

Market Bite Uganda

*Challenges and opportunities for MSME
finance in the time of COVID-19*

November 2021



Content

Executive Summary: Ugandan MSMEs offer a \$8.8 billion potential market opportunity.....	1	Serving the MSME market in Uganda: conclusions and recommendations	12
Infographic 1: MSME market overview	2	i. Addressing the quality and accessibility of credit information will support the ability of financiers to assess MSMEs' creditworthiness	12
MSME market context: economic growth and reforms support MSMEs.....	3	ii. Addressing informality will support access to finance for MSMEs as well as revenue collection for the government.....	13
Economic outlook: growth expected to pick back up post COVID-19	3	iii. Increasing innovation and efficiency in MSME delivery models will reduce cost of serving the MSME sector	13
Enabling environment: recent developments support MSME lending	4	iv. Developing tailored financing products for MSME market segments can improve reach and sustainability	13
Support for the MSME market: limited uptake of non-financial assistance	4	v. Improving the business services market in Uganda is crucial for MSMEs to access funding to grow their businesses	13
Market Insights: 70 percent of MSMEs have unmet demand for credit	5	How the research was done	14
MSME market size	5	Acknowledgements.....	15
MSME market characteristics	5	Acronyms	16
MSMEs in the agricultural value chain	6		
MSMEs in the tourism value chain	7		
MSMEs in the construction value chain	8		
MSME financing: scope to build supply of MSME finance.....	9		
Demand for MSME financing	9		
Infographic 2: Opportunities for MSME finance in Uganda	10		
Supply of MSME financing	11		

01

Executive Summary

Ugandan MSMEs offer a USD 8.8 billion potential market opportunity

Uganda has a vibrant entrepreneurial business community with an estimated 1.1 million micro-, small-, and medium-sized enterprises (MSMEs) across almost all sectors of the economy. The majority of these are informal micro-entrepreneurs, with about a third of all MSMEs more formalized. They all play a key role in innovation, economic growth, and employment in Uganda.

MSMEs have historically not been the focus of the commercial banking sector in Uganda, but there is an increasing interest in this market from financial institutions. Lack of collateral, lack of credit history, inadequate business skills or financial literacy, and high interest rates have traditionally been barriers to access to formal financial services for MSMEs.

Approximately 10 percent of Ugandan businesses have access to a bank account or a line of credit, and it is estimated that about 70 percent of all MSMEs in Uganda have unmet credit needs.

To assess the actual MSME market opportunity for formal financial services in Uganda, IFC conducted a comprehensive survey of 833 MSMEs in the Central, Western, and Eastern regions in April 2021. The survey focused on those MSMEs that are more formalized and larger in size to provide substantial insight on these market segments.

Based on the survey results, the estimated demand for credit by MSMEs in Uganda is approximately UGX 31.4 trillion (\$8.8 billion¹). The demand is highest among micro and medium enterprises in general, and MSMEs in the trade and hospitality sectors.

Several recent developments may work to open up this market opportunity. The establishment of a collateral registry for movable assets in 2019 as well as Uganda's first credit bureau in 2008 are enabling MSMEs to leverage their assets and credit histories to access finance. The emerging and fast evolving fintech sector could similarly offer new innovative methodologies to strengthen the bankability of MSMEs.

While the COVID-19 pandemic has had a negative impact on overall economic activity in Uganda and affected MSMEs across all sectors, at the time of the survey the economy was expected to pick up again in 2021 and a majority of those MSMEs surveyed by IFC were planning to expand their operations in the next three months. Just over half of them also stated a need for restructured loans and short-term working capital.

To fully realize the potential of Uganda's MSMEs, they require access to finance. To increase access to finance to MSMEs in Uganda, there are several measures that public authorities and private sector actors could take. These include, for example, making use of technology and innovative methods of credit assessments; encouraging greater formalization of MSMEs; employing alternative delivery channels to increase efficiency in serving MSMEs; developing tailored financial products for MSME market segments; and increasing the reach and depth of business development services offered to MSMEs.

For financial services providers in Uganda, this translates into an opportunity to build the MSME finance market and make a sustainable contribution to the domestic business community and the economy.

¹ The exchange rate for November 1, 2021 was used (xe.com). 3,559 UGX = 1 USD.

Infographic 1

MSME Market Overview



94%
Micro enterprises

4%
Small enterprises

2%
Medium enterprises

70% Informal enterprises

30% Formal enterprises

MSME Survey Insights

Micro Enterprises

Small & Medium Enterprises

Formality & sector

- 54% are unregistered businesses.
- Higher share of businesses operating in trade, other service activities and agriculture sectors.

- Higher share of registered businesses. 76% of small and 99% medium are registered.
- Higher share of enterprises in the accommodation, manufacturing and health & social work sectors.

Age & business cycle

- Tend to be younger - 68% are less than 3 years old.
- Majority are growing slowly - 68%.

- Tend to be older - 84% of small and 96% of medium are older than 3 years.
- Majority of small enterprises are growing fast, while medium enterprises are in stable and mature phase

Premises & systems

- Majority are located in street/market stalls. 79% have more than one branch/outlet.
- Limited use of internal finance and management systems as well as general IT facilities.

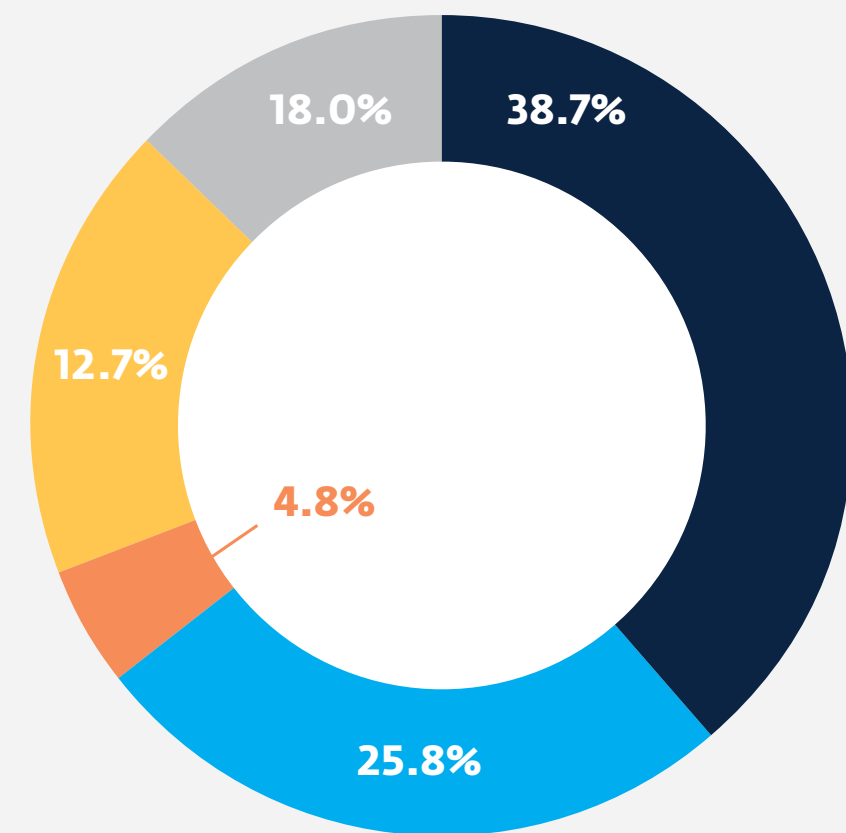
- Majority are located in office blocks and factory plants. 74% have more than one branch/outlet.
- Have greater use of internal finance and management systems and general IT facilities.

Starting needs

- Majority were started due to the need for income and lack of employment.
- Generally require lower start up capital.

- Majority were started due to a need for income as well as identified opportunity in the market.
- Generally require greater start-up capital.

Sources of MSME Financing



38.7%

Commercial Banks

- Focused on larger businesses.
- However, a few banks are increasingly interested in SMEs.

25.8%

Donors

- Provide funding through impact investments and grants.

18.0%

SACCOS and VSLAS

- Primarily focused on rural and low income segments.

12.7%

Credit and Deposit taking MFIs

- Highly focused on MSMEs and low-income segments.
- However, loans are small in size with limited long term funding.

4.8%

Private Equity and Venture Capital

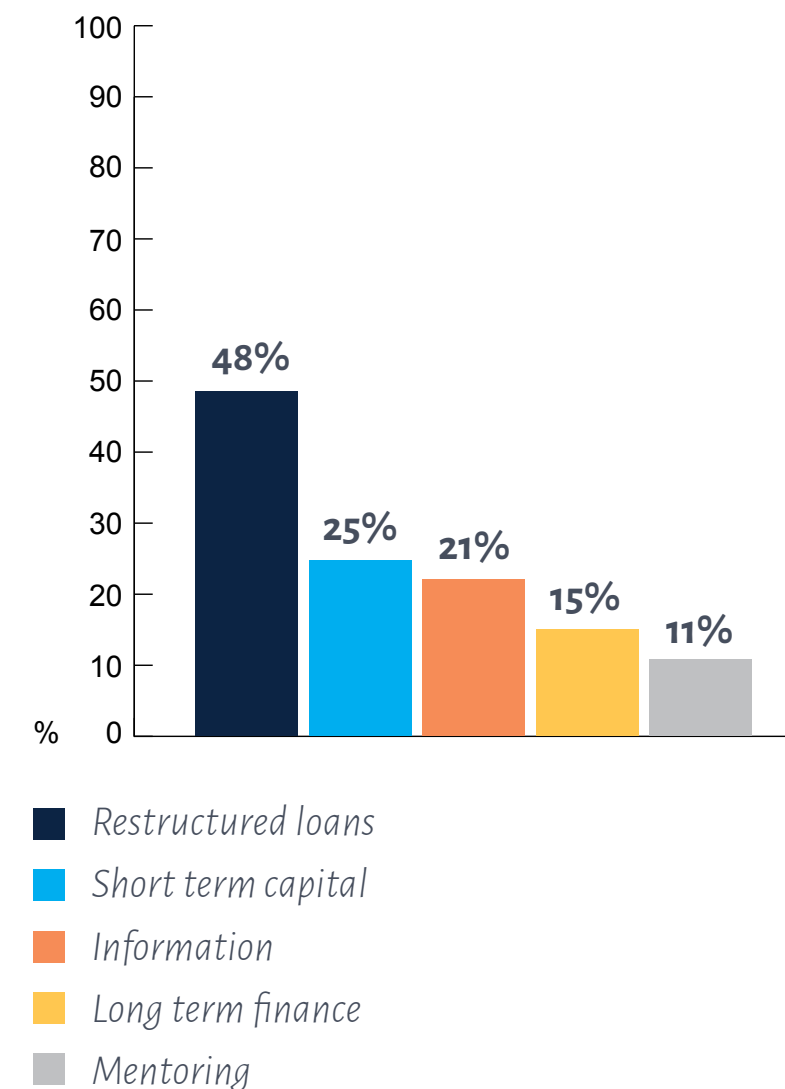
- PE is relatively nascent and focused on larger enterprises.
- VC is growing and mainly targets start ups and small enterprises.

02

MSME market context

Economic growth and reforms support MSMEs

Figure 1: MSME business needs since outbreak of COVID-19
% of MSMEs that expressed respective business needs, multiple answers possible



- 2 IMF, *World Economic Outlook forecasts (WEO)*, 2021
- 3 *Ibid*
- 4 UBOS, *Uganda Statistical Abstract*, 2020
- 5 *Ibid*
- 6 *Ibid*
- 7 UNCDF, *website press release*, 28 May 2020.
- 8 Bank of Uganda Website, *Bank of Uganda (BOU) put in place Credit Relief Measures*, 2020

Economic outlook: growth expected to pick back up post COVID-19

Uganda has achieved considerable economic growth in the last decade, with an average annual growth rate of 8.2 percent². Although growth has slowed down significantly due to the disruptions caused by the COVID-19 pandemic, it is expected to pick up to 4.3 percent in 2021 from a contraction of 2.1 percent in 2020³. The government's development strategies continue to focus on agriculture, industrialization, tourism, and the nascent oil industry to maintain high rates of economic growth.

Prior to the COVID-19 outbreak, structural transformation was characterized by a decline in agriculture's contribution to GDP and a take-off in industrial production, largely agro-processing. Agriculture still accounts for over a fifth of GDP and generates almost 70 percent of employment. The sector grew at an average of 4.2 percent between 2016 and 2019, underpinned by high cash crop output and an impressive performance in the livestock sector⁴.

Growth in Uganda's services sector is supported by public spending, agricultural incomes, and growth in non-trade related sectors. While recreation, entertainment, and tourism came to a standstill in 2020 resulting in a contraction of 8.5 percent in food and

accommodation services, this was in part offset by a strong rebound in the ICT sector as firms and households embraced online solutions to ensure some continuity of business and daily life. The ICT sector grew by 21.9 percent in 2020, compared to an annual average of around 4 percent 2016-2019⁵.

Between 2016 and 2019 the industrial sector experienced an average growth rate of 7.8 percent, driven by public infrastructure and capital investments in the nascent oil and gas industry. In 2020, growth declined to 2.2 percent due to international trade disruptions, but a pick-up in manufacturing and construction is expected to lift industrial growth in 2021 as government continues to encourage domestic production and import substitution⁶.

COVID-19 has added a layer of urgency to efforts to support MSMEs. Business needs as expressed in the IFC survey (see Figure 1) varied by size of business. Micro-enterprises stressed a need for loan restructuring and short-term capital, while small businesses asked for loan restructuring and information. Medium-sized businesses expressed a need for increased access to longer term financing to provide greater flexibility and to fund various capital needs.

The steep decline in economic activity due to the COVID-19 pandemic prompted the government and partners to introduce measures to mitigate the fallout in the MSME sector. These include a UGX 830 million (about \$230,000 at the time) Small Business Recovery Fund for MSMEs in Northern Uganda in partnership between the Development Bank of Uganda, UNCDF, Private Sector Foundation Uganda and other financing institutions⁷. The government is also providing a total of UGX 50 billion (\$13.3 million at the time) in seed money grants to informal micro entrepreneurs who are members of savings and credit cooperative societies⁸.

Despite the impact of the COVID-19 pandemic on the economy, a majority of MSMEs surveyed by IFC described their businesses as growing fast (27 percent) or stable/mature (24 percent). A large proportion defined their businesses as growing slowly (38 percent), but only 1 percent said they were downscaling and 9 percent were starting up. When asked at the time of the survey what they plan to do in the next three months, over half were planning to expand (52 percent) while most of the others had no plans to change how they operate (43 percent).

Figure 2: Obstacles to MSME growth
% of MSMEs that mentioned respective growth obstacles, multiple answers possible

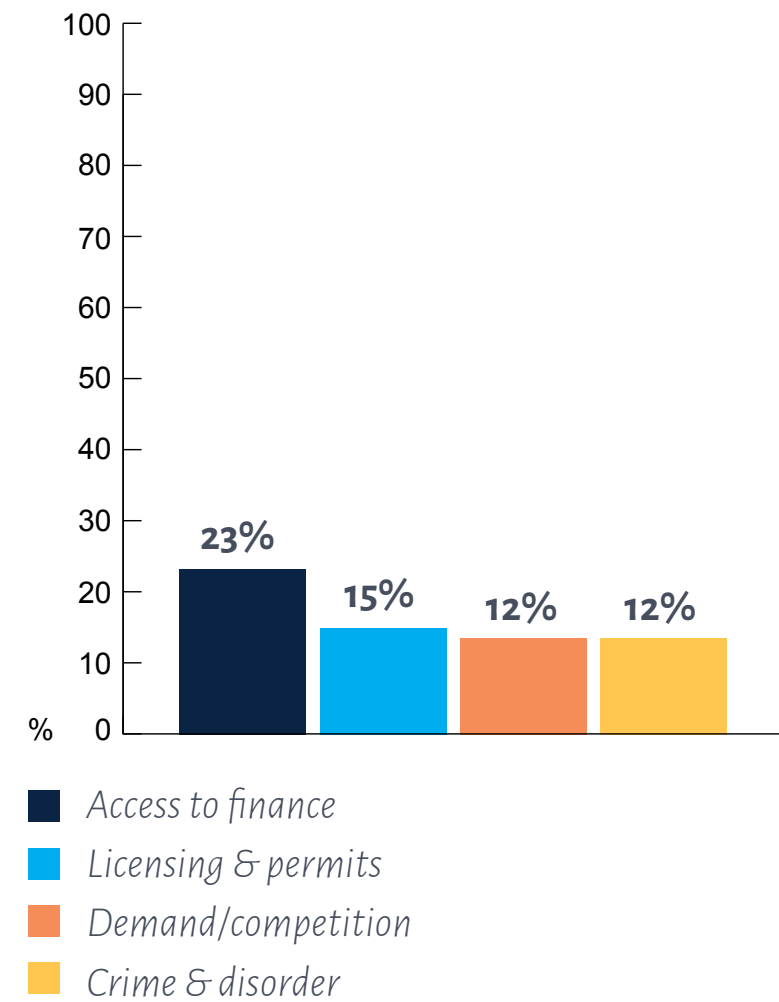
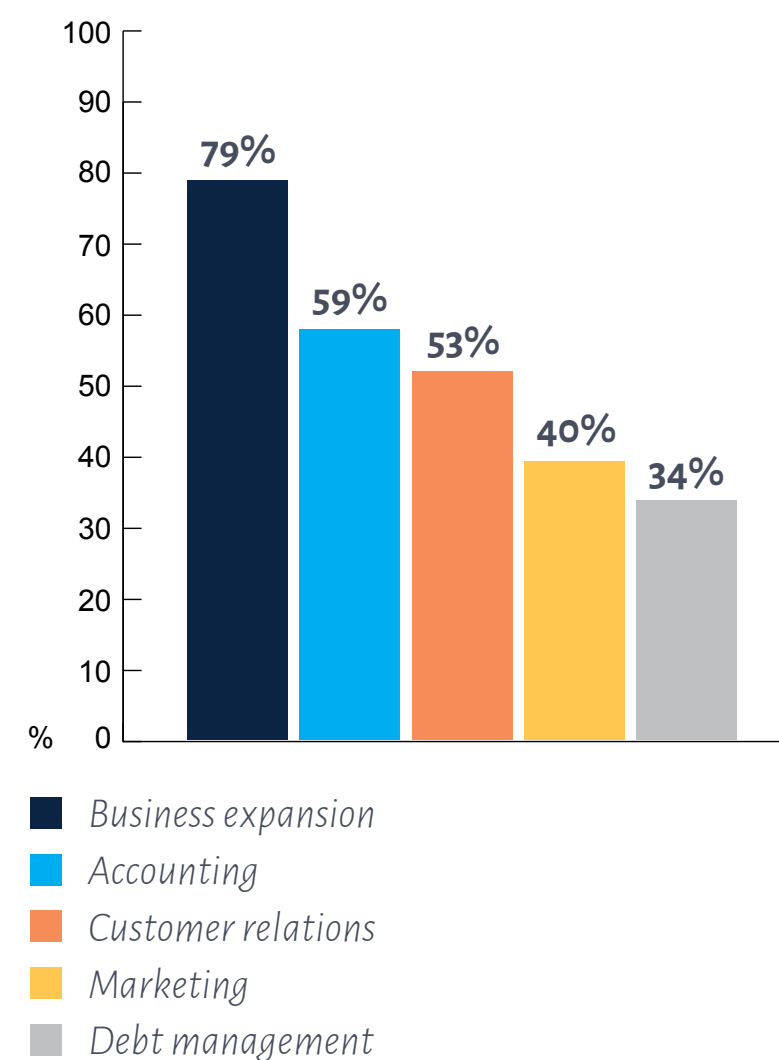


Figure 3: MSME training needs
% of MSMEs that expressed a need for training on respective topics, multiple answers possible



Enabling environment: recent developments support MSME lending

Uganda's business environment is slowly improving as the government tries to digitize government services, improve infrastructure and remove regulatory barriers. With the onset of the COVID-19 pandemic, several online systems were deployed to serve businesses electronically such as new company registrations and business name registration. However, among business owners, there is a lack of understanding of new procedures when it comes to starting a business. Also, the online systems remain nascent and subject to frequent network breakdowns⁹.

Even prior to the COVID-19 pandemic, Uganda had simplified tax registration through the introduction of an online system. The Uganda Registration Services Bureau and Uganda Investment Authority are working to create a one-stop centre for tax registration services. Various stakeholders in Uganda indicate that the government is also working to introduce tax incentives for MSMEs that will significantly reduce the cost of compliance¹⁰.

A positive development in terms of access to finance for MSMEs is the recent establishment of a collateral registry under the Security Interest in Movable Property Act 2019 and the Security Interest in Movable Property Regulations 2019 that came into force on 30 May 2019. The Act makes provisions for the creation, protection, priority, and enforcement of security interests in movable property. Albeit in its' initial stages, it is expected that the collateral registry will enable improved credit assessments and reduce the cost of borrowing in Uganda.

The establishment of a credit reference bureau in 2008 has also made it easier to access credit information and thus enabled lenders to more effectively conduct

risk assessments of clients. However, information from alternative data sources like utilities, retailers and others are still not part of the credit information eco-system. Additionally, knowledge and coverage of the credit bureau remains limited.

Of the MSMEs surveyed by IFC, 23 percent of respondents cited lack of access to finance as the biggest obstacle the firm was facing (see Figure 2). Regulatory constraints were less important, with 15 percent of respondents saying business licensing and permits was the biggest obstacle the firms were facing; 9 percent cited tax administration and rates; and only 1 percent cited labour regulations. Another significant obstacle was increasing competition and/or decreasing demand at 12 percent.

Support for the MSME market: limited uptake of non-financial assistance

The development of MSMEs is prioritized in several government policies and plans focusing on creating a business enabling environment, accelerating industrialization and business linkages, and enhancing productivity and modernization at the firm and household levels.

The MSME National Policy 2015-2025¹¹, for example, seeks to enhance MSME growth by addressing issues such as legal and regulatory mechanisms for competitiveness, formalization, cross-institutional collaboration to support MSMEs, access to technology, skills development, and access to finance. There are also several government procurement policies to encourage local consumption of MSMEs goods.

Uganda has various member-based organizations that advocate for MSMEs while providing business support services. The Federation of Small and

Medium Enterprises (FSME), for example, has 25,000 members¹². It provides advocacy, networking, business advisory services, and training. Incubators and accelerators provide space, product development, incubation, training and mentoring to MSMEs. Enterprise Uganda runs the UN-backed Empretec program to provide an integrated and comprehensive range of business support services for MSMEs¹³.

The reach of these support mechanisms for MSMEs in Uganda remain limited. Of the MSMEs surveyed by IFC, only 15 percent have benefited from government support, just over 30 percent have benefited from industry association initiatives, and only 0.1 percent stated that they had benefited from incubators. Figure 3 shows the training needs of MSMEs.

In terms of access to finance, the Agricultural Credit Facility (ACF) is an example of a joint public-private initiative to support MSMEs. The ACF was set up in 2009 by the government in partnership with financial institutions and the Uganda Development Bank to facilitate the provision of medium- and long-term financing to MSMEs in agriculture and agro-processing. Loans under the ACF are disbursed to farmers and agro-processors through the participating financial institutions at more favorable terms than are generally available under conventional loans. Most loans are above UGX 20 million (\$5,620), and demand for loans is three times the supply¹⁴.

⁹ Key informant interviews conducted in 2021

¹⁰ Ibid

¹¹ Ministry of Trade, Industry and Cooperatives (MTIC), Uganda Micro, Small and Medium Enterprise (MSME) Policy - Sustainable MSMEs for Wealth Creation and Socio-Economic Transformation, June 2015

¹² FSME website, 2021

¹³ Enterprise Uganda website, 2021

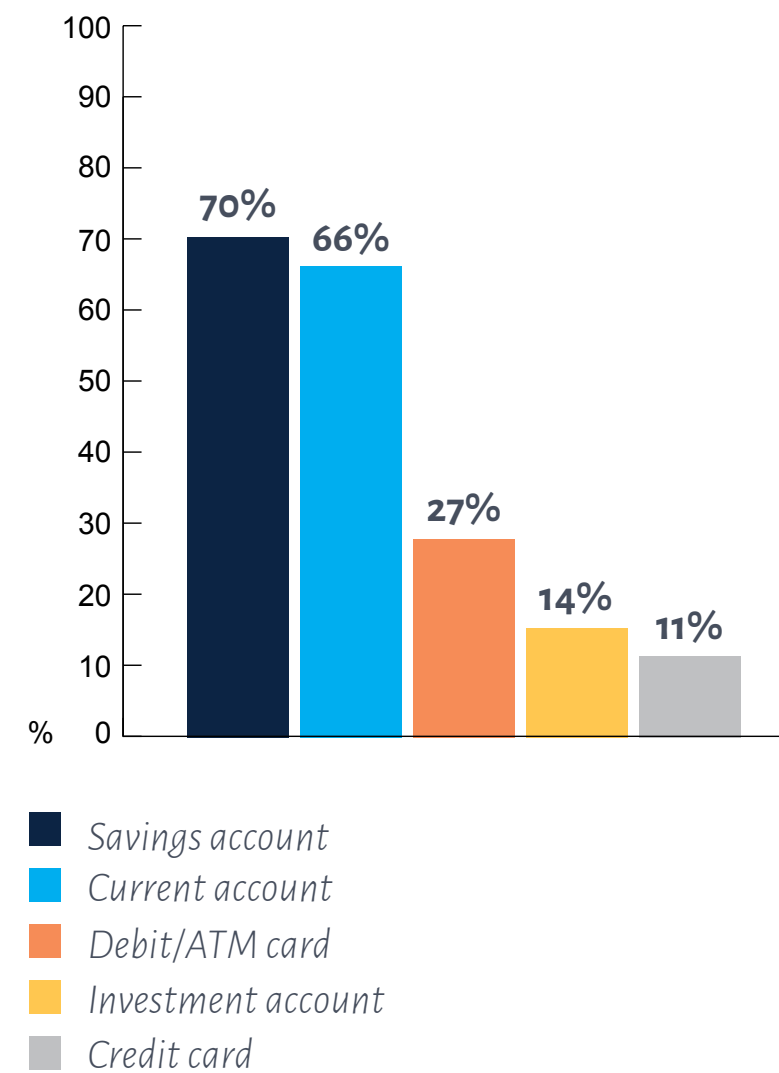
¹⁴ Bank of Uganda website, 2021

03

Market Insights

70 percent of MSMEs have unmet demand for credit

Figure 4: MSME bank product use
% of MSMEs that use a given bank product, multiple answers possible



MSME market size

There are an estimated 1.1 million MSMEs across almost all sectors of the economy¹⁵, contributing close to 20 percent of GDP and generating over 2.5 million jobs¹⁶. The majority of these businesses are informal micro entrepreneurs, but about a third of all MSMEs are more formalized and about 7 percent are classified as small- or medium-sized enterprises with annual turnovers of 10-360 million UGX (\$2,800-101,150; for detailed definitions see page 14)¹⁷. Most businesses are typically family-owned sole proprietorships, and their business lifespans are short. Only 30 percent of businesses have been operating for longer than three years¹⁸. It is estimated that about 70 percent of all MSMEs in Uganda have unmet credit needs¹⁹.

Among those MSMEs surveyed by IFC, close to 90 percent of formal MSMEs have a bank account and the same is true for just over 40 percent of informal enterprises. A further 20 percent of informal businesses have a bank account but do not use it for business purposes. Most of the businesses that are banked either have a savings or current account or both (see Figure 4). Most businesses do not use any finance product or service offered by their banks. Only 10 percent of surveyed businesses had access to a bank loan or line of credit.

The majority of the MSMEs surveyed said that access to finance was one of the biggest obstacles they faced. Access to finance seems to be more of an obstacle for micro-sized businesses with 31 percent of micro businesses citing it as their biggest obstacle, compared to 21 percent for small-scale enterprises and 10 percent for medium-sized ones. Lack of collateral and credit histories are common barriers to accessing finance for MSMEs. High interest rates are another barrier commonly mentioned.

The surveyed MSMEs also revealed the amounts they would want to borrow in the near future. Using these results to calculate an average loan size demanded by MSMEs in Uganda, the size of the demand for credit by MSMEs in Uganda is estimated to be worth UGX 31.4 trillion (\$8.8 billion). Based on this methodology, the segments with the highest number of MSMEs are estimated to have the greatest demand for credit at an aggregate level. These segments are micro enterprises, medium enterprises, and MSMEs in the trade and hospitality sector.

MSME market characteristics

The majority of Ugandan MSMEs are concentrated in the services sectors, mainly in the trade and

accommodation and the food services sectors, as well as the personal and recreational services sector. These sectors have the highest proportion of micro enterprises. MSMEs in agriculture are mainly micro enterprises (71 percent), but with a significant share of small enterprises (18 percent). MSMEs involved in the food processing and manufacturing sectors are mainly micro enterprises (86 percent), with the sector also contributing a significant share to the overall number of MSMEs. MSMEs in sectors such as construction, financial and insurance services, as well as education, health, and social services are relatively larger businesses²⁰.

Ugandan MSMEs are concentrated in Kampala and the Central region, which also contribute the largest share to GDP²¹. These MSMEs are predominantly engaged in trade related services, tourism, education, and cash and food crop production in the agricultural sector.

The following sections cover the characteristics of MSMEs in the agriculture, construction, and tourism value chains, which together contribute about 52 percent of Uganda's GDP. These value chains were chosen because they are very distinct, but also traverse several sectors.

¹⁵ Siemens Stiftung, *Social Enterprises as Job Creators Country Profiles, 2020*

¹⁶ Ibid

¹⁷ Genesis Team Analysis, 2021

¹⁸ MicroSave, *MSME Finance in Uganda – Status and Opportunities for Financial Institutions, 2017*

¹⁹ Ibid

²⁰ Genesis Team Analysis estimates, 2021. These estimates are based on the Census of Business Establishments (COBE) 2010/11 data on the sector split of MSMEs in Uganda and average year-on-year growth rates per sector between 2014 and 2019.

²¹ Genesis Team Analysis estimates, 2021, based on the regional distribution of MSMEs reported in COBE 2010/2011 and analysis based on regional contribution to GDP as reported in the USAID report on *Estimating District GDP in Uganda*

MSMEs in the agricultural value chain

Uganda’s agricultural potential is not yet fully realized with only about 35 percent of arable land currently in cultivation²². Yet, the agricultural sector plays an important role in the economy and about 70 percent of Ugandans depend on agriculture for their livelihoods²³. Manufacturing, specifically agro-processing, is a key focus of the government’s economic development plans and will likely remain so in the medium-term.

The agricultural value chains for cash crops, food crops, and livestock cut across the primary, secondary, and tertiary sectors and include traditional farming activities, agro-processing, chemical manufacturing, and trade. MSME activity in the agricultural value chain is mainly concentrated in the inputs, processing, distribution, and retail stages.

Of the 84 MSMEs in IFC’s survey that were active in the agricultural sector, exactly half said the business was

growing slowly. About a quarter, 23 percent, described the business as growing fast, while 21 percent said the business was stable/mature. Only 6 percent were starting up and none were downscaling (see Figure 5).

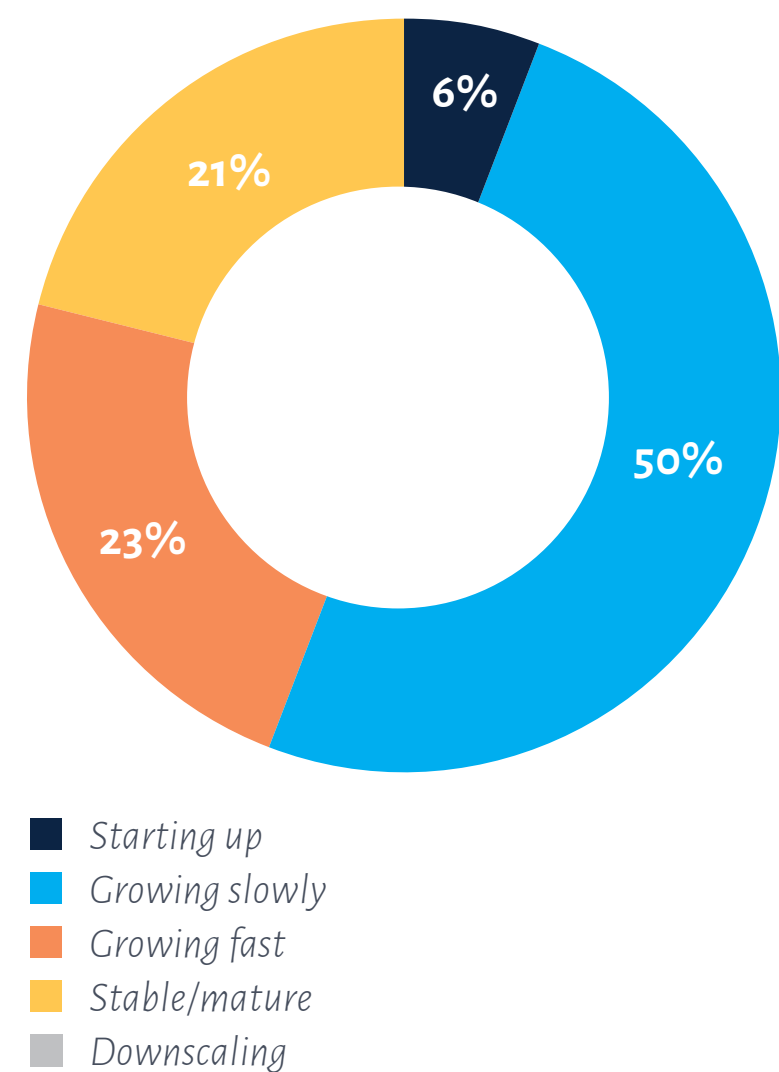
IFC’s survey shows that a lower share of MSMEs in the agricultural sector are banked; 61 percent as compared to 73 percent for MSMEs generally. A lower share of agribusinesses got financing through a bank loan or an MFI (19 percent vs 31 percent) while more got capital from their own savings (24 percent vs 17 percent). A majority of respondents said they consider seeking finance for the business (76 percent), with 48 percent expressing a need for restructured loans and 29 percent requiring short term capital in response to the COVID-19 crisis.

Microfinance Deposit Taking Institutions (MDIs) and MFIs issue the highest number of loans to MSMEs in the agricultural value chain. Of those MSMEs surveyed that access financing from commercial banks, two thirds

use one of three banks serving clients in this sector²⁴. An analysis of the survey results in relation to other factors in the value chain suggests the potential for MSME finance is biggest in the primary and complete processing stages, as shown in table 1.1.

The majority of banked respondents in the agriculture sector make use of a savings account or current account (both 71 percent), while 41 percent use a debit card and 22 percent an investment account (above average). In terms of channels, MSMEs in the agriculture value chain primarily make use of bank branches (92 percent), ATMs (45 percent) and bank agents (33 percent). Just under a fifth of MSMEs in this sector (18 percent) make use of mobile banking, and 12 percent use internet banking.

Figure 5: Business state among surveyed MSMEs in the agri sector
% of MSMEs that described their business as expanding, stable or downscaling



22 FAO, Food and Agricultural Organization Statistics (FAOSTAT), 2020
 23 UBOS, Uganda Statistical Abstract, 2020
 24 The graphic reflects Genesis Team Analysis, based on IFC survey results and UBOS Statistical Abstract, 2021

Table 1.1 MSME financing in the agricultural value chain

	1. AGRICULTURAL INPUTS	2. PRIMARY ACTIVITY	3. INTERMEDIATE PROCESSING	4. COMPLETE PROCESSING	5. DISTRIBUTION AND RETAIL
Presence of MSMEs	Moderate	Low	Moderate	Moderate	High
MSME funding need					
MSME financial / non-financial needs	Training and skills development	Assistance in managing finances for cyclical businesses	Training and skills development	Training and skills development	Support to expand their business

Not a need → An urgent need

MSMEs in the tourism value chain

The tourism industry in Uganda accounts for 7.8 percent of GDP and 6.7 percent of total employment²⁵. Much of the tourism is international ecotourism at high value per traveler. Business travel is also an important component, particularly in Kampala, and accounts for some 40 percent of total tourism receipts and 17 percent of arrivals²⁶.

Compared to neighboring Kenya and Tanzania there could be room to expand the Ugandan tourism sector. In Kenya and Tanzania, 75 percent of visitors come for leisure. These countries also receive three and six times more visitors from Europe than Uganda does²⁷.

MSMEs are active in all parts of the tourism value chain; tour operators, transportation, accommodation, restaurants, and excursions. Most of the tour operators are MSMEs, though the market for Ugandan-based actors is limited by international competition. Most MSMEs

operating in the transportation stage of the value chain are likely micro and informal. In the accommodation stage there are smaller hotels and B&Bs, most of which are medium to small businesses. There are many MSMEs in the food services industry, operating as restaurants and caterers. Most businesses operating in the excursions and discretionary expenses segment are also MSMEs.

Most MSMEs in the tourism sector surveyed by IFC are small businesses (70 percent) followed by medium (23 percent) and micro businesses (7 percent), 58 percent of whom were owned by men and 42 percent by women. More businesses said they were growing fast (35 percent) than growing slowly (33 percent), while 22 percent said they were stable/mature. Eight percent were starting up and only 1 percent was downscaling (see Figure 6).

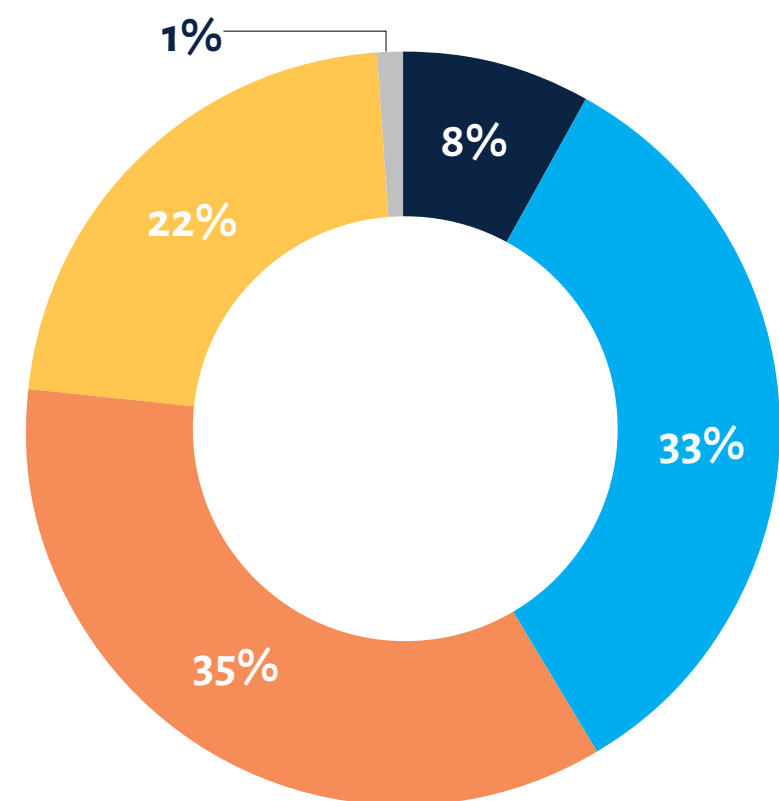
Of the firms in the tourism sector surveyed by IFC, just over 70 percent of MSMEs in the accommodation and restaurant sectors are banked. The majority only use basic

transaction and investment accounts such as checking and savings accounts. Across the stages of the tourism value chain, MSMEs express a need for loan restructuring, short-term working capital and long-term funding, as well as business training and skills development.

In terms of channels, MSMEs in transport and accommodation sectors primarily make use of bank branches (91 percent and 93 percent respectively), bank agents (39 percent for both), and ATMs (39 percent and 37 percent). Fewer make use of mobile banking (17 percent and 13 percent) and internet banking (13 percent and 10 percent).

An analysis of the survey results in relation to other factors in the value chain suggests the potential for MSME finance is biggest among travel agents, transport companies and firms offering excursions or similar, as shown in table 1.2²⁸.

Figure 6: Business state among surveyed MSMEs in accommodation, food and entertainment
% of MSMEs that described their business as expanding, stable or downscaling



- Starting up
- Growing slowly
- Growing fast
- Stable/mature
- Downscaling

25 World Bank, Data Indicators, 2021
 26 International Growth Centre, COVID-19 and Uganda's tourism sector, 2021
 27 Ibid
 28 The graphic reflects Genesis Team Analysis, based on IFC survey results, UBOS Statistical Abstract, 2021, and World Bank Data Indicators, 2021

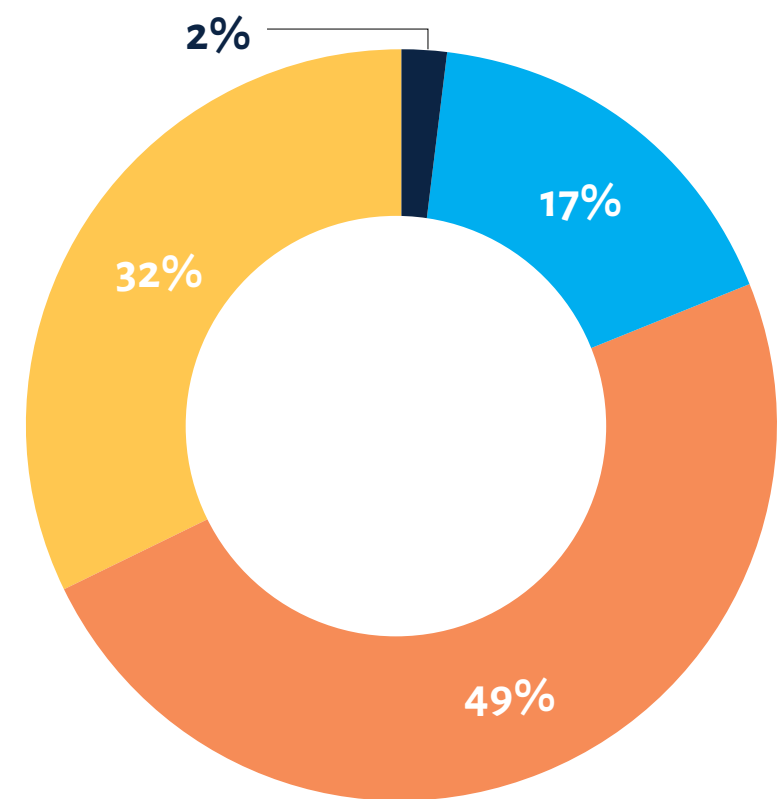
Table 1.2 MSME financing in the tourism value chain

	1. TOURISM SERVICES (Travel agents etc)	2. TRANSPORT	3. ACCOMMODATION	4. RESTAURANTS	5. EXCURSIONS & DISCRETIONARY EXPENSES
Presence of MSMEs	Low	High	Moderate to high	Moderate to high	High
MSME funding need	●	◐	◑	◒	◓
MSME financial / non-financial needs	Tailored market intelligence, digital skills development	Support to expand their businesses	Training and skills development	Training and skills development	Support to expand their businesses

Not a need ○ → ● An urgent need

Figure 7: Business state among surveyed MSMEs in construction

% of MSMEs that described their business as expanding, stable or downscaling



- Starting up
- Growing slowly
- Growing fast
- Stable/mature
- Downscaling

29 The Uganda Report, 2018.

<https://uganda.the-report.com/>

30 Centre for affordable housing and finance, Uganda's Housing Construction and Housing Rental Activities, 2020

31 The graphic reflects Genesis Team Analysis, based on IFC survey results, Centre for affordable housing and finance: Uganda's Housing Construction and Housing Rental Activities, 2020, and 2019 Baseline Assessment of Development Minerals in Uganda, 2018.

MSMEs in the construction value chain

Uganda's construction sector has been growing rapidly over the past decade. This growth in the construction sector is largely attributed to an accelerated rate of public investment in energy and infrastructure. The upward trend in public investment is consistent with the strategy outlined in the National Vision 2040 and the second National Development Plan, which focus on addressing infrastructure deficits and to build production facilities in preparation for exploitation of the country's oil resources. Estimates from the Petroleum Authority of Uganda put the total value of investments that will be made over the next three to five years at over \$20 billion²⁹. These will include the construction of an oil refinery, an oil export pipeline, a new international airport, and regional road networks.

Growth in the construction industry is also driven by Uganda's growing population, which offers significant scope for construction of residential dwellings.

In 2019, just under 60 percent of the plans submitted were approved for residential buildings while close to 29 percent were approved for commercial buildings³⁰. There is a high presence of MSMEs in the mining and quarrying stage of the value chain, medium presence of MSMEs in the manufacturing stage, mainly in metal works, and a large number of informal real estate agents in the final stage of the value chain.

Close to half of the surveyed MSMEs in the construction industry, 49 percent, said they were growing fast and 32 percent said they were stable or mature (see Figure 7). Only 17 percent said their businesses were growing slowly, and none were downscaling. Almost all of the sampled MSMEs in the construction industry, 92 percent, are banked. Of those that didn't have a bank account, 40 percent said it was because they do not trust banks. The majority of banked MSMEs only used basic transaction and investment accounts such as checking and savings accounts.

A majority of MSMEs consider seeking finance for their businesses (80 percent or more depending on sector), primarily to expand the business. In response to the COVID-19 crisis, surveyed MSMEs in this value chain expressed a need for restructured loans, short term capital and long term financing. Only a very small number said they had no financing needs. An analysis of the survey results in relation to other factors in the value chain suggests the potential for MSME finance is biggest in the mining and construction industries, as shown in table 1.3³¹.

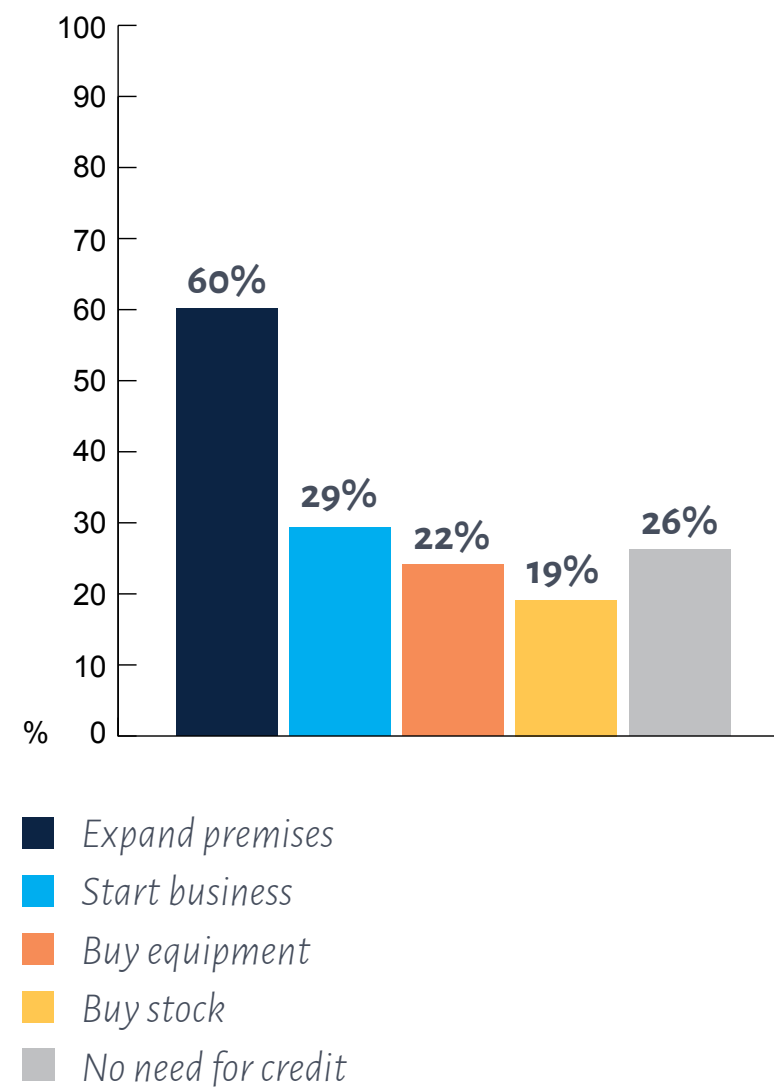
Table 1.3 MSME financing in the manufacturing value chain

	1. MINING AND QUARRYING	2. MANUFACTURING	3. BUSINESS SERVICES	4. CONSTRUCTION	5. REAL ESTATE
Presence of MSMEs	Moderate	Low	Moderate	Moderate	High
MSME funding need	●	◐	◑	●	◐
MSME financial / non-financial needs	Training and skills development	Assistance in managing finances for cyclical businesses	Information on business tips and support services	Information, Training and skills development	Information, Training and skills development

Not a need ○ → ● An urgent need

04

Figure 8: Purpose for borrowing in the future
% of MSMEs that mentioned respective reasons for taking out a loan in the future, multiple answers possible



³² Genesis Team analysis based on Moody's Analytics Bank Focus 2021, BoU Financial Stability Report June 2019, BoU Banking Statistical Report 2019, BoU Banking Statistical Abstract 2019, GIIN The Landscape of Impact Investing In Uganda 2015, CIIP Financing of Small and Medium-Sized Enterprises in Uganda 2016, and financial statements, annual reports and websites of relevant financial institutions.

³³ Bank of Uganda, Financial Stability Report, June 2020

³⁴ MSME share of loans is estimated using the average share of MSME loans to total gross loans of eight banks, with information sourced from Moody's Analytics Bank Focus, 2021, Financial Statements and Annual reports of Banks, and Bank of Uganda Financial Stability Report June 2020

MSME Financing

Scope to build supply of MSME finance

The IFC survey confirms that micro-enterprises make less use of business accounts and have lower uptake of financial products and services. This market segment is currently primarily served by microfinance institutions. MSMEs that are formalized and larger in size make use of a broader range of financial products and services, and a higher portion source financing from commercial banks.

In 2019, the financial sector in Uganda supplied an estimated UGX 6.1 trillion (\$1.7 billion) in financing to MSMEs³². Commercial banks dominate the financial system, accounting for over 70 percent of financial assets and contributing the largest share of MSME finance supply³³. In practice, bank lending to MSMEs remains limited in comparison to overall loan portfolios. In 2019 lending to MSMEs only represented 17 percent of total loans outstanding³⁴.

Demand for MSME financing

The IFC survey shows that bank account ownership among MSMEs is higher among larger, formal, urban-based and male-owned MSMEs. Account ownership is higher in larger industry sectors. Conversely, the use of retail accounts for business transactions is higher among smaller, informal, female-owned, and rural MSMEs. This practice is also more prevalent in the service sectors. The

main bank channels used by MSMEs are branch tellers, bank agents, and ATMs. The use of alternative channels is higher among MSME segments that use retail accounts more, such as micro, informal, female-owned, and trade-sector MSMEs.

Cash is the prevalent payment acceptance instrument among MSMEs. Its use is higher among smaller, informal and women-owned MSMEs. Its use is also high in the trade and hospitality sector. The survey not only revealed a high acceptance of cash payments by MSMEs, but also a preference for cash use and acceptance among MSMEs. This preference is driven by the ease of using cash and the speed of settlement of cash transactions.

More than half of the sampled MSMEs were not using any credit products. The share of MSMEs not using credit products was highest among informal, micro, female-owned MSMEs as well as MSMEs in the education and professional services sector. The main credit products used by those accessing formal credit were working capital finance and term loans. MSMEs are primarily seeking finance to expand the business (see Figure 8).

Infographic 2 on page 10 highlights some of the the key factors required to analyze the opportunities for MSME

finance in Uganda. The opportunity for formal financial institutions to grow their MSME businesses within the major MSME segments can be assessed based on the number of MSMEs, the general uptake of formal financial services, and the effort that would be required to effectively serve each segment. Based on these criteria, formal SMEs presents a given opportunity. These kinds of MSMEs are fairly common and are growing. They have a moderate uptake of electronic payments and some use alternative banking channels.

On the sectoral side, the greatest opportunity to generate income from transaction processing (i.e. non-interest income) lies in the sectors with high volumes of retail payments – trade, hospitality, and the education sectors. To unlock these opportunities will require a great deal of innovation, more so in the competition with cash as a payment instrument. With the right partnerships and innovations, digital payment and finance tools can be developed. Because of their convenience and efficiencies, they compete with cash and they enable financial institutions to serve MSMEs more effectively.

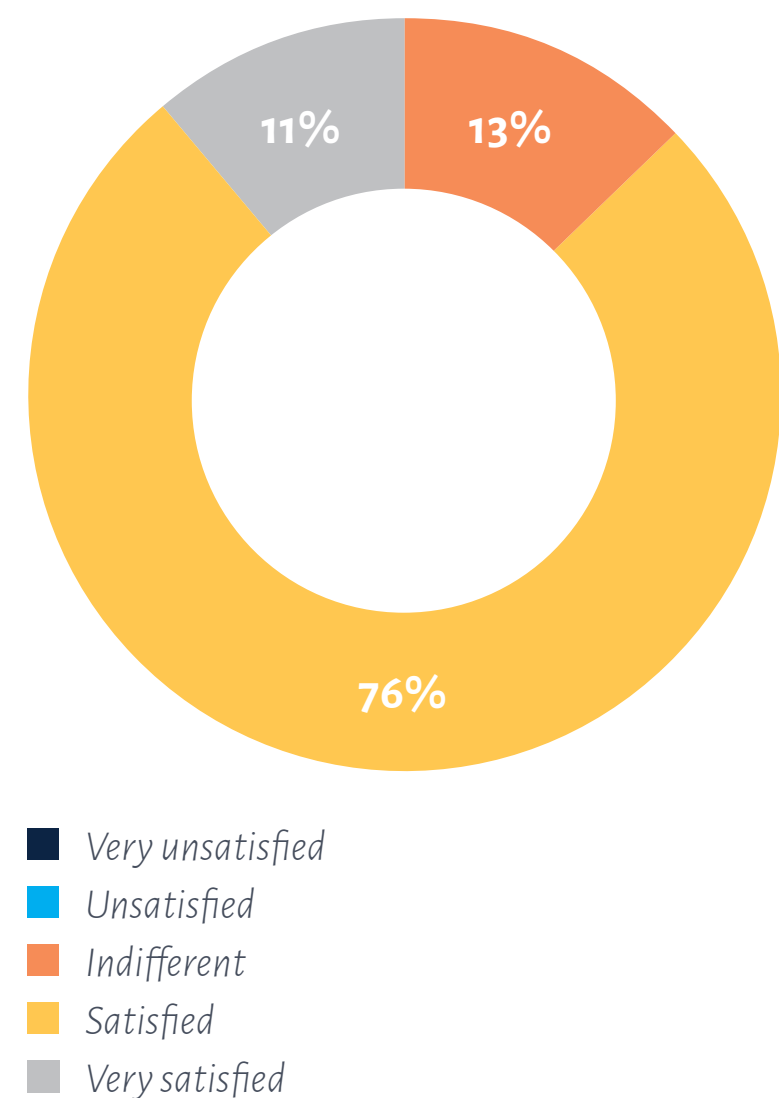
Infographic 2

Opportunities for MSME finance in Uganda

MSME Segment	Prevalence	Uptake of transaction services	Uptake of formal FI financing	Effort required to serve segment	Current penetration by banks
Micro	Very High				
Small	Moderate				
Medium	Low				
Formal	Moderate				
Informal	High				
Female owned MSMEs	Moderate				
Male owned MSMEs	High				
Agriculture	Low				
Manufacturing	Moderate				
Construction & real estate	Low				
Trade	Very High				
Hospitality	High				
Professional Services	Low				
Education	Low				

Figure 9: Level of satisfaction among banked MSMEs with their bank

% of MSMEs that expressed respective satisfaction levels



35 Moody's, *Analytics Bank Focus*, 2021; *Financial Statements and Annual reports of Banks; Bank of Uganda, Financial Stability Report*, June 2020

36 Bank of Uganda, *Financial Stability Report*, June 2020

37 Bank of Uganda, *Working Paper No. 06/2018, What Explains High Lending Interest Rates in Uganda*, June 2019

38 Bank of Uganda, *Banking Statistical Abstract*, 2019

Supply of MSME financing

Some of the large financial institutions in Uganda have an MSME offering, however, this lending is mostly to medium and large enterprises. Six of the 13 largest banks have a high focus on MSME clients, while a further three have a moderate focus on MSMEs. Four banks have a low or no focus on MSMEs³⁵.

The banking industry mainly lends to the construction and real estate sector (21 percent), households (18 percent) and trade and commerce sectors (17 percent), making up 54 percent of the loans from banks to the private sector. This is followed by the manufacturing sector (13 percent), agricultural sector (12 percent) and community and social services sector (8 percent). The transport and communication sector makes up 5 percent of total lending to the private sector and the mining and quarrying sector makes up 4 percent³⁶.

Smaller, MSME-focused banks in Uganda have lower efficiency ratios with high operating costs and high dependence on interest-bearing assets to cover overheads³⁷. A key contributor to this is the higher cost of serving MSMEs, more so on the lower end of the market, due to a low uptake of digital channels. Leading banks focusing on MSMEs are, however, able to achieve reasonable overall values for cost to income, non-performing loans, and net interest margin. In general, financial institutions that most successfully serve MSMEs offer well designed products tailored to the needs of different segments, level a degree of automation to run efficient operations, price appropriately to cover costs and still remain competitive, incentivize

field staff to boost productivity, and build strong credit underwriting skills to ensure portfolio quality.

Overall, banks offer relatively basic MSME products with limited tailoring for women entrepreneurs or the agricultural sector. Of the top eight commercial banks serving the MSME segment, only four offer specialized products to MSMEs in, for example, the agricultural sector, and none offer specialized products to women-owned businesses.

MFIs and MDIs are becoming important providers of financial services to MSMEs. Credit institutions extended over UGX 420 billion (\$115 million at the time) to MSMEs in 2019, while MDIs extended UGX 367 billion (\$100 million at the time) in loans to MSMEs the same year³⁸. Jointly this accounts for 34 percent of the amount of credit extended to MSMEs by commercial banks, which was approximately UGX 2.3 trillion (\$627 million at the time). Most of this lending was concentrated in the trade and agricultural sectors.

MFIs use informal and underdeveloped credit scoring models with much of the lending approach being relationship based. High operating costs result in high cost to income ratios and low profitability. MFIs and MDIs tailor their products to meet individual client needs. However, generally they offer short term loans and agriculture loans with limited leasing or gender specific products.

Fintechs are not authorized to offer loans to MSMEs, however, they can partner with local mobile network

operators and financial institutions to provide digital solutions that improve efficiency in serving clients. There are a couple of fintechs in partnerships with MNOs targeting semi-formal MSMEs offering fast and unsecured working capital loans based on algorithms assessing behavioural data to judge credit worthiness and disbursing loans via mobile money. Other fintechs offer digital loan repayments or focus on the special needs of MSMEs in the agricultural sector.

IFC's survey shows that formal and informal businesses mainly choose a bank based on consistently good service or based on recommendations by other business owners. Service and location are important factors when choosing a bank, and MSMEs also tend to choose the same banks that the customers of the business use.

Bank branches are the main method of connecting to a bank, followed by bank agents and ATMs. Almost half of respondents (49 percent) would consider opening a savings or checking account via a mobile app or a bank agent, while only 11 percent would want to apply for a loan through a mobile app.

A large majority, 87 percent, of respondents are satisfied or very satisfied (11 percent) with their current bank (see Figure 9), and 69 percent said they are likely or very likely to recommend their bank to another business. The surest way to improve bank customer satisfaction would be to reduce rates and fees.

05

Serving the MSME market in Uganda

Conclusions and recommendations

To fully realize the potential of Uganda's over one million MSMEs and their contribution to the economy, they need better access to finance. In order to increase MSMEs' access to finance in Uganda, public authorities and private sector actors can take several approaches. For financial services providers in Uganda, this translates into an opportunity to build the MSME finance market and make a sustainable contribution to the business community and the economy.

Measures to improve access to finance for MSMEs center around five areas that cut across various dimensions that are necessary for MSME growth and development.

i. Addressing the quality and accessibility of credit information will support the ability of financiers to assess MSMEs' creditworthiness.

Lack of traditional and alternative credit information makes scoring of credit applicants difficult, which adds to the real and perceived risk of lending to MSMEs. Similarly, collateral is a key barrier for MSMEs to access financing. This is due to the lack of ownership of fixed assets as well as the lack of recognition of movable or alternative assets.

Finding alternatives to traditional lending based on fixed collateral and creating the regulatory and institutional frameworks to support such lending methods can enable MSMEs to access the resources they require to launch, operate, and grow their businesses. An important step towards this is to improve awareness and usage of credit bureaus and the collateral registry.

Recommendation for government and public authorities:

- Prioritize ongoing and planned projects to improve MSME credit information sharing. This will support the financial sector to better serve the banking needs of MSMEs, support value-chain development and inform business linkages.
- Implement and enforce policy to report full file credit information to credit reporting service providers.

- Allow for the integration of the credit information system with other public databases (i.e., business registration, insolvency, collateral registries, the National Identification and Registration Authority (NIRA), utility companies and court records)
- Expand information sharing through onboarding of non-bank financial institutions that are not currently submitting information to the bureau.
- Support the adoption and usage of alternative data, including mainstreaming sharing of for example utility data with bureaus, for credit decision making and portfolio performance monitoring.

Recommendations for financial institutions

- To actively work with the Bank of Uganda, Credit Bureaus and the Security Interest in Movable Property Registry System (SIMPO) to provide capacity and increase awareness and usage of these tools among existing and potential MSME clients.
- Support the adoption and usage of alternative data for credit decision making and portfolio performance monitoring through the digitization of MSMEs and development of alternative data scoring models.
- Support the implementation of cashflow-linked agriculture risk assessment solutions for efficient assessment of agriculture lending risks that enable expedited lending decisions by financial institutions.
- Expand information sharing from non-bank financial institutions providing support to small lenders to adopt technology to digitize their operations and submit data to the credit reporting service providers (CRSPs) through shared loan management systems.
- Leverage fintech and innovative technology tools to support the development or deepening of secondary markets for movable assets (i.e. marketplace platform - mobile and web application); capacity building; marketing and consumer awareness.
- Develop asset-based lending products such as invoice discounting and leasing.

ii. Addressing informality will support access to finance for MSMEs as well as revenue collection for the government.

The large number of informal enterprises in the MSME sector are often not banked nor do they keep proper record-keeping processes in the form of financial accounts or audited financial statements. As a result, loan origination and assessment processes are costly or unviable. This is especially true with micro-entrepreneurs.

Recommendations for government and public authorities:

- Prioritize and enhance ongoing efforts to improve usage and uptake of the online one-stop-shop center and registration process.
- Ministry of Finance to introduce tax incentives for MSMEs that could significantly reduce the cost of compliance and encourage formalization.

Recommendations for industry associations:

- Enhance ongoing efforts to provide business development services to MSMEs that include information on the benefits of formalization.

Recommendation for financial institutions:

- Work with public authorities, business associations and other relevant stakeholders to inform existing and potential MSME clients on the benefits of formalization.

iii. Increasing innovation and efficiency in MSME delivery models will reduce cost of serving the MSME sector:

High operational costs and inefficiencies prevent financial institutions from effectively serving the MSME market. Inefficiencies can be addressed along the customer journey, from marketing to loan repayments.

Recommendations for government and public authorities:

- Bank of Uganda to develop open banking regulations that support tech-integration and information-sharing among financial institutions and DFS providers.
- Increase interoperability in the DFS system to encourage more competition and innovation.

Recommendations for financial institutions:

- Explore non-traditional delivery channels and distribution arrangements and look into reaching MSME market through agent, electronic and mobile banking. This may include collaboration or partnerships with fintechs or other non-traditional market actors.

iv. Developing tailored financing products for MSME market segments can improve reach and sustainability.

MSME product offerings are quite standard with limited segmentation, particularly for women entrepreneurs and the agricultural sector. There is a need to design and implement new products based on market needs.

Recommendations for government and public authorities:

- Develop more risk-sharing arrangements with financial institutions to increase funding to specific MSME market segments.

Recommendations for industry associations:

- Provide information to financial institutions on the product needs of MSMEs along parameters such as industry, geography, asset size, turnover etc that can serve as a basis for financial institutions to explore tailored products for such market segments.

Recommendations for financial institutions:

- Develop tailored products and offerings for MSMEs, for both assets and liabilities offerings, as per the needs of key segments.

v. Improving the business services market in Uganda is crucial for MSMEs to access funding to grow their businesses.

While Uganda has a vibrant entrepreneurial business community, there is a need for quality business services to support Ugandan entrepreneurs to the next level. There are a number of business development services (BDS) providers in Uganda, but awareness of such services by MSMEs is low. There is also scope to improve the quality and depth of some of the BDS available to MSMEs.

Recommendations for government and public authorities:

- To scale the reach and impact of capacity-building initiatives to create an enabling support network of training institutions to provide customized training and mentorship programs for MSMEs. Key areas of focus should be financial literacy, governance, and market intelligence.

Recommendations for industry associations:

- Raise awareness of existing public and private sector BDS services to MSMEs through sensitization campaigns in partnership with government and industry.

Recommendations for financial institutions:

- To design appropriate non-financial services packages that will help to secure portfolios by building capacity of clients as well as serve as important marketing tools for financial products targeted at MSMEs.

06

How the research was done

This report is based on a survey of 833 MSMEs in Uganda conducted in the Central, Western, and Eastern regions in April 2021, in combination with 20 stakeholder interviews and desktop research of relevant reports and statistics.

The MSME definition in Uganda includes all types of enterprises irrespective of their legal form (such as family enterprises, sole proprietorships, or cooperatives) or whether they are formal or informal enterprises. The Uganda National Bureau of Statistics (UNBS) has adopted a categorization of enterprises based on the fulfilment of the minimum requirements of the following criteria: 1) number of employees, and 2) annual sales turnover. The table below shows this official definition by the UNBS³⁹:

Table 2.1: The Uganda National Bureau of Statistics definition of MSMEs

Indicator/ Size of the Enterprise	Micro Enterprises	Small Enterprise	Medium-size Enterprise
Annual turn-over (UGX)	<10M	10M-100M	100M – 360M
Annual turn-over (USD)*	<3K	3K- 27K	27K -97K
Employees	1-4	5-49	50-99

The World Bank and IFC have the following global definition of MSMEs based on number of employees, annual sales turnover, total assets and loan size proxies for micro, small, and medium-size enterprises.

Table 2.2: The IFC definition of MSMEs

Indicator/ Size of the Enterprise	Micro Enterprises	Small Enterprise	Medium-size Enterprise
Employees	<10	10<50	50-300
Annual turn-over (USD)	<100K	100K- 3M	3M -15M
Total Assets (USD)	<100K	100K<3M	3M-15M
MSME loan size proxy	<10K	10K-100K	100K – 1M or 2M

This report uses a combination of the above two sets of definitions to categorize enterprises by size. The definition of MSME size categorized by employee numbers takes the UNBS definition of micro enterprises but sets the upper limit of the definition of medium enterprises to be in line with the IFC definition. There is a large disparity between the two sets of definitions for the annual turnover criteria. To bridge this, the IFC definition by turnover was scaled down using the price level ratio of PPP conversion factor (GDP) to market exchange rate (34.8 percent). Thus the following definitions by number of employees and annual turnover was used to categorize MSMEs in this report.

³⁹ Ministry of Trade, Industry and Cooperatives (MTIC), Uganda Micro, Small and Medium Enterprise (MSME) Policy - Sustainable MSMEs for Wealth Creation and Socio-Economic Transformation, June 2015 *Average exchange rate in 2019 of 1 USD = 3,705 UGX and rounded off to the nearest thousand.

Table 2.3: Definition of MSMEs used in this report

Indicator/ Size of the Enterprise	Micro Enterprises	Small Enterprise	Medium-size Enterprise
Annual turn-over (UGX)	< 120M	120M – 3.5B	3.5B – 20B
Annual turn-over (USD)	< 35K	35K – 1M	USD 1M – 5M
Employees	< 5	5 - 49	50 - 300

The survey sample was skewed towards MSMEs that are more formalized and larger in size (40 percent were micro-enterprises; 44 percent small firms; and 16 percent were medium-sized firms). There were more male-owned firms (57 percent) than women-owned businesses (43 percent), and about two thirds of proprietors were between 30 and 49 years old. The sectors most prominently represented in the survey sample were wholesale and retail trade (14 percent), other service activities (14 percent), accommodation and food services (10 percent), agriculture (10 percent), manufacturing (9 percent), and health services (9 percent). The survey covered up to 300 questions on topics such as business performance, financial services, and financial literacy.

Additionally, in-depth interviews were held with 20 stakeholders representing the public, private, financial and NGO sectors to corroborate data and deepen understanding of the MSME market context. Stakeholder interviews covered topics such as how MSME policy priorities are translating into actions that benefit MSMEs, feedback that stakeholders are receiving from MSMEs on the support they need to access finance, and the benefits and challenges MSMEs encounter when working with financial services providers.

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Acronyms

	DEFINITION
ACF	Agricultural Credit Facility
BDS	Business Development Services
BoU	Bank of Uganda
CIIP	Competitive Industry and Innovation Program
COVID-19	Coronavirus 2019
DFS	Digital Financial Services
EU	European Union
FI	Financial Institution
GDP	Gross Domestic Product
GIIN	Global Impact Investing Network
GoU	Government of Uganda
ICT	Information, Communication and Technology
IFC	International Finance Corporation
IMF	International Monetary Fund

	DEFINITION
MDI	Microfinance Deposit Taking Institution
MFI	Microfinance Institution
MSME	Micro, Small and Medium Enterprises
NFS	Non-financial services
PE	Private Equity
PPP	Purchasing Power Parity
SACCO	Savings and Credit Cooperative Organization
UBOS	Uganda Bureau of Statistics
UGX	Ugandan shilling
UNBS	Uganda National Bureau of Statistics
UNCDF	United Nations Capital Development Fund
USD	United States Dollar
VSLA	Village Savings and Loan Associations



IFC Market Bites

IFC Market Bites is a series of reports based on comprehensive market assessments conducted by IFC's Financial Institutions Group to provide market knowledge and support financial inclusion in Africa.

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