Acta Universitatis Danubius
ŒCONOMICA

Pragmatic Policy Recommendations to the Challenges of Micro Finance Institutions in Uganda: A Case of Selected Districts in Uganda

Ben Ssembajjwe[1]

Abstract: The study was set to investigate the challenges facing microfinance institution with a case of four districts and propose policy recommendations in Uganda. These included Mpigi, Wakiso, Luwero and Mukono. The study was guided by two specific objectives; to examine the major challenges facing the Microfinance institutions and to propose policy recommendations. The study used both qualitative and quantitative method of analysis. Data was collected using a structured questionnaire from a total of 136 respondents who included credit officers, top management officers Responses were categorized based on likert scale and means were generated using SPSS as package for interpretation of findings. The views of the officials were qualitatively analyzed and conclusions were made. The results of the study indicated; lack of collateral security, high bank rates, less government support, lack of information about clients, limited management capacity, high default rates, inadequate loan funds and microfinance institution have turned out to be profit oriented, poor management capacity and loan diversion as challenges. The study recommended an increase in loan funds by mobilizing more saving and obtaining loans on lower interest rates, employment of qualified personnel and training the existing staff, encouragement of group lending, credit insurance and increased monitoring and supervision. Further study can be carried out in other areas of Uganda especially in a rural seeing.

Keywords. Microfinance; Challenges; Uganda

JEL Classification: G21; M21; I32

1. Introduction

MFIs came in response to failure by formal financial institutions to extend financial services to the poor because of high transaction costs involved. Poor people require small scale services that are not time consuming to provide relative to the cost of processing the services and they cannot provide deposits or collateral to secure loans (Kabeer, 2008), thus seeing micro finance as their savior. The microfinance industry

[1] Nelson Mandela University, South Africa, Address: University Way, Summerstrand, Gqeberha, 6019, South Africa, Corresponding author: ssemban@yahoo.com.

in Uganda is fairly new. The credit schemes started in mid the 1980s as simple components of social welfare program. They followed a project-oriented approach, disbursed credit at subsidized interest rates, had very poor repayment rates and they were therefore typically rather short-lived (IFAD, 2014). According to IFAD (2013), the first true microfinance institutions like FINCA and Uganda's Women Finance Trust (UWFT) appeared in the early 1990s. These, however, received significant client outreach and recognition in mid 1990s. With increased interest from donors and NGOs discovering that they could make a lasting impact on poverty alleviation by offering sustainable financial services, the microfinance industry began to take shape. Formal microfinance started in Uganda in the late 1980s through foreign funded NGOs. During the 1990s, the government developed interest in this sector and actively participated in credit delivery through a number of programmes. While these programmes had noble objectives, they were misrepresented, misdirected, and had little or no impact on the intended objectives. Microfinance has been increasing since 1996 when stakeholders formally came together. There has been nevertheless, inadequate and scattered information on the sector yet, the availability of accurate, complete, and timely information is critical for policy formulation and planning, policy monitoring, and prudent investment decisions Uganda Bureau of Statistics (2010) in Uganda, Microfinance has been enlarging since 1996 when stakeholders formally came together but there was inadequate and scattered information on the microfinance sector industry. There was a general and widespread belief that microfinance services were accessible to the rural population mainly through Burial Societies, 'Merry-go-rounds', Rotating Savings and Credit Associations (ROSCAs), and Accumulating Savings and Credit Associations (ASCAs). At the same time, it was emerging that the provision of microfinance was rapidly becoming institutionalized and delivered through specialized Micro Finance Institutions (MFIs) such as FINCA-Uganda, Uganda Microfinance Union, Opportunities Uganda and Finance Trust Bank. According to the Status Report For Uganda (2006), the viewing of private sector as the most important contributor to economic growth by the government of Uganda further made microfinance to become a key issue for Ministry of Finance and Economic Planning (MFPED) as well as Bank of Uganda (BoU), as both made themselves acquainted with national and international experiences and practices in this field. The establishment of training and technical assistance to MFIs by Center for Microfinance in key areas including; loan tracking, interest rate setting, business planning, product development, and ownership and governance provided valuable capacity building to the microfinance industry (Karlan, etal 2014). The emergence of further strong collaborative efforts among donors, government, the central bank, practitioners and capacity building providers resulted into the full microfinance institution which is exists in Uganda today (Grameen Foundation, 2014). Although it has been seen to be a new growth in Uganda's economic industry, the micro finance industry has continued to develop over time with the establishment and growth of institutions responsible for the regulation and supervision of the micro finance sector. Such institutions include AMFIU which is the main organization in ensuring the growth of micro finance institutions in the country. According to AMFIU (2013), the setup of the Association of Micro Enterprise Finance Institutions of Uganda (AMFIU) in 1997, helped to serve as a practitioner platform to share experiences and technologies and act as a lobby and advocacy body for Ugandan MFIs. Currently, a significant number of MFIs have taken important steps towards professionalization and transformation into well organized, well-managed and commercially viable institutions that provide financial services to an increasing number of clients with proven poverty reducing impact (DFID Uganda, 2012). Further, this has been supported by the favorable environmental conditions in which the Ugandan microfinance industry has thrived over the past years. These include; macroeconomic stability, strong and competent MFIs, practitioners and donors committed to best practices, MFIs with international alliances, and a largely supportive government and a constructive cooperation among stakeholders. MFIs have been noticed to be expanding over years. In the mid and late 1990s, different microfinance stakeholders felt it wise that the micro finance industry needed clear coordination. It was not until 1996 when different stakeholders, most especially the donor agencies which used to finance the activities of micro finances, initiated the idea of coordinating the activities of the industry. To make this a reality, the MFIs which were there by then such as FINCA, UWFT and Cooperative Bank decided to be the spear headers of the association so as to see that the activities of the industry would be boosted. This was done with the help of already developed micro finance industries from Latin America and South-East Asia. In 1998, the then Cooperative Bank Agencies liaised with the government to come up with a concept paper, meetings were made tirelessly and an agreement was reached and this marked the birth of Association of Microfinance in Uganda (AMFIU). This was done to ensure that there could be an increase in the level of outreach maximization for the industry. It was launched in 1997 although it never had a physical address. Therefore, it consolidated its position as the micro finance network organization in Uganda. In the year 2000, it managed to secure grants to cater for both operational and administrative staff. Currently, it is the most developed and strongest micro finance network organization in sub Saharan Africa. Kalyango (2004) states that by April 2004, the Association had 97 members of MFIs, 80 MFIs, 16 associate members 1bank representing over 90% of the microfinance sector in terms of outreach and MFIs were active in 52 out of 56 districts in Uganda which were there by then. By 2009, the member institutions were 117; these constituted 79 MFIs as ordinary members. These included formal banks, credit institutions, non-deposit taking MFIs and SACCOs. Others were associate members which included regional organizations, wholesaler of funds, individual people, private sector and development centers**.** MF Transparency (2011) its membership is low due strict eligibility criteria, which depend on some minimum standards. MFIs under this association by 2008, was estimated to be serving almost 1.6 million people as savers and 450,000 active borrowers of which 69% were female. In more than 20 years, Uganda's Microfinance Industry has grown from an insignificant sideline to a key subsector in the economy. The clientele during this period increased from below 300,000 to over, 3.5 million due to the adaptation of international sound practices and stakeholder's cohesion (AMFIU, 2008). Microfinance Transparence (2011) revealed it out that the microfinance sector is considered as the most vibrant and successful in Africa. This has been attributed to government's enabling environment, macro-economic stability, the weakness of the formal financial sector, sound donor commitment, strong capacity builder stakeholder coordination and health competition. The interplay of all these factors in a favourable to the sector cannot leave it hanging in failure but rather to boost its performance and growth. The major causes and challenges of the failure of some of the established micro finance institutions may not be fully traced in this literature but can be seen in the findings of this study. A Report by MFPED (2006) of the Census of Financial institutions in Uganda revealed that, a total of 1263 institutional outlet (headquarters and branches) were existing in Uganda by 2006 covering all districts of Uganda of which 1207 were active or eligible.

2. Statement of the Problem

There is no clear study that tries to single out the major challenges facing MFIs in Uganda and propose possible policy recommendations in the four districts. Most of the MFIs offer loans without collateral securities which increases the risk of bade debts. Few microfinance experiences sustained growth, although a majority grow only a little or continue their operations at a constant level. This could be explained by challenges they face. Kasekende (2011) states that the most commonly used source of credit were; shops (54%), friends (25%) and informal groups (24%). Only 7%were found to have borrowed from commercial banks while 3%and 2%were borrowing from microfinance deposit-accepting institution (MDI) in Uganda. MDIs and SACCOs respectively. A number of studies have done (Kiiru 2007, Akuamoah and Agyeri ,2013, Aghion and Mordoch 2005, Adjei 2010) were in other regions and countries. Therefore, this study is set to investigate the challenges and propose possible policy recommendations. The study will add on the existing literature and it will be useful to local governments and central government in helping to give support these institutions. Also, the owners of the Institutions will make use of the results to better their management. The purpose of the study is to identify changes facing microfinance institutions and propose policy recommendations. The specific objectives are; i) To examine the major challenges facing the Microfinance sector in Uganda and to propose policy recommendations for the Microfinance sector in Uganda

3. Literature Review

3.1. Distribution of Microfinance Institutions in Uganda

The information obtained from the Micro Finance Industry Assessment Report by Consult, F (2008) showed the Central region (with 32%) and the highest number of MFIs, Western region (with 29%), the Eastern region (26%) and the Northern region has only 13%. UBOS (2010). The Central Region is the mother of the country's capital City (Kampala) and this could be one of the reasons as to why it is the leading region in the number of percentage MFIs in the country. The micro finance institutions have certain categorical groupings depending on their level of growth and registration with Bank of Uganda. Tier III is the class includes microfinance institutions that are allowed to accept deposits from customers but only in form of savings accounts. Members of this class of institutions are known as Microfinance Deposit taking Institutions (MDIs). They are authorized to offer checking accounts or to trade in foreign currency. By 30^{th} June 2015, the MDIs that were there included; FINCA Uganda Limited, Pride Microfinance Limited, UGAFODE Microfinance Limited, EFC Uganda Limited and Yako Microfinance Limited. The main capital requirements are defined such that it is sufficient for deposit taking and intermediation. The minimum paid up capital is 500 million or approximately US$ 250,000. In this category, capital adequacy ratio for MDI is 15%t of the risk weighted asset while it is only 8% for commercial banks. MDIs are also required to maintain liquid assets of 15%.

3.2. Challenges of Micro Finance in an Empirical Perspective

Dahir (2010) put emphasis on the major challenges and opportunities in line with micro finance in Pakistan. He found out that these challenges include improper regulations, increasing levels of competition, changing innovations and diversification of products, limited levels of profitability as well as insufficient capacity by management to run the micro finance enterprise. He thus concluded that such challenges limited the growth and expansion of these institutions and thus limiting their rate at which they could serve the poor. Similarly, he also found out that it is not easy to reach poor people as most of them are found deep in rural areas. It is thus expensive to access them.

In the European Union, the major challenge is to adopt a well-designed model that can be used while undertaking the micro finance activities or services. In December 2007, a study undertaken by the European Union found out that Europe lacked the initiative necessary to unlock the potential of micro credit and this is why micro finance is not highly adopted in Europe. In 2009, the sector was hit by the economic turmoil which affected the entire world. It made many would-be clients to fear to obtain credit and save with the micro finance institutions because they were highly affected by the credit crunch and had no capacity to fully repay their duties. Aghion and Morduch (2005), Kiiru and Kenia (2007) and Boateng, and Agyei, (2013). They professed that lack of client information was the major challenge of MFIs. The existence of an information gap in any entity leads to high level of default rates and compromising of quality of product and service delivery, thereby distorting customer retention and attraction. The officials were asked to show how they had mitigated such challenges and their major measure was through interaction being intensified between the field officers and the clients to work on their complaints. They also mentioned that the Credit Reference Bureau (CRB) was introduced to fight such cases of multiple borrowing. This confirms the earlier observation by Muhumuza (2014). He argued that, it is easy to control the borrowing rates of customers by having automated systems that can track their records. In addition, loans officers tried to find more information on the potential clients from their areas of residence by consulting local leaders who are known as Local Council one (LCI) chairpersons. Also, to reduce on information asymmetry, the MFI workers revealed that they asked clients to try to form groups to access group lending. This follows a similar path with the path of Aigbokhan Ben (2011). He affirmed that, forming group lending and joint liabilities help clients to reduce the problem of asymmetric information which is the major factor that may lead to failure of microfinance markets. Dahir (2015) undertook a study in which he analyzed the challenges of microfinance in Tanzania. He found out that the major challenges included; high default risks inherited from borrowers, limited understanding of the concept of microfinance by the clients, inadequate funding particularly due to few donor agencies, as well as limited support from the government. This is slightly different from that of Adjei (2010) in his study in Ghana who noted that the key challenges confronting the microfinance institutions in developing countries include capacity building, inadequate and expensive infrastructure base, credit delivery and management, information gathering and dissemination, regulation and supervision. On the same, Mohammed Yunus (2010) noted that key challenges as improper regulation, increased competition from the formal financial banking sector, instability, limited management capacity, political interference, high transaction costs, inadequate investment in agriculture development and low levels of knowledge. Boateng and Agyei (2013), in their study were able to find out that lack of adequate client information ranked highest as the challenge of microfinance with 80% followed by higher information technology with 73% and lack of vehicle for transport ranked 3rd with 60% and others were lack of qualified staff, higher salary level, lack of a qualified research team among others. In nutshell there are various challenges that impede the growth of microfinance institutions

4. Methodology

The researcher engaged 136 MFIs officials including 31 in top management and 105 credit officers. The officers included senior accountants, branch managers, regional finance managers, regional credit managers, operations managers and logistic officers. The respondents were asked to give their views about the challenges faced by MFIs. The responses were categorized based on a Five-Likert scale where 1-Strongly disagree, 2-Disagree, 3-Neutral,4-Agree and 5-Strongly agree. These were generalized into means for interpretation of the findings with mean responses of 1.00- 1.79 (very low/very weak), 1.80-2.59 (low/weak), 2.60-3.39 (moderate), 3.40-4.19 (high or strong) and 4.20-5.00 (very strong/very high). Information was analyzed using SPSS to generate means and make interpretations.

5. Presentation and Discussion of Findings

5.1. Social-Demographic Characteristics of the Survey Respondents

Demographic characteristics of the sampled respondents in terms of their gender, age, position, among others were considered. The officials were expected to have experience in managing MFIs.

The results indicate that 56.6% of the respondents were male and 43.4% were female. This is contrary to what Carton and Wien (2001) found out. He contended that MFIs recruit female credit officers and women constitute approximately a half of the senior management, but board members are mainly men. Further, the officials who were the informants were asked to indicate their age groups and the findings revealed that majority of the officials interviewed were between 26-35, were 83%, those who were in age group 20-25 were 16.9% and 36-65 were 22.1%. This was because MFI employs managers and accountants (top management), who are people with experience and this explains why this category of age had a good percentage. In addition, respondents were asked about the rate of interest charged and the interest rates for the various MFIs were different but within the limits of the controls of Bank of Uganda for different periods for example in 2016, no micro finance was lending below 13%. Different clients had obtained loans at different interest rates. However, the findings indicated that interest ranged between 21-40% per annum loan.

Table 1. Challenges of MFIs in Selected Districts in Uganda

S/N	Variables	Min	Max	Mean (2dp)	SD(2dp)
1	The MFIs in Uganda are over-taxed and this limits their level of surplus income	1.00	5.00	3.62	0.94
2	Many people hate the services of MFIs since they fear the high interest rates on the loanable funds	1.00	5.00	3.47	0.88
3	Many people are poor and have no collateral securities thus fear to deal with MFIs	1.00	5.00	3.95	0.95
4	MFIs are not well spread in Uganda and this limits the rate of them serving the people	1.00	5.00	3.15	0.85
5	Many people are not aware of the products of MFIs and thus they do not like dealing with them.	1.00	5.00	3.11	082
6	The bank rate is high, and this leads to high interest rate which distorts the picture of the MFIs in Uganda	1.00	5.00	3.76	0.83
7	Some MFIs have turned out to be profit-oriented thus ignoring their objective of helping the poor to access credit or finance	1.00	5.00	3.90	0.90
8	Some MFIs are biased towards certain sex like female.	1.00	5.00	3.60	0.89
9	MFIs have less support from government	1.00	5.00	3.83	0.89
10	There is information gap between MFIs and the would-be Clients	1.00	5.00	3.81	0.88
11	Limited management capacity of MFIs is one of the strongest challenges	1.00	5.00	3.43	1.07
12	Lack of standardized monitoring systems of MFIs is a big challenge to MFIs	1.00	5.00	3.46	0.82
13	Improper regulations by Bank of Uganda have been a great challenge to MFIs	1.00	5.00	3.59	0.79
14	Lack of adequate loans or equity capital to increase loanable funds is another challenge to MFIs	1.00	5.00	3.65	0.91
15	Illegal NGO operations have narrowed the market for MFIs	1.00	5.00	3.52	1.08

Source: Primary data July 2018

From table above, the findings revealed that most of the officials of microfinance indicated that MFIs in Uganda are faced with various challenges which included over-taxed with a high mean of 3.62 response, high interest rates on the loanable funds with a high mean of 3.47 responses. Furthermore, many people have no collateral securities, a high mean of 3.95. This is a similar view with Chirwa and Ephraim (2002) that poor people lack collateral security. The results indicated that bank rate is high, with a high mean of 3.76, some MFIs have turned out to be profit oriented ignoring their objective of helping the poor to access credit a high mean of 3.90. The results indicate that some MFIs are biased towards certain sex like female and such gender bias limit the clientele base. With such a high mean of 3.60, its true that some MFIs are sex biased, since in Uganda there some MFIs that were specifically started for assisting the women. The results indicate that MFIs in Uganda have less support from government with a mean of 3.83. This means that most of the MFIs are operated privately. Therefore, it implies that they need to generate some profits to cover their operational costs. This justifies why many of them are turning out to become profit-oriented. Lack of adequate loan or equity capital to increase loanable funds is another challenge that MFIs face. This was supported by a mean response 3.65 with which many officials agreed with this fact. With limited capital and funds to lend out, even the number of clients becomes limited. Growth is thus not enhanced. There is information gap between and the would- be clients. This was supported by a mean response of 3.8. It ends us lowering on the number of customers for the MFIs and eventually leads to low levels of turnover and hinders their capacity to achieve their objective of sustainability. The findings are consistent with Akuamoah and Agyeri (2013) who indicated that 85% revealed that lack information was a major challenge Other challenges that had a mean above 3 .0 included MFIs are not well spread in Uganda, many people are not aware of their products of MFIs, Limited management capacity of MFIs is one of the strongest challenges. This was supported by a high mean response of 3.43, Lack of scandalized monitoring system of MFIs is a big challenge and improper regulations by bank of Uganda. Most of the officials agreed that there are illegal NGO operations which have narrowed the market for MFIs. This was supported by an average mean of 3.52. This is due to the failure of Bank of Uganda to monitor the various MFIs in the country. The study also through structure question was able to find out other challenges which included loan diversion (use of a loan for a purpose other than that for which it was approved), high default rates, information asymmetry, limited staff competencies and clients obtaining multi-loans were among the major challenges.

6. Policy Recommendations and Areas for Further Research

Recommendations proposed in for the study are based on the findings. To an increase the loanable mount given to clients by mobilise more savings and at the same time solicit for donor funding to have enough learnable funds. To trained clients in managing the loans. To adopt integrated system to pick up any client that has more than one loan. This will reduce the risk involved with multiplicity of loans. MFIs should employ well qualified personnel with the required competencies, such as risk management skills, assessment skills and the ability to select a client and entrepreneur skills. Increased in monitoring and supervising clients by the loan officers. MFIs should be strict about the credit worthiness using the four 'Cs'.These are character, capacity, capital collateral and condition and common sense. In the same way the Ps should be taken into account, purpose, person and productivity, planning scheme or projection, payment of instalments and protection or security. Group lending be encouraged. This will reduce the problem of information asymmetry, as many of those in a group know each other and repayment is a group responsibility. Credit insurance should be encouraged to protect the loan**.** Standard management information systems and appropriate horizontal and vertical communication systems. In addition, modern technology should be adopted to track the progress of loan payments. MFIs should improve their market intelligence, focusing on customer needs, competitors and the core competencies needed in MFIs. MFIs should be alert in gathering information on the profiles of their clients, their needs and preferences, their beliefs and attitudes and their buying habits. Another recommendation is the formation of a village bank, whereby MFIs organize clients into a group of 20 -50 people who function as a bank and one loan is issued to the village bank and after a specified period the money is repaid with interest. Lastly, the study recommends the enforcement of contracts. The study recommended other areas for further study; these are there is a need to study challenges facing microfinance in a rural setting since this covered semi-urban area. Further still a need to study hoe each of the major challenges and high interest rates impact of the ole of microfinance in improving the welfare of it clients.

References

*** (2014). *IFAD Donor Matrix*. Kampala, Uganda: IFAD.

Adjei, J. K. (2010). *Microfinance and poverty reduction: The experience of Ghana*. BOLD Communications Limited

Aigbokhan, B. E. & Asemota, A. E. (2011). An Assessment of Microfinance as a Tool for Poverty Reduction and Social Capital Formation: Evidence on Nigeria. *Global Journal of Finance and Banking Issues*, 5(5), p. 38.

Armendariz & Murdoch, (2005). *Economics of Microfinance*.

Association of Microfinance Institutions of Uganda (AMFIU) (2013). *The State of Microfinance in Uganda 2012/2013*. Kampala, Uganda: AMFIU,

Boateng, I. A. & Agyei, A. (2013). Microfinance in Ghana: development, success factors and challenges. *International Journal of Academic Research in Accounting, Finance and Management Sciences*, *3*(4), pp. 153-160.

Carlton, A. & Wien, L. (2001). *Microfinance in Uganda*. L & R Sozialforschung.

Consult, F. (2008). Uganda microfinance industry assessment.

Dahir, A. M. (2015). The Challenges Facing Microfinance Institutions in Poverty Eradication: A Case Study in Mogadishu. *International Journal of Humanities, Social sciences and Education*, 2(2), pp. 56-62.

DFID Uganda (2012). *Uganda Financial Services Inclusion Programme Business Case*. Kampala, Uganda: DFID Uganda.

FAO, IFAD & WFP. (2013). *The State of Food Insecurity in the World: The multiple dimensions of food security*.

Grameen Foundation (2014). *Mobile Money & Financial Inclusion: Usage of Mobile Money by Microenterprises; Lessons from Uganda*. Kampala, Uganda: Grameen Foundation.

Kabeer, N. (2008). *Mainstreaming gender in social protection for the informal economy*. Commonwealth Secretariat.

Kalyango, D.L. (2004). *Uganda's Experience with Tiered Banking Regulations*.

Karlan, D.; Osei, R.; Osei-Akoto, I. & Udry, C. (2014). Agricultural decisions after relaxing credit and risk constraints. *The Quarterly Journal of Economics*, 129(2), pp. 597-652.

Kasekende, Louis (5 May 2011). *Opportunities and challenges of financial inclusion: Microfinance Conference, organized by the Association of Microfinance Institutions in Uganda (AMFIU)*. Jinja.

Kiiru, J. M. (2007). Microfinance, entrepreneurship and rural development: Empirical evidence from Makueni district, Kenya. *Center for Development Research*, pp. 1-22.

Micro Finance Transparency Annual Report (2011). *Promoting Transparent Pricing for the Microfinance Industry.*

Muhammad Y. (2010). *The Microcredit Model Rise and fall, History of microfinance*.

Muhumuza, W. (2013). Revisiting state intervention: State-sponsored microcredit and poverty reduction in Uganda. *African Journal of Political Science and International Relations*, 7(3), pp. 121-132.

Uganda Bureau of Statistics (UBOS). *Reporting on Census of Micro Finance Institutions in Uganda*. Kampala, Uganda: Uganda Bureau of Statistics.

Yunus, M.; Moingeon, B. & Lehmann-Ortega, L. (2010). Building social business models: Lessons from the Grameen experience. *Long range planning*, 43(2), pp. 308-325.