institutional coordination is in line with the Uganda National Development Plan is essential and needs to be put in place and operationalized. It should have clear strategies for to provide SMEs with technical skills and financial resources to enable implementation of the strategies in a timely, efficient and effective manner. Coordination among several ministries and local governments is necessary to achieve the outcomes of a well thought out strategy. The strategy needs to be integrated into the national policy in other sectors. There is need for an SME Policy Unit which should act as interim measure to facilitate effective coordination. This can be done through categorization and regulation of all Small and Medium Enterprises.

Institutionalized Public-Private Partnerships

Addressing these challenges affecting SMEs requires institutionalized public-private partnership involving government and the private sector including business association. This could be done through mechanisms that strengthen business associations, improve access to finance for SMEs promotion of business development services and improving information dissemination on available initiatives. This implies that public private partnership could be an answer in obtaining good results from MFIS services to SMES.

REFERENCES

- Hiderink H., Lucas P and Kok M. (2009) Beyond 2015: Long term development and millennium.
- Hierman, Bierens J. (2008) The logit model: Estimation, Testing and Interpretation.
- Kasekende Louis and Opondo Henry (2003), “Financing Small and Medium Scale Enterprises. Uganda’s Experience”. Bank of Uganda Working Paper.
- MFPED (2008), “Enhancing the Competitiveness of Micro, small and medium enterprises in Uganda”; Paper discussion 15, Kampala, Uganda.
- Yunus, Mohammad (2003), “Banker to the Poor: Micro-Lending and the Battle against World Poverty”. Alan Jolis, New York.