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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

PROCEEDINGS OF THE SYMPOSIUM ON MODALITIES FOR FINANCING SMEs IN UGANDA

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NOTE

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CONTENTS

PREFACE

The sustainable growth of the Ugandan economy is directly related to the rate of enterprise creation and development. This in turn depends on the ease with which small- and medium-sized enterprises (SMEs) can be started and financed, given their large contribution to the national economy. One of the critical constraints facing Ugandan SMEs has been widely acknowledged to be a lack of access to credit.

Obtaining the medium- to long-term financing they need from commercial banks if they are to realize their business potential remains the major obstacle for SMEs. Without finance, SMEs cannot acquire new technologies, compete in the global market or establish linkages with larger firms.

Uganda's banking sector has a history of high default rates, discouraging banks from lending to local SMEs that are known to have higher risks and transaction costs. At the same time, there is fierce competition among banks, donors, international financial institutions and investment authorities for bankable and/or fundable projects. There is thus a gap to be filled between potential borrowers and lenders.

The Central Bank of Uganda, the Bank of Uganda, is unique in that it is concerned both with monetary stability and development, particularly of local enterprises. Accordingly, the Bank of Uganda invited UNCTAD and Enterprie Uganda to organize a one-day symposium as an opportunity for all stakeholders to identify obstacles and solutions.

While insufficient domestic savings is often mentioned as contributing to the lack of financing for SMEs, the Bank of Uganda reported that there was in fact sufficient liquidity in the banking sector. This was confirmed by commercial bank representatives, in whose view the real problem was a lack of bankable SME projects and a lack of creditworthy SMEs.

The dialogue between the Government, the bankers and SMEs resulted in the formulation of a plan of action for all stakeholders and the creation of a special SME task force to follow up on the recommendations. UNCTAD is actively involved in steering the Task Force.

It is encouraging to see that both public and private sectors are combining their efforts to remedy a market failure in Uganda's economy which is preventing it from realizing trade and investment opportunities in the post-Doha period. We hope that under the auspices of the Task Force, Ugandan SMEs will see improved access to medium- and long-term finance which can help them to build the productive capacity needed to compete in the global market. It is also hoped that Uganda will set a valuable example to neighbouring African countries in moving ahead on their own initiative.

Rubens Ricupero
Secretary-General of UNCTAD
Geneva, December 2002

INTRODUCTION

The symposium on "Modalities for Financing Small- and Medium-Scale Enterprises" took place on 30 April 2002 at the International Conference Centre in Kampala, Uganda and was attended by about 260 participants from SMEs, commercial banks, government offices and the donor community. The principal objectives were:

- To create a platform for public-private sector dialogue;
- To identify the main obstacles to SMEs' accessing finance from formal sources;
- To suggest practical solutions and innovative ways to resolve the problem; and
- To formulate an action plan to be used as a road map by stakeholders in implementing the symposium's recommendations.

In a keynote address, Mr. Gerald Ssendula, Minister of Finance, Planning and Economic Development, acknowledged the significant role played by SMEs in Uganda's economic growth and called for better measures of their contributions. He said that SMEs must understand why banks were discouraged from lending to SMEs. But he also requested banks to develop more positive attitudes towards SMEs. The symposium would be a step in the right direction for healthy interaction among SMEs, banks, the Government and the donor community, and he welcomed recommendations to be submitted at the end of the symposium, which could be included in his forthcoming budget.

While insufficient domestic savings is often given as a reason for a lack of financing for SMEs, the Bank of Uganda reported that there was in fact sufficient liquidity in the banking sector. This was confirmed by commercial bank representatives and in their view, the real problem was a lack of bankable SME projects and a lack of creditworthy SMEs.

The Symposium's question-and-answer sessions were particularly useful for interaction among participants. During the Symposium, the banking community repeatedly emphasized the importance of improving SMEs' accounting in order to demonstrate to the commercial banks the soundness of their business prospects and their ability to repay loans.

The discussions revolved around the following questions:

1. What are the reasons for limited access to credit and other forms of finance for SMEs? How can SMEs themselves resolve this problem?

2. How can existing financial and banking institutions improve their level of financial intermediation for SMEs?

3. What government intervention is required in order to enhance and coordinate delivery of credit to SMEs?

4. What roles can the donor community, non-governmental organizations (NGOs) and private-sector intermediaries play in improving SMEs' access to finance?

The discussions resulted in the drafting of a plan of action for the Government, SMEs, business development service providers, commercial banks and the international community, as well as a set of recommendations for immediate action by the Minister of Finance, Planning and Economic Development (see part IV, Appendix).

A special SME Task Force for financing was appointed from among the relevant stakeholders to consider ways and means of implementing the recommended policies and measures, monitor progress on a regular basis and report back in April 2003. The chair of the SME Task Force is the President of the Ugandan Bankers' Association, and the vice-chair is from the Bank of Uganda.

PART I

Introductory Remarks

Opening Remarks

by
Sam Nahamya
Permanent Secretary
Ministry of Tourism, Trade and Industry

The Ugandan economy has made significant recovery since 1987, and is on the way to sustainable growth and development. This is being made possible by prudent policies that have been consistently pursued for the last 15 years.

It is estimated that there are about 800,000 micro and small-scale enterprises in Uganda, the majority of which are located in rural areas and on the outskirts of urban areas, producing goods and services consumed not only by the low-income class but also by some sections of the middle class. In Kampala, these enterprises are located in Katwe, Nakawa, Wandegeya and Ndeeba, and produce items such as steel windows, steel gates and furniture. These goods and services are very important to our people.

As in most developing countries, small and medium-scale enterprises form a significant part of the Ugandan economy. Nevertheless, they face a number of problems, including access to finance from formal sources, which is often considered to be the most important problem. That is why this symposium on "Modalities for Financing Small and Medium-Scale Enterprises" is not only very important for SMEs, but also important for financial institutions, the Government and all other stakeholders in the SME subsector.

SME Finance: Missing Middle

by
Lorraine Ruffing
Head
Technology and Enterprise Branch
DITE, UNCTAD

Despite the events of 11 September and heightened political uncertainty in the world, the post-Doha period opens up many opportunities for increased trade and investment. But how can developing countries realize those opportunities if they lack world-class enterprises that can export or attract investment? The main objective of this symposium is unlock the great potential that lies in Uganda's entrepreneurs by giving them access to finance, including commercial credit and venture capital, through:

- Starting a public-private sector dialogue;
- Identifying the main obstacles to financing SMEs in Uganda;
- Discussing practical solutions;
- Formulating an action plan for the main stakeholders.

The obstacles to SME lending are universal. However, there is growing evidence that some commercial banks in developed countries have found innovative ways around these obstacles and are serving SMEs and making a profit.

In a typical OECD country, SMEs contribute about 85 per cent of GDP, in developing countries about 50 per cent, and according to the French Ministry of Foreign Affairs, about 58 per cent in Uganda.

Ugandan SMEs have to grow and compete in the global economy, and the banks have probably the most important role to play. Without finance, SMEs cannot acquire or absorb new technologies, nor can they expand to serve global markets or even establish business linkages with larger firms in the post-Doha period. Finance seems to be the obstacle and/or the key to everything.

Instead of relying on the bank, SMEs tend to rely on informal sources of funds such as family, friends, credit cards, supplier credit and customer advances. This is because commercial banks prefer selected customers such as Governments and large enterprises, thus crowding out SMEs. From commercial banks' point of view, lending to SMEs involves high transaction costs due to:

- Small amounts which require large amounts of time/effort;
- Cumbersome administrative procedures;
- Lack of understanding of SME needs;
- Inability to assess creditworthiness;
- Poor financial information;
- Unreliable accounting;
- Unrealistic business plans.

Lack of financial information increases the transaction costs of banks, or even worse makes it impossible to evaluate the chances of their getting their money back. It is commonly stated by bankers that most SMEs, even in the formal economy, do only tax accounting and usually underdeclare sales/profits. So in the end, banks and venture capitalists do not have reliable financial information which would indicate a track record. And even worse, SME owners and managers do not have the information they need for management purposes. They sometimes keep three sets of books: one for the taxman, one for themselves and one for their ex-wives. At the end of the day they don't know where their profit centres are. That is why UNCTAD is working on a new, user-friendly system of accounting for SMEs.

In addition to generating high transaction costs, SMEs pose high risks. In fact, the default rate for Ugandan SMEs was 78 per cent. But SMEs have little collateral to ensure against these risks. They also suffer from:

- Low capitalization;
- Vulnerability to market fluctuations; and
- High mortality rates.

In countries without strong bankruptcy laws or contract enforcement, banks have difficulty in enforcing repayment or foreclosing when loans go bad. The most important issue the symposium has to examine is how to reduce the risks and transaction costs of banks by increasing the supply of creditworthy SMEs.

Keynote Address

by
Gerald Ssendaula
Minister of Finance, Planning and Economic Development

This symposium is very important for two broad reasons. First, it is being held in a developing country environment where SMEs are widespread. Secondly, SMEs are very important for a developing economy because they provide employment opportunities and a basis for developing new ideas, and contribute to economic growth and sustainable development.

SMEs themselves are growth- and development-oriented. Therefore, if an enabling policy, a legal and regulatory framework and the necessary infrastructure to reduce the cost of doing business are accompanied by a stable macroeconomic environment, SMEs can play a significant role in economic development. Of course, this framework assumes the existence of perfect market conditions. In imperfect market situations, there is a need to go beyond creating free market-based conditions and putting in place strategic support measures to eliminate imperfections.

Creating an environment conducive for SMEs will, however, bear fruit if SMEs themselves positively respond to the environment. In addition, SMEs must make themselves attractive for bank lending because no professionally run bank will attempt to lend to any business which is not creditworthy or has no track record of being able to repay a loan. Some of the factors that have discouraged banks from lending to SMEs include:

- Poorly compiled records and accounts, especially audited accounts;
- Low level of technical and management skills;
- Outdated technologies with few economies of scale and unacceptable rates of return;
- Lack of professionalism and networking;
- Lack of collateral;
- Lack of market outlets due to poor quality and non-standardized products;
- Poor linkages with large scale enterprises; and
- SMEs' limited knowledge of business opportunities.

It makes business sense for banks not to lend to start-ups and/or small-scale businesses, which have not accumulated a minimum amount of assets or demonstrated both business capability and creditworthiness. But the banks, on the other hand, have to develop positive attitudes towards SMEs and find alternative, innovative ways of assessing risks. In small open economies such as the Ugandan economy, where there are relatively few large firms, investment choices are limited and banks have to begin relying on small firms to grow with together. With increased competition in the Ugandan financial sector, this will develop and soon we shall see banks identifying SMEs and growing them into large-scale enterprises.

Since 1987, the Ugandan Government has implemented a number of policy measures under the Economic Recovery Programme to create an enabling environment, where the private sector is encouraged to participate in economic growth. The annual inflation rate has been brought down over the years from 250 per cent in 1986 to the current single-digit levels – and economic activities have been deregulated to pave the way for the private sector to become the engine of growth. The balance of payments has improved and the real growth rate has averaged over 6 per cent a year over the last 10 years. Macroeconomic stability has been restored, and Uganda has moved from a period of rehabilitation to growth in real income levels.

As a complement to macroeconomic policies, considerable progress has also been made in structural reforms covering various sectors of the economy. Through liberalization and privatization, Uganda has opened the economy to private players. The deregulation of commodity prices has resulted in increased income for the farmers who form the bulk of Uganda's population. Other reforms were put into effect through non-restrictive licensing, which has eliminated anti-production biases in the system.

The financial sector policy initiatives have introduced measures to eliminate an overvalued exchange rate and the segmentation in the foreign exchange market which had for long dogged the export and import sectors. Through fiscal and monetary reforms, the Government has been able to positively influence economic performance by creating an enabling environment to facilitate, revitalize and promote fresh investments, which are necessary for triggering sustained and robust growth.

In order to consolidate these achievements, plans have been drawn up to systematically steer economic growth and development. These plans include the Poverty Eradication Action Plan, the Plan for Modernisation of Agriculture and the Medium-Term Competitiveness Strategy for Private Sector Development. To operationalize some elements of these plans that address SMEs, a Micro- and Small-Scale Enterprise Policy Unit (MSEPU) has been established in the Ministry of Finance, Planning and Economic Development (MFPED). This unit is responsible for coordinating all activities for the promotion of SMEs.

Despite the remarkable progress made so far, there are still several challenges ahead that require joint efforts. The first is the issue of an acceptable definition of SMEs. The MSEPU has defined micro and small-scale enterprises, but the definition of medium-scale enterprises is still lacking. There is a need to reach industry consensus on the definition of micro and small-scale enterprises and to define medium-scale enterprises. Secondly, there is evidence that SMEs have benefited from the business-conducive policy environment created by the Government. Nevertheless, this evidence is not supported by any research findings. Therefore, research on SMEs is needed in order to establish their contribution to the economy in terms of employment, GDP and exports in order to better evaluate the impact of SME policies.

Furthermore, there is the issue of coordination at various levels of agencies promoting SMEs. For instance, ministries which are directly responsible for SMEs, namely the Ministry of Tourism, Trade and Industry and the Ministry of Finance, Planning and Economic Development, should establish working and coordination committees for the SMEs. Coordination is also required among the private sector, donors and various agencies, the Government and other stakeholders. In this way, the promotion and development of SMEs will be more systematic and the benefits will be visible and realized faster.

Today's symposium is a step in the right direction to involve all the key players in promoting SMEs and charting the way forward for their development. It creates an opportunity for a healthy interaction between SMEs, banks, government, donors and other agencies involved in the promotion and development of SMEs. Therefore, all participants are invited to actively participate in identifying the problems of SMEs and why they cannot access finance from formal sources. In addition, the symposium should identify roles and responsibilities, make concrete proposals and develop a strategy on how to overcome the obstacles that SMEs face in accessing finance.

Opening Speech

by
Daouda Toure
Resident Representative
UNDP

UNDP is committed to supporting private sector development in Uganda, since the main vehicle for achieving sustainable economic growth in that country is the development of SMEs. One example of specific interventions that UNDP has undertaken in supporting SMEs is the establishment of Enterprise Uganda within the framework of the Enterprise Africa Regional Initiative. However, one of the greatest challenges faced by Enterprise Uganda in executing its mandate is SMEs' lack of access to finance.

In order to create sustainable SME growth and development, an appropriate mix of talents must be assembled to share the tremendous responsibilities involved. The Bank of Uganda should come up with the right programmes and right managers to address the needs of SMEs and ensure matching of financial institutions and borrowers, given that there is too much liquidity in the Ugandan banking sector. The Government should resolve macroeconomic impediments and revisit policies that specifically impinge on SMEs. The banking sector must build partnerships with business development service providers such as Enterprise Uganda. The donor community is encouraged to provide its support in a coordinated and synergized manner. Entrepreneurs must recognize the benefit of using business services and patronize institutions such as Enterprise Uganda in order to enhance their competitiveness and creditworthiness.

PART II

Presentations

Uganda's Financial Sector and Capital Markets

by
Richard Apire
Director
Development Finance Department
Bank of Uganda

INTRODUCTION

The financial sector plays a central role in the growth and development of an economy through mobilization and intermediation of financial resources and their allocation. This can be optimally achieved under two fundamental conditions:

- A stable and sustained macroeconomic environment; and
- An efficient, effective and sound financial system.

A stable and sustained macroeconomic environment is a necessary condition for eliminating possible distortions within the economy, while an efficient, effective and sound financial sector creates a competitive environment for a large number of financial service providers to emerge and provide a wide range of demand-driven financial services.

In most developing economies, including Uganda, the formal financial sector is composed of a few formal financial institutions. As a result, the majority of the population accesses financial services from semi-formal and informal financial institutions. Currently, it is estimated that the microfinance subsector in Uganda provides financial services to 550,000 clients through 500 outlets and has a loan portfolio and deposit base of more than US$ 37 million and US$ 30 million respectively. Compared with the loan portfolio and deposit base of the formal banking sector, this represents a significant part of financial sector transactions in the economy.

THE CURRENT STATUS OF THE FINANCIAL SECTOR

Financial sector reforms

Financial sector reforms were introduced in 1991 with the key objective of laying the foundation for a market-based financial system. Specifically, the reform efforts aimed at addressing weaknesses in key financial institutions. The process of developing basic financial short-term and long-term markets was also instituted. The latter process started with the development of basic markets in short-term, highly liquid and relatively less risky financial instruments such as inter-bank loans and Treasury bills.

Following the progress recorded in the money market, the process of establishing long-term and private financial instruments was also launched with the establishment of the Capital Markets Authority.

To enhance the scope and efficiency of Uganda's financial infrastructure, the Banking Act of 1969 was repealed, with the Financial Institutions Statute (FIS) replacing it in 1993. Changes in the Act included the removal of interest rate controls, reduction of barriers to entry by private banks and restriction of the direct role of government in administering credit. This framework was supplemented by parallel measures to strengthen the Bank of Uganda's banking supervision, to foster financial discipline through new legislation, regulations and policies, and to improve the efficiency and profitability of financial institutions. The reforms also led to the restructuring and privatization of inefficient financial institutions.

Despite the reforms, Uganda's formal financial sector has undergone a series of upheavals in the recent past, the effects of which are still being felt. Some commercial banks were closed and there was an interruption in the sale of the largest public bank, the Bank of Uganda. These factors, together with a slow response by the Government to unfreeze savings accounts, and accordingly pay depositors of failed banks, contributed in a major way to the decline in the general public's confidence in the country's banking system.

In order to address the emerging weaknesses in the financial sector and increase its outreach, the Government is undertaking further reviews of the regulatory and supervisory framework. The FIS is being critically reviewed and the Micro-Deposit Taking Financial Institutions Bill is currently before Parliament for debate and possible enactment.

Composition of the financial sector

The Bank of Uganda (BOU), as the country's central bank, is responsible for the supervision of the financial sector. Seventeen commercial banks, compared with nine in 1990, dominate Uganda's financial market and are now fully controlled by the private sector. Six credit institutions, compared with eight in 1990, are subject to supervision by the BOU. Most of the credit institutions, except the Housing Finance Company of Uganda (HFCU), are locally and privately owned finance companies. Three development banks, compared with two in 1990, are non-deposit-taking institutions and are not supervised by the BOU. The Development Finance Company of Uganda (DFCU) is owned by foreign international institutions, while three East African States jointly own the East Africa Development Bank (EADB), and the Government of Uganda owns the Uganda Development Bank (UDB). The Post Bank, a spin-off from the old public telecommunications enterprise, is State-owned, and was previously called the Post Office Savings Bank.

There are 18 insurance companies, compared with 12 in 1990. Only one of them, namely the National Insurance Company, is owned by the Government. There is one private building society, whereas there were 10 in 1990. There is one National Social Security Fund (NSSF), owned by workers who contribute money to it. There are three leasing companies, whereas none existed in 1990. EADB also provides leasing facilities. Non-bank and non-credit institutions providing microfinance services include over 500 microfinance institutions.

The performance of banks in the recent past

Over the years, the reforms in the financial sector have been viewed as both positive and negative. In 1993, the Bank of Uganda, in ensuring prudence in the financial sector, closed Teefee and Ugadev Banks. More recently four banks, namely the International Credit Bank, the Co-operative Bank, the Greenland Bank and the Trust Bank, were closed because of imprudent banking practices.

While the closure of banks was definitely a major dent in the financial sector’s credibility, it provided an opportunity for the Government, the BOU and the banking sector to reflect critically on the possible measures necessary for improving the sector's performance. Building on the earlier successes during the initial periods of the reforms plus measures put in place following the bank closures, the banking sector has become much stronger and the BOU's supervision capacity has also significantly improved.

The health of the banking sector has also significantly improved. The minimum capital requirement for both banks and credit institutions was further increased at the beginning of this year, and they are required to fully comply with the new requirements by the end of 2003. For banks, the minimum unimpaired capital was raised from Ush 2 billion to Ush 4 billion, while for credit institutions it was raised from Ush 500 million to Ush 1 billion. Most banks have met this requirement and have accordingly increased their capacity to provide financial services to the private sector.

In addition, both the asset quality and base of banks have improved as well. The total assets of commercial banks at end of June 2000 amounted to Ush 1,519 billion. The ratio of non-performing loans in commercial banks had proportionately fallen to 6.9

per cent at the end of June 2001, down from 12.43 per cent at the end of June 2000 and 36 per cent at the end of June 1999.

However, while the banking sector is continuing to grow stronger, as reflected by the asset base, asset quality and level of deposits, the banks are awash with liquidity. Although the level of deposits is growing and the volume of loans to the private sector is also increasing, the rate at which the latter is growing is lower than the rate at which deposits are growing. This has increased the level of liquidity in the banking sector.

The slow growth in credit to the private sector has been attributed to a number of factors, including:

- The extremely stringent approach that the banks use to scrutinize project proposals and customers before granting them loans;
- High lending rates;
- Lack of bankable projects;
- High cost associated with lending to SMEs; and
- The existence of alternative risk-free investment opportunities for banks, such as Treasury bills at the BOU.

The capital market

The Uganda Stock Exchange became fully operational in 1998. To date, it has listed three floating rate bonds, issued by PTA Bank, EADB and the Mobile Telephone Network (MTN), while four equities were issued, namely, Uganda Clays, BATU, East Africa Breweries and Kenya Airways. Other firms are expected to follow. However, traders on the Stock Exchange are not yet sensitive to price changes as they tend to hold onto the shares they buy from the Stock Exchange, and this results in a low level of activity.

Nevertheless, the establishment of the Stock Exchange is an extremely important development in the financial sector, since it has provided yet more investment opportunities and sources of funding for potential investors. Awareness remains to be created among the business community, particularly with respect to the listing requirements for the Stock Exchange, such as full financial disclosure and provision of audited accounts.

Other forms of financing sources have recently emerged, some of which have become relatively significant in Uganda. They include lease financing, equity finance and a more a unique form of equity finance – venture capital.

While there are many challenges to the development of equity capital, especially for SMEs, it is important to promote venture capital in Uganda.[1] Solutions to overcoming these challenges include improving corporate governance, putting emphasis on domestic resource mobilization, financial deepening, creating an entrepreneurial class and, generally, creating a conducive investment environment. Thus, the establishment of the Capital Markets Authority is a significant step in creating a viable capital market in Uganda.

THE FINANCIAL SECTOR AND SMES

Small businesses rely on both formal and informal finance. These options steadily increase over time as they build up their assets and reputations. However, while this holds true in economies where studies have been undertaken, the situation in economies where empirical data do not exist is less clear. The inadequacy of data on transactions between banks and SMEs is further complicated by a lack of national definitions of SMEs, which are important for guiding research in policy issues and the formulation of policy proposals and the evaluation of their impacts. In Uganda, there is already a national definition for micro and small-scale enterprises, but none exists for medium-scale enterprises.

There is a need to define a framework for guiding the promotion of medium-scale enterprises, which are widely recognized as an important sector. Without a nationally accepted definition, assertions about inadequate credit flow to SMEs, for example, become weak. Therefore, the challenge faced in promoting SMEs in Uganda is twofold.

First, there is the lack of nationally accepted definitions of SMEs. It is also important to note that when definitions are developed, they should not be kept under lock and key in offices but disseminated to all stakeholders, and regularly reviewed to reflect the dynamic nature of SMEs' development.

There is the question of availability of data. This is an issue at the national level, at the banks' level and also at the level of SMEs themselves. Without comprehensive information on SMEs, very little is known about transactions between them and banks. A framework is therefore needed for assembling information that would be useful in gauging the level of financial transactions between banks and SMEs in order to develop informed arguments and policies.

[1] Venture capital is more appropriate for start-ups, which do not have a track record. Incentives could be given to venture capitalists to encourage them to invest in SMEs.

Reasons why banks may not lend to SMEs

While the banks are definitely more qualified to talk about lending to SMEs, it is a widely held view that banks, particularly commercial banks, have difficulties in financing start-ups and SMEs in spite of the significant number of SMEs. In addition, SMEs dominate economic activities and make a very large contribution to GDP. Some of the reasons why banks are reluctant to lend to SMEs are given below.

Problem of banks

- Limited branch network
- Limited range of financial instruments and lending conditions
- Banks' risk-averse behaviour; preference for investing in Treasury bills
- Non-performing assets, which make the banks too cautious to undertake further lending
- Lack of established information network such as a credit reference bureau for tracking defaulters
- Weak inter-bank collaboration
- Banks' inadequate capacity to appraise the creditworthiness of SMEs

Problem of SMEs

- Lack of collateral required by banks
- Inadequately compiled financial records and accounts, especially audited accounts
- Low level of technical and management skills
- Inadequate technologies; no economies of scale
- Low rate of return on capital
- Lack of professionalism
- Lack of market outlets due to poor quality and non-standardized products
- Poor linkage with large-scale enterprises
- Limited knowledge of business opportunities
- Risky business activities such as agriculture

CHALLENGES AHEAD

Banks need to:

- Understand the dynamics of SMEs
- Design new approaches for reaching out to SMEs
- Design appropriate products for SMEs
- Provide appropriate training to their staff to respond to those needs

- Explore the possibility of formal linkages with microfinance institutions and use them to increase the outreach

SMEs need to:

- Understand what borrowing from a bank is all about
- Present themselves as viable businesses
- Prepare credible project proposals
- Keep financial accounts

The Government and the BOU need to:

- Create an enabling policy, legal and regulatory environment
- Facilitate development of various financial markets
- Address issues of market failure through capacity building of SMEs
- Create a framework for providing public information

Donors need to:

- Support the Government, SMEs and microfinance institutions in a coherent and coordinated manner

CONCLUSION

Uganda's financial sector has significantly improved despite the turbulence it has experienced since the introduction of financial sector reforms in 1992. These improvements are evident in the expansion of the sector and the increased number of monetary instruments available for undertaking financial transactions.

However, these improvements have not been translated into strong credit growth in the private sector. In particular, the SMEs have not been adequately serviced by the banks and other financial institutions. This is a challenge to all the stakeholders in the financial sector, which requires concerted efforts from by all of them. The banks need to develop more innovative ways of lending to SMEs more profitably, while the SMEs must also strive to make themselves more attractive to banks by improving their record keeping, financial management and adopting modem techniques of doing business.

Between the banks and SMEs lie the Government, donors and other stakeholders. As is currently the case, the Government, with the support of donors, should continue to create the necessary enabling environment, including through reforming the legal and regulatory framework and working on the physical infrastructure to promote private sector growth. This could be supplemented by strategic interventions such as:

- The establishment of an industrial estate at Namave, along the Kampala-Jinja Road, to address market failures
- Facilitating the establishment of a credit scoring system which would provide information about the performance of potential borrowers
- Establishment of special funds for equity investment and lines of credit, such as EIB-Apex at the BOU
- Promoting institutions to support the development of SMEs, such as Enterprise Uganda, on whose Board the BOU is represented

These strategic interventions, coupled with the creation of an enabling investment climate, should improve the credit flow to SMEs.

Financing of Small and Medium Enterprises: The Banker's Perspective

by
Frank Griffiths
Managing Director
Barclay's Bank

SMEs in Uganda have the most difficulty in accessing finance. Large, well-capitalized companies rarely have any problem, while micro businesses are increasingly being catered to by the plethora of microfinance institutions operating in the country.

The cost of finance is also an issue. Large, successful corporations are able to access finance at relatively low rates. Micro businesses, however, are charged very high rates of interest, but the loans tend to be relatively short-term. Therefore, the actual amount of interest being paid is acceptable when seen in the context of the overall transaction.

SMEs require longer-term funding. However, because of the inherent risks perceived by banks, their cost of finance is generally quite expensive. The challenge then is how to assist the "missing middle" in accessing finance.

It is important to appreciate the banker's point of view. Bankers are in business, like anyone else, to make profits for their shareholders. But they also have a duty to their depositors and thus are quite naturally averse to taking undue risks. Whilst a bank's job is to assist in financial intermediation, it is not obliged to lend to anyone that it does not wish to do business with.

Ideally, small business customers should have well-established systems for gathering information and forecasting and would find no difficulty in keeping their bankers informed of their current financial position and prospects. However, the vast majority of small enterprises are unable or unwilling to provide such information and, therefore, a bank is obliged to deal with them as it finds them.

At this point it is worth reminding would-be borrowers that they have considerable choices when choosing their commercial banks. In the Ugandan market, there are 17 to choose from. It is probably fair to say that the transnational banks concentrate on the high end of the corporate market. This may change as opportunities in this segment diminish and banks are forced to look elsewhere for opportunities. For example, the recent acquisition of Uganda Commercial Bank by Stanbic may well see the combined bank targeting the SME market as a means of increasing revenues, having acquired a large volume of customers. Centenary Rural Development Bank actively targets the smaller business customer. Thus, potential borrowers should open accounts and establish relationships with those banks which are likely to be sympathetic to SMEs.

THE PROBLEMS FACING BANKS WHEN FINANCING SMES

For bankers to consider any financing proposal, cash flow forecast and budgets are usually required. If customers are unable to produce them themselves, banks will usually look to a bookkeeper or accountant to assist them. Once those documents are produced, bankers will then wish to question assumptions behind them. Sales in such projections are often excessively optimistic. It is by no means unusual to find that the projections are produced from the bottom up; thus, potential sales are based on what is required to obtain the finance and not necessarily the potential sales target. The lack of historical sales data then makes it difficult to verify whether the sales targets are realistic. The difficulty that the banker faces is to distinguish between impressive-looking documents produced and designed to maximize the chances of obtaining a loan and the underlying soundness of the lending proposition It is ironic that cash flow forecasts are always positive. Bankers would be prudent to be sceptical of these forecasts unless they are supported by recent actual performance.

The particular problem faced in appraising unsophisticated small businesses is the assembly of independent evidence to support the key assumptions that underlie their proposal. What evidence we require will generally be in the following areas:

The ability and integrity of the proprietors of the business

- How long have they had a relationship with us?
- Do they have a track record with any other bank or with us? Why are they coming to us?
- Has the account been satisfactorily conducted?
- What is their reputation in town?
- What experience do they have of running a business?
- What is their personal commitment to the business? How much is their stake?
- Inquire of any credit reference agency; the fact that there is currently no such agency in Uganda is a significant drawback.

The availability of physical and production resources

- Are the premises of the right size and in a good location?
- Is the machinery in good condition? How old is it? Maintenance record?

- Any key people? What happens if they leave?

The present and potential profitability of the business

- Historical accounts?
- Taxman accounts! Then what is the true position?
- Has cash been taken out? Where is it?
- Break-even analysis
- If a businessman is unable to produce rudimentary information, we do not lend.

The impact of the business on the future cash flow

- We can see evidence of past liquidity by reference to historical bank statements, assuming that all business activity passed through an account or is not multi-banked
- Do customers pay on time?
- Some businessmen operate a number of companies and have a tendency to treat them all as one entity with a multitude of inter-company transactions.

The adequacy of present and planned capital resources

- How much capital does the customer have in the business?
- A directors' guarantee supported by a mortgage over property cannot be viewed as capital. It is merely evidence of commitment.

- Businesses with inadequate capital will often have a significant borrowing requirement, the interest cost of which will increase its break-even point.
- Businesses with low capital bases have to generate a higher level of sales to be viable.

Many of these companies are owner- or family-operated. As a result, they do not keep business and personal finance separate. Thus, when a family problem appears, such as school fees for a relative's child, inevitably the cash for the business is used. This means that while one immediate problem is solved, a potential future cash flow problem for the business ensues.

There is a need for trust between a banker and his customer. A bank makes inquiries and when it finds that customers have been less than honest, for instance by failing to disclose banking arrangements at another institution, the relationship will tend to break down and once broken, it is difficult to mend.

One approach to mitigate the high degree of uncertainty that surrounds much small business lending is to insist on "good" security in all cases. It undoubtedly has a major role to play in making small business propositions acceptable. Nevertheless, its availability should not absolve bankers from the need to form a judgement about the underlying viability of any project.

The bank's preference will be to lend by way of loan rather than overdraft. By this mechanism the bank can establish an automatic monitoring mechanism for ensuring repayment as well as trying to ensure that the funds are used for the purpose for which they are granted. There have been too many instances where customers have used trading overdraft facilities for fixed asset purchases; this has robbed the business of much-needed working capital and led to its ultimate demise.

Businesses should expect to be able to provide the bank with monthly information to enable progress to be monitored. Accuracy is important. One should not try to cover up bad news. If there is a problem, we can try to see what can be done. A "head in the sand" attitude helps no one and if trust is broken it will lead to the bank taking the necessary steps to recover its loan.

Banks see SME lending as a high-risk activity, given the larger proportion of business failures in this segment. As a result, they will inevitably charge a higher risk premium. The price can, to some extent, be mitigated depending on:

- The level of capital that the owner has in the business
- The degree of profitability
- The extent to which profits remain in the business
- The value/desirability of security offered

Security in Uganda can be difficult. There is little market for property outside Kampala and in the event of failure these properties prove difficult to sell. There is a propensity by some valuers, not all, to overvalue, since valuation fees are based on the value attached to the property. Few valuers carry any, or sufficient, professional indemnity insurance on which banks can rely in the event of a dispute.

The Government and USAID are trying to help through various guarantee programmes. The introduction of the Export Guarantee Scheme run by Bank of Uganda has enabled under-capitalized companies to gain access to higher levels of financing than would otherwise have been possible.

The USAID scheme provides banks with a 50 per cent guarantee, enabling them to look more favourably on those marginal propositions where the customer has a good project but lacks adequate security. As mentioned before, security itself should not persuade a banker to lend. The underlying proposition has to have merit; otherwise, a bank will not use the guarantees just mentioned.

While access to finance by SMEs is difficult in general, it is made all the more difficult by the lack of good underlying corporate infrastructure in Uganda. Such infrastructure includes:

- Up-to-date company law, including receivership and liquidation laws
- An effective and modern companies register
- The ability to register effective charges on vehicles etc.
- Legislation to make asset financing more attractive
- A credit reference agency (one is due to start operating shortly)
- A national identifier, e.g. a social security number or national ID system
- An efficient legal system enabling speedy resolution of cases

In summary, SMEs could significantly improve their chances of obtaining credit by not complaining that banks’ requirements are too strict. They could do better by:

- Choosing their bank and establishing a relationship
- Maintaining better financial records
- Producing financial statements
- Operating their businesses with more discipline
- Educating themselves about banks' requirements.

Financing of SMEs

by
Juma Kisaame
General Manager
Leasing, DFCU Group

INTRODUCTION

The private sector is a key engine of development. In particular, the majority of businesses in Uganda (more than 90 per cent) are SMEs, providing jobs through which people can acquire skills and generate income. In fact, SMEs contribute two-thirds of national income and have proved to be a powerful force for poverty reduction and the foundation for a middle class.

The reasons for the difficulty in financing SMEs are as follows:

- Start-ups with limited or no credit history
- Lack of suitable collateral
- Undercapitalization
- Poor corporate governance
- Red tape and regulation of business practices
- Fragile informal sector with no strong voice
- Lack of sustainability
- Slim chance of survival due to small size and poor product quality in the fierce competition of globalization
- Lack of a resolution mechanism for commercial disputes
- Poor debt repayment culture
- Limited or lack of investment in IT
- Limited ability to manage the environment on a sustainable basis

DFCU'S INNOVATIVE FINANCIAL PRODUCTS

1. Leasing facilities

In its simplest form, a lease is a *contract* between an owner of equipment (the lessor) and another party (the lessee) giving the lessee *possession and use of a specific asset* in return for payment of *specified rentals* over an *agreed period*. The lessee selects the equipment and the lessor purchases it for the former's use. The benefits of leasing include:

- Medium-term finance, providing an alternative to traditional credit

- Minimum capital outlay
- Fiscal benefits; capital allowances claimed by lessee
- Easy budgeting because of fixed and equalized rentals
- Facilities structured to suit lessee's needs
- Applies across all sectors and types of equipment
- Simple documentation and lower transaction costs
- Technology transfer and modernization of production
- Investment is "self-funding", i.e. repayments match economic life of the asset

Key features of DFCU's facilities

- Size of facility: Ush 2 million to Ush 500 million
- Lease currency: US$ or Ush to match lessee income
- Repayment period: 2-5 years
- Nature of equipment: any asset of a durable and identifiable nature such as plant, equipment, machinery, commercial vehicles and business cars
- Cash contribution: typically 15-20 per cent of equipment cost
- Ownership of the asset: lessor maintains full ownership throughout the lease period
- Option to purchase: exercised by lessee at end of the lease
- VAT: charged on rentals where applicable
- Insurance and maintenance: responsibility of lessee

There are constraints on the development of a vibrant leasing industry. For example, existing legislation is not supportive. It is sometimes difficult to procure equipment owing to limited access to suitable funding sources. Leasing also involves high administrative costs.

2. Insurance premium financing

The DFCU Insurance Premium Financing (IPF) facility is designed to enable SMEs to meet their insurance premiums promptly and spread the repayments within 10 months. Benefits of the IPF facility are:

To the policy holders

- Ability to plan and manage cash flow with ease
- A fixed rate with no hidden extra costs
- Provides an alternative source of working capital
- Prompt renewal of insurance cover
- Enhances ability to purchase comprehensive insurance cover
- Simple to arrange

To the underwriters/brokers

- Better control of receivables
- Increased liquidity and capacity to settle claims on demand
- Increased investment income due to enhanced cash collection
- Marketing tool – increased business
- Higher customer retention and better value proposition

DFCU's mode of operations

- The insured obtains a quotation from the underwriter
- DFCU negotiates terms and executes agreements
- DFCU pays the full premium to the underwriter
- The insured repays advance in convenient monthly instalments over four to ten months
- Policy cancelled on default
- The underwriter refunds outstanding premium on a pro rata basis

WAY FORWARD

There is need for carefully chosen, transparent and well-designed interventions, especially in expanding access to such critical resources as capital, skills and industry information, to help small businesses move on faster, straighter growth paths. Possible areas of intervention in order to create a business-conducive environment are as follows:

Conducive business environment

- Lighter regulation and effective legislation
- Simple and favourable fiscal regimes
- Harmonizing and rationalizing business laws
- Simplifying registration and other administrative barriers to investment

Effective dispute resolution

- Strengthening the commercial courts in terms of speed and capacity
- Promoting the use of CADER services and training more arbitrators

Strengthen financial intermediaries

- Catalyzing establishment of leasing companies

- Fiscal incentives
- Credit enhancement and risk sharing schemes – SPEED/DFID
- Formation of a credit reference bureau
- Effective bank payment system
- Suitable lines of credit
- Venture capital, capital markets

Government/donor support in capacity building

- Technical assistance
- Skills/technology transfer
- Research and product development
- Sustainable domestic consulting and business support services
- Supporting development of independent associations
- Developing SMEs' capacity to manage the environment on a sustainable basis

Trade and Advisory services

- Dissemination of market and trade information – UNCCI, UIA, UBS
- Promoting regular public/private dialogue
- Promoting use of computers and access to the Internet

Supply chain linkages

- Nucleus firms (marketing, production)
- Outsourcing by large firms – core competence
- Training/skills transfer by large companies

CONCLUSION

SMEs must be part of the development equation. In emerging markets, they are actually the private sector, and sustainable development and employment creation cannot be achieved without them.

The Ugandan Government Policy Framework and Strategy for the Promotion and Development of SMEs

by
Henry Mbaguta
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MSE Policy Unit
Ministry of Finance, Planning and Economic Development

Micro enterprises in Uganda are defined as enterprises having:

- Fewer than five employees, including family members
- Working capital of less than Ush 2.5 million
- Turnover value of Ush 10 million

Small enterprises are defined as having:

- Up to a maximum of 50 employees
- Working capital of less than Ush 50 million
- Turnover value of Ush 10-50 million throughout each year of operation

The objective of the Poverty Eradication Action Plan (PEAP) is to reduce absolute poverty to 10 per cent through fast and sustainable economic growth. The Government's Medium Term Competitive Strategy (MTCS) aims at improving the business environment, increasing competitiveness and promoting the private sector. In particular, the MTCS addresses the specific elements for SME development such as:

- Improving infrastructure
- Strengthening the financial sector and improving SME access
- Reforming the commercial justice sector

There is a lack of coordination in mitigating the constraints facing SMEs. The Government has drafted a policy framework for SMEs, focusing on the legal and regulatory framework, capacity building and access to financing. Among the elements in the "Access to Finance" Reform are:

- Increasing access to capital at reasonable costs
- Reducing risks associated with lending
- Promoting financial products
- Restoring public confidence in the financial sector

- Providing incentives for diversification

Financing suitable for SMEs is still insufficient, and this results in limited growth and survival of SMEs. All stakeholders are invited to participate in the formulation and implementation of an SME-friendly policy to fully address the recommendations of the symposium.

The Role of the PSF in Promoting SMEs

by
Gideon Badagawa
Senior Policy Analyst
Private Sector Foundation

INTRODUCTION

Small and medium-sized enterprises (SMEs) form the backbone of the private sector all over the world, but more especially in emerging economies. It is estimated that SMEs make up approximately 90 per cent of Uganda's private sector. As the apex of private sector business associations in Uganda, SMEs are the primary constituency that the Private Sector Foundation (PSF) serves. This paper considers the PSF's experience in supporting SMEs. It also highlights the constraints that SMEs face in accessing finance and proposes mechanisms through which these obstacles can be removed.

1. PSF MANDATE

The PSF was formed in 1995 in response to the need to improve the operating environment for private businesses in Uganda. Its mission is to improve the business environment in Uganda through policy research, advocacy, designing and coordinating development of private sector initiatives, promotion of dialogue, facilitating transfer of new technologies and training. Membership of the PSF is voluntary. It now comprises over 40 business associations, professional bodies and corporates in Uganda, as compared with 13 private associations in 1996. The PSF is governed by a Board of 10 directors, elected by members at the annual general meeting.

2. EXPERIENCE OF THE PSF IN SUPPPORTING SMEs

Within the purview of its mandate, the PSF has supported SMEs mainly through policy advocacy, injection of know-how into business and capacity building.

2.1 POLICY ADVOCACY

The policy advocacy agenda for the PSF is developed through communication with members, and consensus building. One of the issues that has repeatedly featured on the national policy agenda is the high cost of credit and limited access to it, particularly by SMEs. Other policy concerns for which the PSF has advocated include pension sector reform, waiver of withholding tax on commercial paper and, restructuring of the Uganda Development Bank.

2.2 PROVISION OF BUSINESS DEVELOPMENT SERVICES

The PSF led the way in introducing and managing business development services (BDS) in Uganda in 1996. The focus on BDS in 1996 was on a single institution providing subsidies to allow small enterprises to become more competitive. The new approach is based on offering BDS on a financially sustainable basis. This market approach is the foundation on which the PSF manages BDS initiatives.

BUDS

The PSF managed the Business Uganda Development Scheme (BUDS), which was developed as a component of the Private Sector Competitiveness Project. The aim of BUDS was to enhance the competitiveness of the private sector by facilitating the injection of know-how and expertise into small and medium-sized Ugandan firms. The project life was four years, with a total estimated budget of $7.56 million, comprising $3 million in grant funds, $3 million matching expenditure by clients and $1.56 million for investment and recurrent expenditure. By the end of the project in June 2001, total reimbursements were $2.88 million. The scheme had worked with over 740 firms and organizations and agreed on over 1,400 activities.

BUDS-SSE

Owing to the success of BUDS, the European Union selected the PSF to manage a scheme designed to provide business development services to micro and small enterprises in Uganda. The aim was to facilitate acquisition of know-how by small enterprises through capacity building and training. The total grant is 700,000 euro, with each recipient eligible for a cumulative limit of 5,000 euro. So far, the scheme has received overwhelming support country-wide.

3. DIFFICULTIES IN ACCESSING FINANCING FROM FORMAL SOURCES

High cost of finance

The high cost of finance and limited access to credit remain key impediments to private sector growth in Uganda. Commercial banks' average lending rates have been over 23 per cent for the past three years. These rates compare unfavourably with those of our East African partner States. Indeed, very few private businesses in Uganda can achieve an internal rate of return as high as 25 per cent to justify borrowing from the Uganda's commercial banking sector. Domestic deposits have been targeted to cushion fiscal indiscipline and to fund budgetary shortfalls, further pushing up the interest rates. If Uganda is to market itself as an attractive investment destination, this must change.

Poor information sharing between banks and SMEs

Inadequate information escalates the cost of borrowing and constrains access to the required credit. Banks usually do not supply all the required information to the small borrowers, except the lending rates - that is, other fees are not mentioned. When these are added up, the cost of borrowing escalates. On the other hand, small borrowers do not supply all the information required by banks, thereby constraining their own access to credit.

Lack of acceptable collateral

Many banks, particularly the transnational ones, do not accept collateral outside a 5 kilometre radius of the city centre. Even for urban-based SMEs, this condition is a severe constraint. It has been suggested that microfinance could salvage the small borrowers, but the financing requirements of SMEs are beyond the limits of many microfinance institutions. In addition, the very short-term nature of microfinance, coupled with the high interest rates, makes microfinance institutions unsuitable as a funding mechanism for financing in this sector.

Limited sources of long-term finance

Uganda's financial sector is dominated by commercial banks, with a limited number of development banks. As a result, SMEs frequently use the more readily available short-term financing instruments for medium- to long-term investments. In addition to reducing their profitability and constraining their ability to pay, this situation diverts investment decisions away from capital-intensive ventures.

Insufficient depth of the financial sector

The business needs of enterprises are generally varied. For these needs to be adequately addressed by the financial sector, the latter must be equally diverse. This calls for a wide variety of long-, medium- and short-term products, and a healthy composition of both debt and equity instruments, as well as those instruments specifically tailored for the unique needs of certain sectors. The financial sector in Uganda is narrow with only a few standard products, and this limits the options available to SMEs.

4. PERSPECTIVE OF BANKS AND OTHER LENDING INSTITUTIONS

High risk of lending to SMEs

Larger enterprises have relatively fewer problems in accessing credit, compared with SMEs. This is because of their sound track record of profitability, international shareholding and a long-term relationship with banks, which translate into a lower risk rating. At the opposite end of the spectrum, micro enterprises are able to access loans through microfinance institutions, albeit at high cost. Medium-sized enterprises are "too large" to be served by microfinance institutions, and are therefore left to bear the brunt of the imbalances in the financial sector in Uganda.

Lending institutions rate SMEs as highly risky. Commercial banks are loaded with a high proportion of non-performing assets, and are therefore keen to avoid risk. Nevertheless, the question that must be answered by financial institutions is, How should SMEs' risk be managed effectively? For this is part of bankers' business. This is critical because SMEs dominate the business sector in Uganda and because they are at the core of future enterprise development, and hence economic growth. Resolution of this problem will go a long way in reducing the cost of credit for all businesses in Uganda.

Inadequate legal and regulatory environment

The delayed tabling, debating and passing of the Financial Institutions Bill by the Parliament have further constrained SMEs' access to business finance by delaying the legal framework that would pave the way for the formal establishment of key instruments and institutions, such as the credit reference bureau.

Lack of contract enforcement

Uganda's commercial justice system has seen some improvement in the recent past, with the establishment of the Tax Appeals Tribunal and the Commercial Court, among others. However, more needs to be done in order to streamline and improve land and business registries. This will go a long way in combating fraud, fostering compliance with regulation and ensuring that business contracts are enforced.

Other problems particular to SMEs

- Inadequate capacity to develop bankable projects
- Lack of good corporate governance, i.e. transparency in business as well as accountability
- Nascent savings and credit management culture
- Inadequate knowledge of business as a long-term profession

5. PROPOSALS ON THE WAY FORWARD

5.1 MICROFINANCE INSTITUTIONS AS INTERMEDIARIES

Because commercial banks need high-value security, preferably in Kampala, which is not available to SMEs, there is a need to support the microfinance industry (MFI) and expand outreach. This would ease availability of credit, especially for medium-sized, rural-based enterprises. Interest rates in the MFI, however, are much higher than those offered by commercial banks, although the conditions of payment are more appealing to small borrowers. Government, probably through the Rural Microfinance Support Programme (RMSP), could open up affordable funds for on-lending through the MFI. Inasmuch as the private sector appreciates the policy of liberalizing interest rates, it is thought that the Government can design a mechanism to support SMEs' access to affordable finance, for example, especially through fair competition and appropriate regulation.

5.2 CAPACITY BUILDING FOR SMEs

SMEs lack the capacity to organize and keep business records, and this constrains their access to commercial bank credit. Another consequence is that they cannot establish their performance in terms of revenue and profitability over time, which is one of the banks' key requirements. It is thus crucial that small borrowers be sensitized about how to improve their access to business finance, particularly from banks. More emphasis should be put on controlling risk and improving repayment culture through SMEs' maintenance of sound business records.

In order to address this, the Government needs to support the private sector in designing and setting up programmes through which to recruit, train and deploy "financial extension workers," as in the case of agriculture. These will study, and assist SMEs in compiling, business records and calculating their cash flows. Such workers will be required to be prudent enough to command credibility from the banks to which borrowers are affiliated. Financial extension workers would therefore be required to build a track record and to be accredited to specific banks, and should not be expected to submit fraudulent records to such banks.

5.3 IMPROVING ACCESS TO LONG-TERM FINANCING

There is a need to review and establish opportunities that will help expand financial instruments and improve access to business finance. Specifically, opportunities such as equity financing and other non-bank loan financing, including issuance of bonds, asset leasing and venture capital, could be reviewed as a means of accessing long-term finance. Mechanisms for lending through the Uganda Development Bank should be made clear to potential borrowers. The private sector commends the efforts of some banks, such as DFCU, in widening the scope of leasing arrangements to upcountry centres, and particularly so for SMEs.

5.4 BANK OF UGANDA LINES OF CREDIT

Funds through the Bank of Uganda (BOU) "lines of credit" are still expensive. Funds should come direct to commercial banks for pre- and post-financing. The BOU would need only to monitor flows and regulate the industry. Funds ought to be available from one centre, which is also the institution that should carry out credit evaluation.

5.5 RURAL BANKING

It is expensive to operate rural banking and yet crucial for mobilization of rural savings. Government should provide clear incentives for banks to extend credit and mobilize savings in rural areas. Although microfinance institutions need to go rural, they should not substitute for rural banks. This should boost support to rural-based enterprises.

5.6 STRONG LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework honours loan contracts so that banks' perceived risks may be reduced. In this regard, the ongoing reform of commercial laws is a step in the right direction. Furthermore, the process of passing legislation to reduce the default rate by establishing the Credit Reference Bureau should be energized.

CONCLUSION

Despite the constraints in the legal and regulatory environment and the financial sector, SMEs have been able to drive Uganda's economic growth. While some developments in the financial sector are taking place slowly, there is a need for joint efforts by the private sector, regulators and the Government in order to ensure that government policies do not stifle the growth and vibrancy of SMEs in Uganda. As business is built on trust, there is a need to build mutual trust between SMEs and other stakeholders such as banks, other financial institutions and policy makers. Continued support for capacity building must be provided to SMEs in order to enable them to continue to play a vital role in economic development in Uganda. Furthermore, diversified financial products must offered to meet the varying needs of SMEs.

SME Finance: Making a Profit by Servicing the Sector

by
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Head
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DITE, UNCTAD

In the last five years lending to SMEs has increased dramatically in developed countries owing to various financial innovations. These innovations are resolving the problems of high transaction costs and risks. Among the leaders in SME financing are:

Europe	USA*
Swedbank (Sweden)	US Bancorp
German Savings Banks	Union Planters Corporation
Stadtsparkasse Hannover (Germany)	Wells Fargo & Company
NatWest (UK)	Bank One Corporation
CERA Bank (Belgium)	Bank of America Corporation
ING Bank (Netherlands)	Citigroup, Inc.
Groupe Banques Populaires (France)	Chase Manhattan
Banco di Sardegna (Italy)	Fleet Financial Group, Inc.
	Bank of New York Company

*Out of 57 small business-friendly banks, with more than $10 billion in assets.

FINANCIAL INNOVATIONS

In order to lower transaction costs, these commercial banks segment their market and offer the right product to the right client. They have adopted IT in the entire lending process from application analysis, pricing and monitoring. They tend to have a good branch network and delegate loan approvals to bank staff. They have also developed a sophisticated credit policy-making mechanism, and employ credit scoring and risk-oriented pricing. In addition, they often use external business appraisals.

Credit scoring is a statistical method used to assess the risk of default by a credit applicant, based on the analysis of a large sample of past borrowers. The score assigned to each applicant is a single quantitative measure to calculate the probability that the applicant will default according to his/her observed characteristics.

Risks of non-payment are dealt with by commercial banks differently, such as through:

- Pricing loans according to level of risk
- Mutual guarantee schemes
- Covenants
- Risk self-assessment
- Peer pressure
- Promises of continued credit
- Savings with credit

COMBINING FINANCIAL AND NON-FINANCIAL SERVICES

What most commercial banks in the developed countries have done is to combine their financial services with business services. NatWest has a Business One Stop Shop, which helps entrepreneurs make their business a success. Better yet, banks strike up a partnership with business development services (BDS) providers:

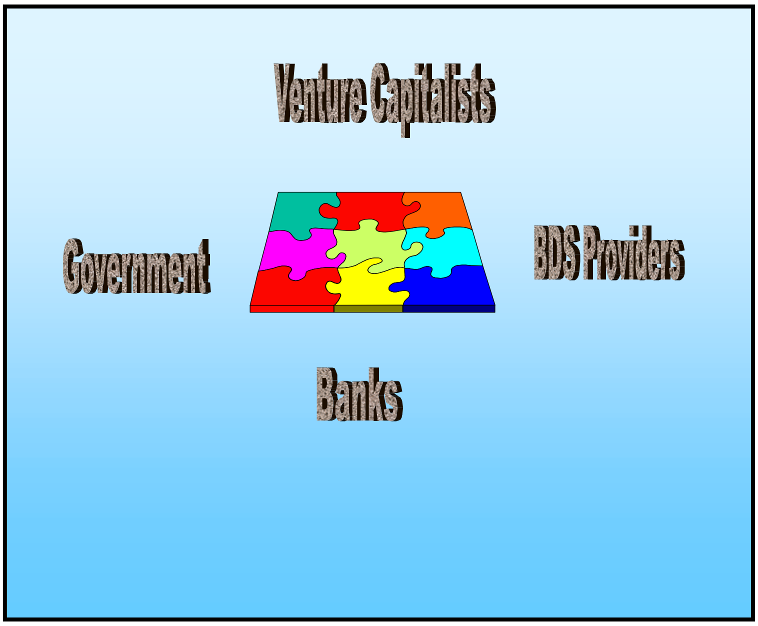
- To minimize both risk and transaction costs for banks and equity capitalists; and
- To make access to credit and equity less costly and less cumbersome for SMEs.

SMEs with potential in developing countries need to be get into shape. They need "handholding" in the pre- and post-finance stage. How can the gap between banks and SMEs be bridged? A BDS provider can:

- Identify potential clients for the bank
- Judge creditworthiness
- Install adequate accounting systems
- Pre-screen project proposals
- Monitor repayment
- Exert peer pressure
- Maintain one-to-one contacts

These activities will minimize risks and transactions costs because, unlike the banker, the BDS provider is close to his client, knows his problems and his needs, and his performance record.

COMBINING FINANCIAL AND NON-FINANCIAL SERVICES



The crucial question is: what conditions, assurances and incentives are necessary for entering into partnerships with BDS providers? How can we start the process?

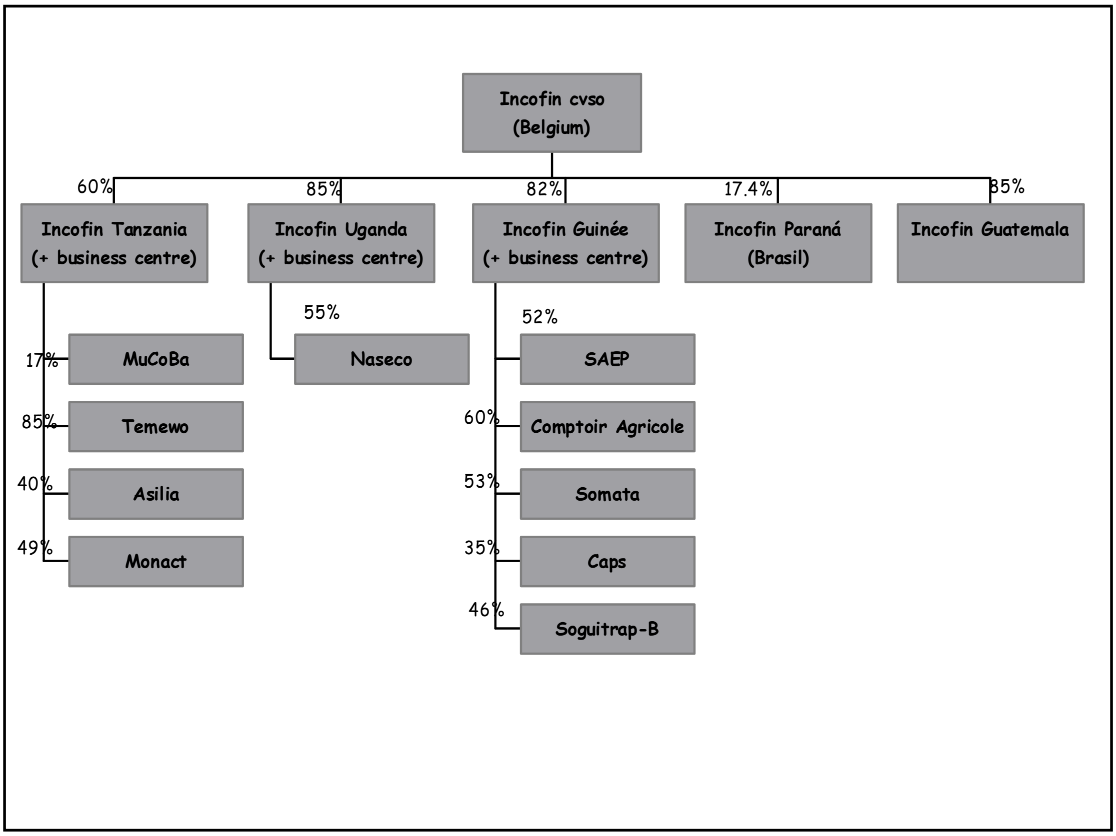
Microequity in practice

by
Loïc De Cannière
Managing Director
Incofin Belgium

THE MISSION OF INCOFIN

Incofin is a Belgian private investment company, founded by companies and managers wishing to support entrepreneurship in the Southern hemisphere. Incofin wishes to enable small entrepreneurs in the South to develop their own business and to contribute to sustainable development by assisting them in achieving self-development.

CURRENT SHAREHOLDINGS



Incofin operates in accordance with the highest professional standards; it uses an investment approach and does not make grants. Its current capital is EUR 1 million, with the net asset value at EUR 1.8 million as of 31 December 2001. As the private placement under way will result in a capital of EUR 2 million by the end of 2002, the net asset value by the end of 2002 will be approximately EUR 3 million.

PRODUCTS

Developing and operating business centres

By offering office space, training, coaching and financing to local entrepreneurs, business centres in the South serve as incubators for new economic activities. In addition to the three existing business centres in Uganda, the United Republic of Tanzania and Guinea, two new centres are in preparation in South Africa and Congo.

The goals of operating business centres include:

- Strengthening existing companies through management assistance
- Working according to "best practices" through cooperation with other international organizations such as UNCTAD/Empretec and ILO
- Undertaking the regional headquarter functions for Incofin Group
- Hosting the local team managing the "microequity" investment fund: screening, preparation of investment decisions and follow-up

Equity family for SMEs

Incofin offers a microequity facility for SMEs and has shareholdings in agro-businesses such as seed multiplication, weaning food, commercializing vegetables and vegetal oil production, as well as metal workshops, computer centres, and leather products. Important parameters for the selection of businesses are:

- Quality and reliability of a local operational partner
- Relevance for development
- Strict analysis of business plans
- Profitability and sustainability
- Follow-up plan, including reporting and audit
- Pre-negotiated exit

Microfinance

Incofin operates microfinance funds in Uganda, the United Republic of Tanzania and Guinea with considerable expertise in the areas of management, software and procedures. It has achieved high repayment rates. Furthermore, cooperation is under way with the International Finance Corporation (World Bank) to establish a microfinance bank in the United Republic of Tanzania that will finance outgrowers supplying sugar cane to the South African ILLOVO sugar plant in Kilombero (10,000 farmers).

Ex-Change: The Flemish senior expert platform

Ex-Change is a platform which matches demands for technical assistance from SMEs in the South with available know-how amongst Flemish senior experts. This is based on the concept of PUM, a similar Dutch organization, which has a database of 3,000 senior experts and organizes yearly about 1,500 missions.

Ex-Change is financed by the Flemish Government. In 2002, 10 missions will be organized. In three years from now, 100 missions are expected to take place yearly. The Ex-Change missions typically take about 2-3 weeks and are free of charge for the beneficiary SME, except local costs. Currently, the European Union is considering co-funding with the Flemish Government.

Partnerships between entrepreneurs from North and South

Incofin encourages entrepreneurs from the North, often SMEs, to conclude partnership agreements with SMEs from the South. These agreements are non-financial, but aim at sharing expertise concerning management, markets and technical know-how. Examples are:

- Mukati (Hoima) and Wyckaert Constructions (Ghent)
- Equator Valley Farm (Mkosi) and Minds in Motion (Ghent)

COOPERATION BETWEEN ENTERPRISE UGANDA AND INCOFIN UGANDA

Incofin Uganda's involvement is in the following areas:

- Training: recruits clients for Empretec training in western Uganda and provides Incofin Uganda's premises, including secretarial services for use by Enterprise Uganda. Incofin Uganda also provides post-training services to Enterprise Uganda trainees.
- Ex-Change: assists the development of SMEs associated with Enterprise Uganda through Belgian volunteers.
- Partnerships: attempts to twin Belgian companies with SMEs associated with Enterprise Uganda.
- Microequity: channels investment funds to SMEs associated with Enterprise Uganda.

INCOFIN UGANDA: EQUITY FACILITY FOR SMES

A disadvantage of microcredits is that they tend to be small amounts with short durations, not corresponding with payback of investments. They often require high interest payable at the wrong moments. In addition, there is generally no contribution to improvement of management. Therefore, growth-oriented SMEs need other financing instruments.

A microequity facility can provide tailor-made financing satisfying the needs of expanding, profitable and promising SMEs. The characteristics of microequity include:

- Adequate time path for remuneration of capital invested
- Adequate agreements on guarantees, rather than collaterals
- Support in terms of managerial capacities and business analysis
- Support in access to markets

Such a facility should be managed by a competent local team of investment managers in charge of screening markets and investment applications, reviewing business plans, preparing investment decisions, preparing legal documentation and following up investments. No such facility exists in East Africa.

The sustainability of the facility depends on a) the capacity building of the local Incofin team for which donor funding is required, and b) risk mitigation through:

- Thorough analysis of the investment applications whereby Enterprise Uganda will have a good picture of the quality of applicants
- Due diligence
- Strong legal capacities to guarantee the quality of agreements
- Diversification

Financing SMEs: Experience of EMPRETEC Ghana Foundation

by
Osei-Yeboah
Head
Credit Operation
EMPRETEC Ghana Foundation

INTRODUCTION

The EMPRETEC Ghana Foundation (EGF) has since 1996 operated two mechanisms to facilitate the access of small and medium-sized enterprises (SMEs) to credit and capital. The first one is the credit component of the Capacity Development and Utilization Programme (CDUP), funded by the United Nations Development Programme (UNDP). This is commonly called the Credit Sourcing Scheme. The other mechanism is the Mutualistic EMPRETEC Guarantee Association (MEGA).

CREDIT SOURCING SCHEME

EMPRETEC was one of the agencies identified in 1995 to implement the CDUP developed at the instance of the Government of Ghana to alleviate poverty and enhance the capacity of the private sector, among other considerations. The project had the following components:

- Commercialization of science and technology
- Employment generation
- Skills and entrepreneurship development
- Credit sourcing

The EMPRETEC Ghana Foundation was chosen to implement the credit sourcing component of the programme. The objectives of this component were:

- To build the production capacity of SMEs
- To facilitate the growth and expansion of SMEs; and
- To build the capacity of the Empretec Ghana Foundation in credit delivery

These were to be achieved by granting credit to micro, small and medium-sized enterprises operating in three main sectors, namely, tourism, construction and non-traditional exports. These sectors were considered very important to the developmental objectives of the country at the time. The scope has lately been expanded to include the manufacturing and service sectors.

The scheme started in February 1996 with a seed fund of $700,000 provided by UNDP. The fund was converted to local currency at the time (i.e. 1.14 billion cedis), and this has been the only cash source of funding except vehicles and other equipment provided by UNDP.

MODE OF OPERATION

In the implementation of the scheme, credit centres were established in five regional capitals. These offices are run by well-trained and experienced professionals who serve as credit managers and are equipped with resources that include computers, four-wheel vehicles and support staff.

Because of the high risk of extending credit to SMEs, EMPRETEC adopted a unique approach to financing under the project. Credit services were combined with the other components of the EMPRETEC model, such as capacity building of the entrepreneur and his/her enterprise.

Prospective clients are carefully screened and trained where necessary, such as in loan management, bookkeeping and accounting. In addition, their enterprises are assessed and corrective measures are adopted to improve their viability. Most of the initial beneficiaries were people who had trained in the other component of the programme, namely skills and entrepreneurship development.

A Loan Approval Committee composed of experienced bankers, accountants, financial experts and small-scale entrepreneurs has been constituted, and it meets regularly to consider loan applications submitted by the credit centres. It also monitors loan repayment performance through regular visits, business counselling and impact assessment.

Some features of the scheme are as follows:

- Loans can be used to finance both the working capital and fixed asset needs of the business.
- Repayment periods range between 12 months and 18 months for working capital and equipment financing, respectively.
- Interest has been at the relatively lower rate of 35 per cent per annum since the inception of the Scheme. During this period, normal bank rates were in excess of 50 per cent per annum.
- Loan amounts currently range between $100 and $1,000 for micro financing and up to $6,700 for SME financing.
- Group lending methodology is used for micro financing.

- Security requirements are drastically relaxed. The assets of the business, together with third-party personal guarantees, are acceptable as security for the loan. No collateral is required.

ACHIEVEMENTS

The Credit Sourcing Scheme has been quite successful. As of December 2001, the initial capital of $700,000 had been rolled over more than three times and had financed $2.24 million in total to 1,052 beneficiaries. Roughly 62 per cent of these beneficiaries were women, and 38 per cent men. In terms of loan amounts, the women accounted for 34 per cent and 66 per cent men. Repayment performance has been very good, with a recovery rate of about 90 per cent throughout the period.

The scheme has performed much better when measured in the local currency terms. The initial capital of $700,000 equivalent (1.14 billion cedis) had been rolled over more than six times and had financed 6.4 billion cedis in loans as of December 2001.

Owing to the rapid depreciation of the local currency by about 353 per cent between 1997 and 2001, from an average exchange rate of 1,982 cedis to the dollar to 7,000 cedis, the seed fund had depreciated drastically to $211,594 (i.e. 30 per cent of the original amount) by December 2001. Nevertheless, this amount translates to 1.48 billion cedis, representing a 30 per cent growth in the original fund of 1.14 billion cedis.

During the six years of the scheme's operation, 3,264 jobs were created, contributing to poverty reduction. Not only was the working capital of the beneficiaries improved, but they also acquired basic tools and equipment. Thus, SMEs' production capacity has grown. The banking culture of Ghana has improved. Furthermore, the institutional capacity of EMPRETEC in credit delivery has been built and, in addition, the national presence of EMPRETEC has broadened.

MEGA SCHEME

MEGA is a mutual guarantee scheme used as a method of funding SMEs. It has been implemented since December 1996 in response to the demands from empretecos, beneficiaries of EMPRETEC's flagship Entrepreneurship Development Workshop, to help them deal with difficulties in accessing credit from the formal sector.

The essence of the scheme is that by mutually guaranteeing each other bank borrowing on the basis of a fund created by regular joint contributions by SMEs themselves, they are put in a position to access finance, which they could not otherwise do.

MODE OF OPERATION

Between 6 and 16 businesses come together to form a MEGA Group. The members agree to contribute an agreed sum of money every month into a common fund known as Loan Guarantee Fund (LGF). In the initial stages, the United Kingdom's Department for International Development (DFID) provided matching funds equivalent to the group's contribution to the LGF. The fund is placed in an interest-bearing investment account with a participating financial institution (PFI). The contributions so far made are multiplied by a factor of four by the PFI to create a loanable fund from which members can easily obtain credit. After a probation period of six months, a member of a group qualifies to apply for a loan.

Loan requests are analysed by the MEGA secretariat, while a report is presented to a Loan Approval Committee for consideration. The Loan Approval Committee comprises representatives from the PFI, the EMPRETEC Ghana Foundation and two members of the MEGA Group. Here again security requirements are relaxed. A debenture charge over the company's assets and a lien on the LGF serve as security for the loan.

ACHIEVEMENTS

As of December 2001, there were 405 members of the foundation comprising 37 MEGA Groups. Investment income now amounts to $227,000 with total loanable funds of $908,000, out of which $467,000 has been granted. Loan amounts approved have ranged from $270 to $10,700, while loan repayment periods have varied between 12 and 18 months. The interest rates charged on MEGA loans by the PFI are typically 4 per cent below the market rate. The extra security provided by the guarantee enables the members to borrow at a lower interest rate.

LESSONS LEARNT

The EMPRETEC Ghana Foundation has learned a number of useful lessons from the two credit mechanisms that it has been operating:

- Despite increased competition and added innovation in the Ghanaian financial sector, there remains a wide gap in the credit market when it comes to financing SMEs.
- SMEs require extensive training and support services to develop their management, production and marketing skills.
- Institutional bias by banks towards SMEs exists. This is largely because the risk profile of SMEs is high and SME lending also involves high monitoring and management costs.

- Yet SMEs need credit and capital for expanding their working capital and for new equipment to increase their production capacity.
- Despite the fact that the provision of non-financial services, particularly in the area of skills and entrepreneurship development, has proved to be very effective in improving the performance of SMEs, more often than not, SMEs cannot afford the commercial rates charged by the service providers.
- Because of the high cost associated with lending to SMEs, most credit facilitation schemes suffer by way of sustainability in the long run.
- The MEGA scheme has offered a number of SMEs the opportunity to demonstrate directly to the participating banks their ability to perform in loan repayment. This has improved their credit rating with the banks, thus enabling the businesses to secure much larger loans directly from the banks on their own merit.
- Much as the two credit schemes operated by EMPRETEC have been a useful mechanism, they only provide the short-term credit needs of the business. The crucial long-term credit needs of the SME remain unsolved.

CONCLUSION

SMEs are a major component of the private sector, which has been identified as the engine for growth in the overall developmental effort of the Government of Ghana. This is largely because over 80 per cent of all registered businesses in Ghana fall within this category. SMEs are not only found in almost all the various sectors of the Ghanaian economy, but also are major source of employment, including self-employment, generating substantial income and growth.

The inaccessibility of credit and capital is a major impediment to the development of SMEs, particularly because it prevents them from acquiring the new technology that would make them more productive and more competitive. There is, therefore, an urgent need for collaborative efforts by all stakeholders to find a lasting solution to the credit needs of the SMEs. This is the segment of the economy where businesses are too small to have access to bank credit and at the same time too large to be satisfied with microcredit.

SPEED Project

by
Jack Thompson
Project Coordinator
Support for Private Enterprise Expansion and Development (SPEED)

The SPEED Project, funded by USAID for the period from 1 March 2001 to 31 December 2003 aims at expanding sustainable opportunities to support business growth and rural development. The objectives of SPEED are to assist SMEs by:

- Increasing access to financial services;
- Creating and expanding agricultural and non-agricultural enterprises; and
- Strengthening legal and regulatory frameworks for business development in the SME and microfinance sectors.

All this effort is taking place within the Medium Term Competitiveness Strategy of the Government of Uganda (GOU).

SPEED is guided by three principles. The first is sector focus, by which SPEED is positioned to provide maximum support to initiatives targeted by the GOU and USAID through the complete project. Sector focus also represents a good solid business strategy. It provides maximum opportunity for SPEED to design and package business opportunities in which all of SPEED's client groups are involved.

The second guiding principle is targeting market-linked business opportunities. SPEED will design market-linked, bankable business solutions to sector growth. Interventions will be linked to defined market opportunities, to involve large numbers of producers, SMEs, and processors, and to provide opportunities for the introduction of new approaches to financing and business development services (BDS).

The final guiding principle demands that we work ourselves out of a job. SPEED is a short-term effort. Therefore, it is imperative that we build capacity at every level, in each entity we work with, and in every deal. We hope, for example, that two and a half years from now, the banks and finance companies will pursue the SME sector on their own, simply because of the opportunity it offers – for new clients with expanding businesses, and profits for the institution.

SPEED has three interdependent components. First, the Business Environment component focuses on improving the efficiency and operations of selected public and private institutions with a view to improving the overall business environment. Examples include alternative dispute resolution, the land and companies registries, and policy and advocacy activities.

Secondly, the Business Capacity component focuses on strengthening BDS providers and increasing business capacity in selected agricultural and non-agricultural sectors. We seek to develop and support market-linked ventures that have significant economic impact and develop business capacity among a large number of producers, processors, exporters and SMEs. Examples include working with UCDA on six coffee deals to provide technical assistance and training, with Kinyara Sugarcane Growers Ltd. to increase yields, reduce production costs and strengthen links with the factory, and with KSGL to help it become more commercially oriented.

Third, the Financing component aims to increase the use of financial services by SPEED clients. SPEED focuses on MFIs and works in four key areas: assisting four MFIs to become MDIs; assisting a further five MFIs to move towards FSS; developing linkages between MFIs and financial institutions; and involvement in various MFI industry forums and activities. SPEED also works with the financial services sector to increase financial flows to SMEs and target the missing middle with their assets of USh 3 million to 425 million.

SME FINANCING INCREASED THROUGH KEY ACTIVITIES

Financial Sector Working Group

SPEED has formed a Financial Sector Working Group (FSWG) consisting of managers from seven key banks and DFCU Leasing. The FSWG is the primary financial advisor to SPEED and helps to advise and assist with presentation and submission of SPEED-packaged deals to financial institutions. It also serves to find solutions to issues and problems related to financing.

Training of bank loan officers in SME lending techniques

SPEED fully recognizes the difficulties faced by commercial banks in appraising loan applications from SMEs. Nevertheless, there are profitable business opportunities for the banks in lending to SMEs if the problems associated with a lack of reliable information can be overcome.

The SME lending training programme takes a practical cash-based approach to appraising loan applications from SMEs with specially prepared material designed for practical training. The programme's objective is to build capacity in the Uganda Institution of Bankers (UIB) to establish this programme as part of its standard curriculum through the provision of training-of-trainers courses for UIB staff. There have been two training sessions so far, one in September 2001 and the other in January 2002. Further training is planned for the UIB staff to ensure that UIB is adequately prepared to meet the challenge of delivering the SME lending training programme.

New product and services

SMEs face difficulties in Uganda in raising medium-term finance for the purchase of equipment. Because of the following characteristics, leasing may resolve the usual difficulties in obtaining bank finance:

	Loans	Leases
Product	Provision of finance	Provision of equipment
Collateral required	Land title in Kampala	The equipment
Recovering procedure	Complicated	Recover the equipment
Contract period	Maximum 12 months	2 to 4 years

Leasing works very well in an environment which has a favourable tax regime for financial institutions and a supportive legal framework. Given the importance of leasing in Uganda and its relevance for SMEs, SPEED supports three upcountry leasing centres - including in Mbarara (opened in September 2001) and Mbale (opened in February 2002).

In addition, SPEED will assist selected financial institutions in implementing the Grow Your Business programme, providing BDS to existing or potential SME clients identified by the financial institutions. The overall objective is to develop the business of our regional BDS provider into an integrated SME practice. The mechanism is as follows:

- Regional BDS providers have been appointed and trained
- Financial institutions identify clients
- SPEED's regional consultants provide services to clients, such as bookkeeping, accounting, development of growth strategies, packaging of new ventures and after-care services
- Consultants refer clients back to financial institutions for financing
- SPEED cost-shares for the BDS services in the form of grants

As a pilot, the first awareness workshops are planned for late May 2002 in Mbarara.

Collateral programmes

The USAID/DCA Loan Guarantee Programme has been operational since April 2002 with participation by the following banks – Allied, Citibank, Standard Chartered, Barclays, Nile, Centenary and Stanbic. It provides a 50 per cent guarantee for loans up to US$1 million until 31 January 2007.

SPEED is promoting and monitoring the programme by briefing workshops for bank staff, while the loan and guarantee decisions are made by banks. One bank has already placed three loans under the guarantee.

Partnership to Fight Poverty

by
Charles Ocici
Executive Director
Enterprise Uganda

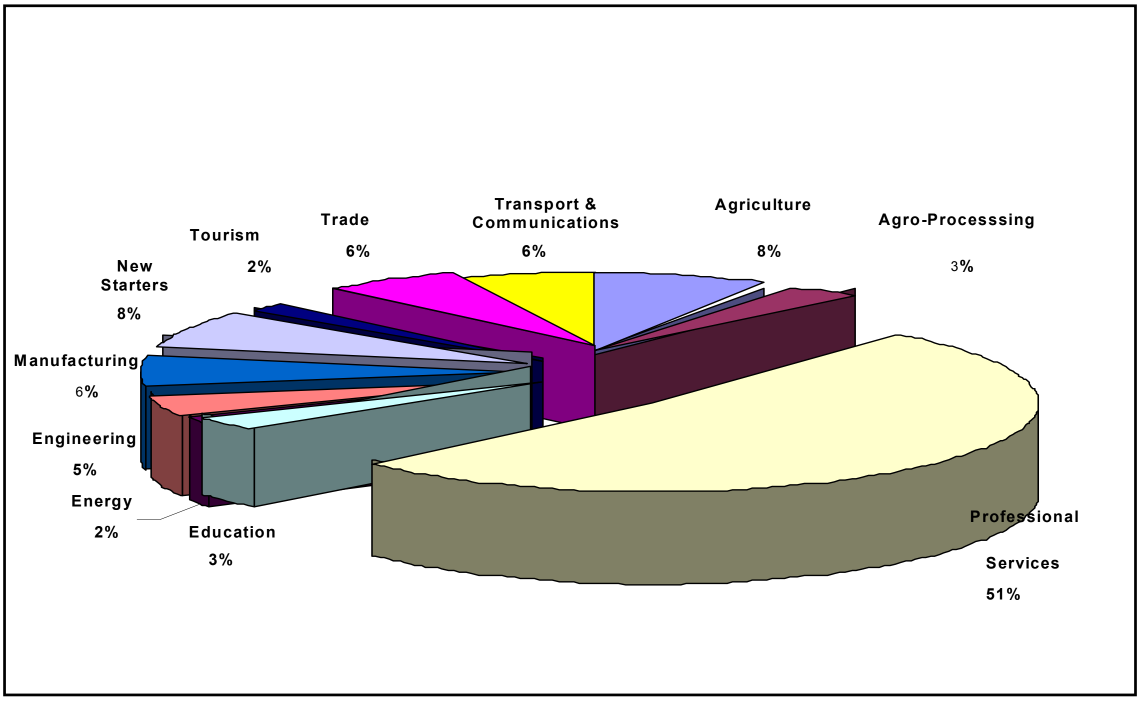
On the basis of the research finding that entrepreneurship traits are transferable through training, Enterprise Uganda aims at developing a new generation of dynamic Ugandan entrepreneurs by actively providing support to SMEs to enhance their productivity, growth and competitiveness. The premier entry product includes an intensive 10-day motivational and entrepreneurship development workshop the methodology of which instils and strengthens entrepreneurship traits. Participants familiarize themselves with, recognize, develop and apply those behaviours in business. Other services provided include:

- General management training;
- Business opportunity identification;
- Preparation of business plans;
- Management advisory and extension services;
- Sourcing of credit;
- Assistance in developing joint ventures with foreign companies;
- Assistance in developing subcontracting linkages with domestically registered large-scale businesses;
- Technology upgrading, enhancement and assisting foreign companies to identify suitable local partners; and
- Export market development, including assistance in handling export contracts.

Of 65 entrepreneurs trained so far, 31 are female and 34 male, and are distributed by region as follows:

Kampala	54	(83%)
Mbale	3	(4.6%)
Fort Portal	2	(3.1%)
Bugiri	1	(1.5%)
Entebbe	1	(1.5%)
Kasese	1	(1.5%)

Mpigi	1	(1.5%)



Nakasongola	1	(1.5%)
Soroti	1	(1.5%)

On the other hand, the distribution by business sector is:

The challenges ahead are:

- Lack of universal definition of SMEs and SME-specific national policy;
- SMEs' limited access to credit;
- Development of a quality pool of service providers that charge rates within the means of most SMEs; and
- Affordability of EMPRETEC Development Workshops for SMEs, especially those in upcountry locations.

PART III

Wrap-up

Closing Statement

by
Louis A. Kasekende
Deputy Governor
Bank of Uganda

Judging from the level of participation, there is no doubt in my mind that this symposium has given an opportunity to key stakeholders in the SME sector in Uganda to identify major constraints encountered in accessing formal finance and steps that must be taken to improve it. I am truly humbled by the response of the participants.

One of the outputs of this symposium is an Action Plan, which will be executed by a core Implementation Committee representing all stakeholders. This is a valuable input in the resolution of a pertinent ingredient in enterprise development. It has differentiated this symposium from many similar ones held on issues of financing SMEs. It is therefore important for the implementation team to ensure that the recommendations, which are in line with the government policy of focusing on the private sector as an engine of growth, are implemented.

Indeed, for one and half decades, the Ugandan Government has championed and promoted policies that address the constraints of the private sector. This started with the launching of the Economic Recovery Programme in 1987, followed by a prolonged period of macroeconomic stability and wide-ranging structural reforms. These have been the hallmarks of Uganda's phenomenal economic progress so far.

In order to consolidate these achievements and address the remaining macro- and other economic challenges, the Government has created frameworks for sustainable economic growth and development. These include the Poverty Eradication Action Plan (PEAP), the Plan for Modernization of Agriculture (PMA) and the latest one, the Medium Term Competitive Strategy (MTCS). It aims at removing constraints that prevent the private sector from being competitive locally and globally. Its priority actions include:

- Reforms in infrastructure to reduce infrastructure-related costs;
- Strengthening the financial sector;
- Reform of the commercial justice sector to improve enforcement of contracts and debt collection;
- Institutional reforms in public procurement, export promotion and tax administration;

- Removal of impediments in the export sector; and
- Improvement of the business environment for microfinance through policy formulation and dialogue

With support from UNDP, UNCTAD and Enterprise Africa, Enterprise Uganda (EU) was launched in December 2001 to deliver hands-on business advisory services to SMEs. It seeks to develop entrepreneurship in this country through a methodology that incorporates internationally tested and well-researched best practices and behaviours of successful entrepreneurs and adult learning techniques. The institutional approach adopted through EU should accelerate the creation of a sizeable pool of skilled persons who can operate sustainable enterprises.

Beyond the Government's efforts and donor support to promote and develop SMEs, this symposium has also given the participants perspectives on the financial institutions, the SMEs themselves and international experiences indicating why SMEs cannot easily access formal finance and what should be done about this. Of all these experiences, EMPRETEC Ghana underscores the need for the SMEs to devise their own ways of guaranteeing borrowing from the banks. Such initiatives play a catalytic role that challenges government and development partners to support the private sector. I would therefore call upon the SMEs in Uganda to take an interest in EMPRETEC's experience with a view to adapting it to our own environment. With joint efforts involving SMEs, government and our development partners, constraints on accessing formal finance by SMEs will be significantly reduced.

When the recommendations in the Action Plan are fully implemented, they will go a long way to building bridges, particularly between bankers and SMEs. Several of the recommendations require Government intervention, and I am sure the appropriate arms of government will take them up and ensure implementation.

In conclusion, I urge the Implementation Committee to oversee the execution of the recommendations and Action Plan and diligently pursue their realization. With these few remarks, I declare the symposium closed. Thank you.

PLAN OF ACTION FOR FINANCING SMES

Preamble

The Symposium participants

Recognizing that sustainable growth in the Ugandan economy is directly related to the rate of enterprise creation and development, which in turn depends on the nation's entrepreneurial culture and the ease with which SMEs can be started and financed,

Realizing that financial institutions often find it difficult to lend to SMEs for reasons such as perceived high risk and high transaction costs,

Considering that there are not enough enterprises which appear to be credit-worthy, in the face of a willingness by the financial sector to finance SMEs,

Invite all stakeholders to participate in their implementation of the following recommendations to resolve the SME financing gap.

I. For Government

1. Set a national definition for small and medium-size enterprises;

2. Improve the reliability of financial information provided by SMEs by adopting user-friendly accounting and reporting requirements consistent with international best practice and enforce such requirements;

3. Require banks to disclose the composition of their loan portfolio by size of business and by gender of the client;

4. Initiate an educational campaign to raise awareness of tax entitlements and responsibilities and promote a culture of payment;

5. Analyse the impact of the current tax system on SMEs including the impact on leasing companies to determine if any adjustments are necessary;

6. Strengthen the ability of business development service providers to make SMEs more creditworthy through special support measures;

7. Consider together with the Bank of Uganda the setting up of a special loan guarantee fund for SMEs; the operation of this fund should not encourage moral hazard;

8. Consider together with the Bank of Uganda the reactivation of a development bank;

9. Increase efforts to develop a long term capital market;

10. Accelerate the pace of reform of the legal and financial framework necessary for an enabling business environment; this includes more rapid dispute settlement and effective bankruptcy and insolvency procedures;

11. Institute a system of national identification.

II. For the Private Sector

For SMEs

1. Develop a culture of transparency and accountability in dealing with the banking community by opening a separate "business" account; and by building up a banking relationship/history with one bank and passing all business transactions through that account;

2. Lobby government, the banking community and donors to establish special credit lines for SMEs;

3. Establish proper legal entities for SMEs businesses in place of informal family arrangements;

4. Plan for credit, equity and insurance needs;

5. Request professional associations whose members serve the public including SMEs to ensure that their members abide by a code of professional ethics and be willing to impose sanctions if they violate it;

6. Join mutual guarantee associations;

For business development service providers

1. Provide assistance to SMEs in the area of accounting, financial management and entrepreneurship that complies with national accounting requirements and/or best practices;

2. Assist SMEs to undertake credit self-assessment;

3. Enter partnerships with banks for credit referrals and monitoring;

4. Organize and supervise mutual guarantee associations among their clients;

5. Improve information flows among SMEs, banks and business development service providers by creating a roster of certified consultants;

For commercial banks

1. Formulate and announce their policy for lending to SMEs and collect data on the composition of their loan portfolios by size of business and by gender of the client;

2. Refer potential clients to reputable business development service providers and consultants;

3. Enter partnerships with business development service providers for credit referrals and monitoring;

4. Establish, together with government, a credit referral agency insuring adequate consumer protection;

5. Support the development of mutual guarantee associations;

6. Increase staff training to work with SMEs and adopt and adapt standardized procedures to cut costs such as credit scoring;

7. Design credit procedures that address SMEs particular circumstances including substitutes for collateral;

8. Create a body together with other relevant stakeholders to oversee the graduation of small clients from MFIs to banks;

9. Create, together with other relevant stakeholders, a forum for regular interaction between SMEs, their associations, banks and BDS providers;

III. For International community

1. Coordinate their assistance to business development service providers to build best practices among SMEs;

2. Ensure that their programmes, particularly guarantee programmes, cover the missing middle, i.e. SMEs;

3. Improve communication and information exchange among the donor community, government and the banking community on financing SMEs;

4. Assist MFIs to build their capacity in financial and human resource areas to mobilize savings and to graduate from micro-borrowers to SME borrowers;

5. Interact with policy makers of the banks and encourage them to train and sensitize their staff and to increase SME lending and publicly disclose it;

IV. Recommendations for immediate action by the Minister

1. Establish a special guarantee fund for SMEs and encourage all donors to participate in it, ensuring that this fund is implemented in a manner that avoids moral hazard;

2. Require all banks to disclose their policies on SME lending and the composition of their loan portfolio by size of business and by gender of client;

3. Promote transparency and accountability among SMEs by improving the reliability of the financial information provided by SMEs using international best practices such as UNCTAD's guidance on a user-friendly accounting and reporting system for SMEs;

4. Accelerate the pace of reform of the legal and financial framework necessary for an enabling business environment; this includes more rapid dispute settlement and effective bankruptcy and insolvency procedures;

5. Designate a focal point dedicated solely for SME information and development to coordinate SME programmes at the national and international level;

6. Together with Bank of Uganda, set up a special SME task force on financing composed of relevant stakeholders to consider ways and means to implement the recommended policies and measures, monitor progress on a regular basis and report back to the relevant stakeholders in April 2003;

   Relevant stakeholders should be drawn from the following organizations, Ministry of Finance, Planning and Economic Development, Bank of Uganda, Ministry of

Trade and Industry, development banks, bankers associations, Enterprise Uganda, European Union, Donor community, Private Sector Foundation, an SME, Government focal point for SME financing, and UNCTAD.

PART IV

Appendix

PROGRAMME

8.00 – 8.30 am	*Registration*
	Introductory Remarks
8.30 – 8.35 am	**Sam Nahamya,** Permanent Secretary, Ministry of Tourism, Trade and Industry
8.35 – 8.45 am	**Lorraine Ruffing**, Head, Technology and Enterprise Branch, DITE, UNCTAD
8.45 – 8.55 am	**Gerald Ssendaula**, Honourable Minister, Ministry of Finance, Planning and Economic Development
8.55 – 9.05 am	**Daouda Toure**, Resident Representative, UNDP
	Presentations I – Banks' View
9.05 – 9.25 am	**Richard Apire**, Director, Development Finance Department, Bank of Uganda
9.25 – 9.45 am	**Frank Griffiths**, Managing Director, Barclay's Bank
9.45 – 10.00 am	**Juma Kisaame**, General Manager, Leasing, DFCU Group
10.00 – 10.40 am	Discussion of Presentations by Banks
10.40 – 10.55 am	*Tea/Coffee Break*
	Presentations II – Local and International Experiences
10.55 – 11.10 am	**Henry Mbaguta,** Assistant Commissioner, MSE Policy Unit, Ministry of Finance, Planning and Economic Development
11.10 – 11.25 am	**Gideon Badagawa**, Senior Policy Analyst, Private Sector Foundation
11.25 – 11.45 am	**Lorraine Ruffing**, Head, Technology and Enterprise Branch, DITE, UNCTAD

11.45 – 12.05 pm Loïc De Cannière, Managing Director, Incofin Belgium

12.05 – 12.20 pm Osei-Yeboah, Head, Credit Operations, EMPRETEC Ghana Foundation

12.20 – 12.30 pm **Jack Thompson**, Project Coordinator, Support for Private Enterprise Expansion and Development (SPEED)

12.30 – 12.45 pm **Charles Ocici**, Executive Director, Enterprise Uganda

12.45 – 1.45 pm Discussion of Local and International Experiences

1.45 – 2.30 pm *Lunch*

2.30 – 4.00 pm Group discussions on various issues including drawing up Plan of Action

4.00 – 4.30 pm *Tea/Coffee Break*

4.30 – 5.45 pm *Wrap-up*

Chairperson
Lorraine Ruffing, Head, Technology and Enterprise Branch, DITE, UNCTAD

Group presentations to the plenary followed by discussions

Recommendations

5.45 – 6.00 pm *Closing Remarks*

Louis A. Kasekende, Deputy Governor, Bank of Uganda

6.00 – 8.00 pm *Cocktail*

Bank of Uganda/Enterprise Uganda

BIOGRAPHICAL DATA OF PRESENTERS

Mr. Richard Apire is currently the Director of Development Finance Department of the Bank of Uganda. He has 30 years' experience in the banking industry, including two years with the World Bank regional mission in Nairobi (1977-1979) and service in several departments in the Bank of Uganda such as foreign exchange management, development finance, trade and external debt, and audit. He holds a Bachelor of Commerce degree from the University of Nairobi.

Mr. Frank Griffiths is Managing Director at Barclays Bank Uganda Ltd. He is an associate of the Chartered Institute of Bankers in the United Kingdom. He has 35 years' experience with Barclays Group.

Mr. Juma Kisaame is currently General Manager at DFCU Leasing Company Ltd. He holds a Bachelor of Commerce degree with honours. His experience includes working as an accountant at the Uganda Development Bank (1988-1992), Head of Finance at the Development Finance Company of Uganda (1992-1995) and Manager of the Finance and Administration at the Non-Performing Assets Recovery Trust (1996-1997).

Mr. Henry Paul Mbaguta is currently a Senior Economist in the Economic Development, Policy and Research Department at the Ministry of Finance, Planning and Economic Development. He holds a Master of Arts degree in Policy Studies from the Southern African Regional Institute for Policy Studies in Zimbabwe and a Bachelor of Arts degree in Economics and Rural Economy. He has also attended various courses in project management, counter-disaster planning and management, debt and financial management, debt sustainability, feasibility analysis, trade promotion, credit analysis and negotiations. His experience includes working as a senior economist in the Ministry of Finance, Planning and Economic Development, in charge of private sector development with particular emphasis on SME development and microfinance, and designing capacity-building programmes for the private sector. He also worked as an desk economist for UN agencies within the Ministry of Finance, Planning and Economic Development, coordinating the return of skilled Ugandans living abroad under Tokten.

Mr. Gideon N. Badagawa is currently Senior Policy Analyst with the Private Sector Foundation (PSF) in Kampala, Uganda, where he is responsible for preparation of researched policy papers on issues affecting the business community. He also leads the planning and implementation of advocacy activities on behalf of the private sector. Prior to joining PSF in 2000, Mr. Badagawa had lectured in the Department of Planning and Applied Statistics at Makerere University for 10 years. He holds a Bachelor of Statistics degree with honours, a Master of Arts degree in Economics, and a PGD in Environmental Management. Mr. Badagawa has researched extensively in the fields of development planning and the environment.

Ms. Lorraine Ruffing received a Ph.D. in Trade and Development Economics from Columbia University in New York. She has taught economics in universities in New York, Santiago and Geneva. She entered the UN in 1981, has worked for 5 different agencies and has served in a number of developing countries, including Chile, Mexico, Uzbekistan and Venezuela. For over a decade, she was in charge of the UN's work on corporate financial accounting. Before joining UNCTAD, she was the UN Deputy Resident Representative in Uzbekistan. She is currently the Head of the Technology and Enterprise Branch in the Division on Investment, Technology and Enterprise Development. The main focus of the work is SME development, which includes identification of best practices in terms of SME financing and transfer of technology.

Mr. Loïc De Cannière is Managing Director of Incofin cvso in Belgium, an investment company for the South. He holds a Master of Arts degree in Economics from the Catholic University of Louvain and a Bachelor's degree in Philosophy from Philosophische Fakultät in Munich. His work experience includes working as an Export and Project Finance Manager at Dredging International n.v. in Zwijndrecht, Belgium, the second largest marine engineering company in the world (1995-2000) and Chief of Staff of the Minister-President of the Government of Flanders/Belgium (1992-1995) and Vice Chief of Staff of the Minister of Public Works (1989-1992).

Mr. Daniel Osei-Yeboah is currently Head of Credit Operations at EMPRETEC Ghana Foundation. His work experience includes 21 years in the banking industry and one year in business development. He holds a Bachelor of Science degree in Agriculture.

Mr. Jack Thompson is the SME Finance Advisor at the USAID-funded Support for Private Enterprise Expansion and Development (SPEED) project. Prior to coming to Uganda, he was for three years the Director of a trade and investment development programme in South Africa assisting SMEs to get into the export market. His 20 years' experience of working in Africa includes both managing commercial and development banks and helping SMEs to be more competitive. An Irish national, he worked for several years in Ireland's Industrial Development Authority, a government agency responsible for industrial planning, promotion and development in Ireland. He holds a Master of Business Administration degree and a Bachelor of Science degree in Experimental Physics and Mathematics. He is a Fellow of the Chartered Institute of Management Accountants.

Mr. Charles Ocici is Executive Director of Enterprise Uganda, the apex management position at the Institution. His professional career includes 15 years of banking and business consultancy, eight years of which were at the Uganda Commercial Bank, where he rose from being a banking officer to corporate credit manager at a city branch. He carried out credit appraisals for micro, small- and medium-scale, short- and medium-term facilities in a wide array of economic sectors across the country. He spent three years as a team leader/task manager at the enterprise development project in the Ministry of Finance, overseeing privatization of public enterprises. He was directly in charge of the portfolio which comprised public enterprises in the banking, petroleum, commodity, telecommunication, hotel and aviation industries. He was an *ex-officio* board member for Uganda Airlines, the Uganda Commercial Bank, the Coffee Marketing Board and Transocean Ltd. He also spent four years at the PTA Bank, a financial arm of COMESA, where he worked initially as a senior project officer giving investment advice on establishment and expansion of medium- and long-term projects, and later worked as a senior officer in charge of projects implementation, monitoring and evaluation. He was secretary to four executive management committees, including management, credit, personnel and loan portfolio management. He holds a Master of Science degree in Agricultural Economics from Makerere University, a Master of Business Administration from Stirling University in United Kingdom, and a Master of Science degree in Investment Analysis from the University of Stirling.

MEMBERS OF THE SME TASK FORCE ON FINANCING

Subsequent to the Symposium a special task force with a one-year life span was established. The following institutions were selected as its members:

1. Uganda Bankers Association (Chair)
2. Bank of Uganda (Vice-chair)
3. Ministry of Finance, Planning and Economic Development
4. Ministry of Tourism, Trade and Industry
5. European Commission
6. SPEED - Support for Private Enterprise Expansion and Development (for the donor community)
7. Private Sector Foundation
8. DMER Associates (SME representative)
9. Enterprise Uganda/UNCTAD (Coordinating Unit)
10. Uganda Microfinance Institutions Association
11. Ugandan National Chamber of Commerce and Industry
12. Development Finance Company of Uganda
13. Uganda Manufacturers Association

It met on 31 May, 27 June and 8 August 2002. Attached are the minutes of its deliberations.

MINUTES OF THE 1ST MEETING OF THE IMPLEMENTATION TASK FORCE FOR FINANCING SMALL AND MEDIUM-SCALE ENTERPRISES (SMEs) HELD ON 31 MAY 2002 AT BANK OF UGANDA

ATTENDANCE LIST

	Name	Institution
1.	Ms. Lorraine Ruffing	UNCTAD/Chair
2.	Mr. Y.B.K Wadembere	DFD/Bank of Uganda/Co-chair
3.	Mr. James Kalibala	UMA
4.	Mr. Emmanuel Kinoni	UBA
5.	Mr. Jack Thompson	USAID/SPEED
6.	Mr. Alain Joaris	European Union
7	Ms. Elizabeth Ongom	European Union
8.	Mrs. Esther Mugarura	UNCCI
9.	Mr. Edward Nasiga	MFPED
10.	Mr. Gideon Badagawa	Private Sector Foundation
11.	Ms. Robinah Sabune-Mutimba	Ministry of TT&I
12.	Mr. Juma Kisaame	DFCU Limited
13.	Mr. Damus Mulagwe	DMER/SME Representative
14.	Mrs. Rosemary Mutyabule	Enterprise Uganda
15	Ms. Naome Nasasira	DFD/BOU
16	Mr. Francis Emuron	DFD/BOU
17	Mr. Nobert Bantura	DFD/BOU
18	Mr. Luke Okumu	DFD/BOU/Secretary

1. The Implementation Committee met on 31 May 2002 at the Bank of Uganda to operationalize the Plan of Action agreed on by the Symposium on Modalities for Financing SMEs, held on 30 April 2002 at the International Conference Centre, Kampala.

2. The following was the agenda:

i) Interim Chairman's Opening Remarks;
ii) Review of Plan of Action;
iii) Prioritization of recommendations in the Plan of Action starting with those for immediate action by the Minister of Finance, Planning and Economic Development;

iv) Inclusion of Action Plan in the Budget Speech in June 2002;

v) Terms of Reference for the Implementation Committee as well as guidelines and procedures including election of office bearers;

vi) Budget;

vii) Targets

After intensive deliberations, the Implementation Committee agreed that the following recommendations are sent to the Minister of Finance, Planning and Economic Development for inclusion in the Budget Speech due on 13 June 2002:

Establish a special Small and Medium-Scale Enterprise (SME) guarantee facility supervised by the Bank of Uganda but managed by the principal stakeholders including commercial banks, microfinance institutions and leasing companies in a manner that avoids moral hazard. Funding for the guarantee facility would come from domestic sources and international financial institutions;

Urge the Uganda Bankers Association (UBA) to encourage their members to design policies on SME lending and disclose them to the Ministry of Finance, Planning and Economic Development (MFPED) and other stakeholders. The banks should also be encouraged to report the composition of their loan portfolio by loan size and gender of client to the Bank of Uganda. For financial institutions, which are not under UBA, it was agreed that the government through the MFPED urges them to do the same;

The MFPED together with the international donor community should undertake support measures to promote partnerships between commercial banks, other financial institutions and business service providers to engage in capacity-building to make SMEs more creditworthy;

Designate Private Sector Foundation in cooperation with business development service providers as the focal point for SME information dissemination and development and for coordination of SME programmes at the national and international level;

The MFPED together with the Bank of Uganda to formally give mandate to the Implementation Committee/special Task Force on SME financing to consider ways and means of implementing the recommended policies and measures. The Committee/Task Force is expected to conclude its work in April 2003. In addition, the Task Force will be responsible for monitoring progress on a regular basis and reporting to the relevant stakeholders;

Begin work on setting a national definition for SMEs; and

Analyze the impact of the current tax system on SME development, including the impact on financing SMEs via equity capital funds, commercial credit, microfinance and leasing (See Annex for an example of such an analysis).

3. The Meeting also resolved that the Implementation Committee/Task Force should be composed of the following stakeholders in the SME sector:

i)	Uganda Bankers Association (UBA) –	Chair
ii)	Bank of Uganda –	Vice-chair
iii)	Enterprise Uganda/UNCTAD –	Coordination
iv)	MFPED	Member
v)	Ministry of Tourism, Trade and Industry (MTT&I) –	Member
vi)	European Union –	Member
vii)	Representative of donor community (SPEED) –	Member
viii)	DMER Associates (SME representative) –	Member
ix)	Representative of Microfinance Institutions –	Member
x)	Ugandan National Chamber of Commerce and Industry –	Member
xi)	Uganda Manufacturers Association –	Member
xii)	Private Sector Foundation –	Member
xiii)	Representative of Development Banks –	Member

4. In the interest of comprehensive discussion and working within scheduled time, it was agreed that two more meetings be held on 13 and 27 June 2002 to:

i) Continue with the review and prioritization of the remaining recommendations in the Action Plan;
ii) Draw up the terms of reference for the Implementation Committee/Task Force for endorsement by MFPED; and
iii) Draw up implementation schedule and identify funding sources for operationalizing the Action Plan.

MINUTES OF THE 2nd MEETING OF THE IMPLEMENTATION TASKFORCE FOR FINANCING SMALL AND MEDIUM-SCALE ENTERPRISES (SMEs) HELD ON 27 JUNE 2002 AT ENTERPRISE UGANDA

ATTENDANCE LIST

	Name	Institution	
1.	Ms. Lorraine Ruffing	UNCTAD	Chair
2.	Mr. Richard Etemesi	Uganda Bankers Association	Co-Chair
3.	Mr. Emmanuel Kikoni	"	Member
4.	Mr. Richard Apire	Bank of Uganda	Vice-chair
5.	Mr. Y.B.K Wadembere	"	Member
6.	Mr. Francis Emuron	"	Member
7.	Mr. Charles Ocici	Enterprise Uganda	Coordinator
8.	Mrs. Rosemary Mutyabule	"	Coordinator
9.	Mr. Edward Masiga	MFPED	Member
10.	Mr. Henry Mbagutta	"	Member
11.	Ms. Elizabeth Ongom	European Union	Member
12.	Mr. Jack Thompson	SPEED	Member
13.	Mr. Damus Mulagwe	DMER Associates (SME representative)	Member
14.	Mrs. Esther Mugarura	UNCCI	Member
15.	Mr. Gideon Badagawa	Private Sector Foundation	Member

Absent with apology:

1.	Ms. Robinah Sabano	Min. of Tourism Trade & Ind.	Member

Absent without apology:

1.	Mr. James Kalibala	Uganda Manufacturers Assoc.	Member
2.	Ms. Naomi Nasasira	Bank of Uganda	Member
3.	Mr. Juma Kisaame	DFCU	Member

<u>Agenda:</u>

i) Interim Chairman's Opening Remarks;
ii) Review of minutes of the previous meeting;
iii) Matters arising;

iv) Confirmation of taskforce leadership;
v) Draw up terms of reference for endorsement by the Ministry of Finance,
vi) Remarks from Chairman;
vii) Review and Prioritization of recommendations in Plan of Action;
viii) AOB

The Executive Director, Enterprise Uganda opened the meeting at 10:15 a.m. by welcoming members. He invited Ms. Lorraine Ruffing, UNCTAD to chair the second meeting until the confirmation of the Task Force Leader at the end of the meeting.

Interim Chairman's Opening Remarks

Ms. Lorraine Ruffing re-capped on the terms of reference of the taskforce and referred to it as a "harassment taskforce". She called upon the members to be focused, committed and dedicated in the execution of its mandate.

Review of the minutes and matters arising

The Chair invited Mr. Richard Apire, Bank of Uganda, to review the minutes of the first Task Force (TF) meeting. He outlined the major issues discussed and the 7 recommendations sent for action to the Minister of Finance, Planning and Economic Development. It was reported that the Minister had not had time to formally incorporate these into his budget speech on 13 June 2002. However, taxation and the Task Force were included in the background to the budget 2002/3, so the Minister had taken note of the Taskforce's work.

Some members of the TF were also of the opinion that if these recommendations were in the background to the Budget 2002/3, then probably an allocation had been made in the actual budget. The TF members further agreed that it was necessary to visit the Minister of Finance, Planning and Economic Development as soon as possible in order to provide him with more detail on the implementation of each of the 7 recommendations and also to ask him to indicate which of the 7 were among his highest priorities. It was decided to form a subgroup to visit the Minister and to work to implement the 7 recommendations.

Action: Subgroup One (SG1)

i) Confirm specific representatives of subgroup one and convoke them to prepare for the visit to the Minister of Finance. The following members were selected;-
   a. Uganda Bankers' Association (leader)
   b. Bank of Uganda
   c. Ministry of Finance, Planning and Economic Development
   d. Private Sector Foundation
   e. Enterprise Uganda (Rosemary to confirm and convene)

ii) Set a meeting with the Minister (Leader SG1)

iii) Questions to raise with the Minister

a. His priorities among the 7 recommendations
b. Next steps to set up the SME loan guarantee facility: how to establish and finance, how to supervise (BOU), how to manage (participating institutions). Given that the Taskforce recommendation was mentioned in the background documentation to the budget, has any allocation been made for its recommendations to the Minister? how are they going to be slotted in?

Confirmation of task force leadership

It was unanimously agreed that Richard Etemesi, President, Uganda Bankers' Association be the leader of the Task Force and its chair; his alternate will be Emmanuel Kikoni; Richard Apire, Bank of Uganda, will be the vice-chair. Enterprise Uganda will provide the Secretariat and will convene the meetings.

Remarks from Chairman

Mr. Richard Etemesi accepted the nomination and pledged his commitment to working with the various stakeholders to improve access to finance by SMEs. He pointed out that banks are keen to increase lending in order to reduce liquidity, and the SMEs provide such an opportunity, as long as the taskforce can play a vital role in minimizing SME risks. He however cautioned members that even though the ultimate objective of the Task Force is to increase SME access to finance, the priorities of the banks differ.

Draw up terms of reference for endorsement by the Ministry of Finance.

Due to the lack of time the terms of reference for the TF were not decided.

Action: TF Leader and Enterprise Uganda to present draft terms of reference at the next meeting.

Review and Prioritization of remaining recommendations in the Plan of Action

The meeting looked at three categories (Government, Private sector and Business Development Service Providers) and picked out the priority recommendations to be followed up by the taskforce as below.

1. Action Plan for government

- Analyze the impact of the current tax system on SMEs including the impact on leasing companies to determine if any adjustments are necessary.

Agreed: DFCU to circulate paper on the impact of taxation on Leasing to Task Force members.

- Strengthen the ability of business development service providers to make SMEs more creditworthy through special support measures.

There was general concern over how SMEs could access any loan guarantee facility given that the common presumption was that they were not "creditworthy". This went back to the discussion of the first meeting on "how to help the victim". It was decided that a common strategy should be designed for making SMEs creditworthy and that government and donor measures should support this strategy.

Agreed: To form a second subgroup in order to design a strategy for SME support for creditworthiness.

Action: Subgroup Two on SME Support Measures (SG2)

i) Confirm and convene the members of the SG2. The following were selected:
   a. Enterprise Uganda
   b. SME representative
   c. Uganda Bankers' Association
   d. SPEED
   e. European Commission (Rosemary to convene meeting)

ii) Design a strategy for making SMEs creditworthy including:

a. a general awareness training course on the basics of financial management, a credit self-assessment, how banks rate them, the purpose and function of the new credit referral service;
b. a roster of reputable business service providers;
c. cost-sharing of business development services through the establishment or accessing of a voucher system/grants to help SMEs pay for initial provision of business development services; (note the EC might already have a matching grant system in place under BUDS);
d. Training of bank loan officers on how to deal with SMEs.

iii) Consider together with the Bank of Uganda the setting up of a special loan guarantee fund for SMEs; the operation of this fund should not encourage moral hazard.

Agreed: To be handled by SG1.

Remaining recommendations

- Initiate an educational campaign to raise awareness of tax entitlements and responsibilities and promote a culture of repayment.

Agreed: This matter should be discussed with the Uganda Revenue Authority to see what action had been taken and if any more was needed.

Action: TF Leader to select a TF member to visit URA and member to report back at next TF meeting on 8 August.

- Consider together with the Bank of Uganda the reactivation of a development bank.

The TF said that the business community was aware that Uganda development bank was reconstituted and would be recapitalized and be in operation in September (2002). The question was how it could be of service to SMEs; could it have a special SME credit window? A former officer in the defunct development bank said that one of the main problems was good financial management in banks. Possibly, the new development bank could help local banks improve their financial management.

Action: Bank of Uganda to inform TF at next meeting about status and functions of the new development bank.

- Increase efforts to develop a long-term capital market.

TF members did not consider this to be within their present scope of action because equity financing for SMEs and listing on the stock exchange were probably not feasible for most in the immediate future.

- Accelerate the pace of reform of the legal and financial framework necessary for an enabling business environment. This includes more rapid dispute settlement and effective bankruptcy and insolvency procedures.

TF discussed the need to evaluate the functioning of the new commercial court and if dispute settlement had been accelerated. SMEs first need counselling to determine if they have a case. It was suggested that the Ministry of Justice should be added to the TF.

Action: Mr. Emanuel Kikoni, UBA to visit the commercial court and evaluate how it is working and what more is needed in terms of dispute settlement, bankruptcy and insolvency procedures. To report back at next meeting.

- Institute a system of national identification.

TF members also considered this outside of their remit. However, it was necessary to have a credit rating verification system for financial transactions. It would be desirable that this was a universally agreed system by the banks, government and enterprises so that SMEs did not have to be rated separately by each bank or credit agency.

Action: Mr. Emanuel Kikoni, UBA and Ms. Esther Mugarura, UNCCI to report at next TF meeting on progress and criteria for a credit rating system and service in Uganda.

2. <u>Action Plan for Business Development Service Providers</u>

- Provide assistance to SMEs in the area of accounting, financial management and entrepreneurship.

Agreed: Subgroup 2 to take action.

- Assist SMEs to undertake credit self-assessment.

Agreed: Subgroup 2 to take action.

- Enter partnerships with banks for credit referrals and monitoring.

Agreed: Sub-group 1 to take action.

- Organize and supervise mutual loan guarantee associations among SMEs.

Agreed: Postponed to late 2002

- Improve information flows among SMEs, banks and business development service providers by creating a roster of certified consultants.

Action: Enterprise Uganda to form roster and to visit the Institute of Chartered Accountants to discuss improving the image of the profession by insisting on adherence to their code of ethics.

3. Action Plan for the Private Sector (SMEs)

- Develop a culture of transparency and accountability in dealing with the banking community by opening a separate "business" account, and by building up a banking relationship/history with one bank and passing all business transactions through that account.

Agreed: The BDS providers to incorporate this aspect into its Financial Management course.

- Lobby government, the banking community and donors to establish special credit lines for SMEs.

Agreed: To discuss it in the context of the Loan guarantee facility. Principles of viability will be retained.

- Establish proper legal entities for SMEs businesses in place of informal family arrangements.

Agreed: To drop recommendation because the committee's interest is in registered and well-established businesses. This could be an awareness creation item.

- Request professional associations whose members serve the public, including SMEs, to ensure that their members abide by a code of professional ethics and be willing to impose sanctions if they violate it.

Action: Enterprise Uganda/BOU to establish relationship with the Institute of Chartered Accountants to ensure that complaints are handled and disciplinary action is taken on accountants who do not adhere to their code of ethics.

- Join mutual guarantee associations.

Agreed: Postponed to late 2002.

Action: Lorraine to contact the Italian Ambassador for an expert in the development of the scheme.

Due to lack of time, it was not possible to complete discussions of the recommendations in the Plan of action under "Commercial banks" and "International community".

Agreed: To complete the review and prioritization of recommendations at the next meeting.

The third meeting was set for 8 August 2002 in Enterprise Uganda.
The meeting ended at 1:05 pm.

MINUTES OF THE 3RD MEETING OF THE IMPLEMENTATION TASKFORCE FOR FINANCING SMALL AND MEDIUM-SCALE ENTERPRISES (SMEs) HELD ON 8 AUGUST 2002 AT ENTERPRISE UGANDA

ATTENDANCE LIST

Name		Institution	
1.	Mr. Charles Ocici	Enterprise Uganda	Chair
2.	Mr. Rik Lojenga	UNCTAD	Member
3.	Mr. Y.B.K Wadembere	BOU	Member
4.	Mr. Francis Emuron	"	Member
5.	Mrs. Rosemary Mutyabule	Enterprise Uganda	Secretary
6.	Ms. Elizabeth Ongom	European Union	Member
7.	Mr. Jack Thompson	SPEED	Member
8.	Mr. Damus Mulagwe	DMER Associates (SME representative)	Member
9.	Mr. Robert Kyukyu	BUDS - SSE	Member
10.	Ms. Robinah Sabano	Min. of Tourism Trade & Ind.	Member
11.	Mr. Martin Mulinda	DFCU Leasing Co.	Member
12.	Mr. Suleiman Namara	UMFIA	Member

Absent with apology:

1.	Mr. Richard Etemesi	Uganda Bankers Association	Chairman
2.	Mr. Emmanuel Kikoni	"	Member
3.	Mr. Richard Apire	Bank of Uganda	Vice-chair
4.	Mr. James Kalibala	Uganda Manufacturers Assoc.	Member
5.	Mr. Henry Mbagutta	MFPED	Member

Absent without apology:

1.	Mr. Edward Masiga	MFPED	Member
2.	Mrs. Esther Mugarura	UNCCI	Member

Agenda

i) Chairman's Opening Remarks
ii) Review of Minutes of the previous meeting and Matters arising
iii) Report from Subgroup 1
iv) Report from Subgroup 2

v) Review and Prioritization of recommendations in Plan of Action
vi) AOB

1. Chairman's Opening Remarks

The Executive Director, Enterprise Uganda opened the meeting at 10:15 a.m. by welcoming members and introducing Mr. Rik Lojenga, UNCTAD. He conveyed the substantive chairman's apologies for not attending the meeting and requested members to nominate a chairperson for the meeting, since the Vice-chairman had also sent in his apologies for not attending the meeting. The meeting unanimously selected Mr. Ocici to chair the meeting.

2. Review Of The Minutes And Matters Arising

The minutes were reviewed with the following amendments.

i) Attendance

The spelling of "Damus" under the Attendance list to read "Damas".

ii) Draw up terms of reference for endorsement by the Ministry of Finance.

Enterprise Uganda secretariat prepared draft terms of reference for the taskforce. These were circulated to members for comment.

Action: Enterprise Uganda to recast the terms of reference to reflect the priority recommendations that were agreed upon at the 2nd taskforce meeting. The terms of reference should also emphasise the mandate of the taskforce as being that of a pressure or lobby group that will work with government to achieve its objectives.

iii) Action Plan for government

DFCU had been requested to circulate a paper on the impact of taxation on leasing to the taskforce members in order to give them an understanding of the issues. Mr. Mulindwa of DFCU leasing reported that the paper was being finalized and would be availed to the taskforce members.

Action: DFCU to send the paper to Enterprise Uganda by 15 August 2002.

Action: Mr. Thompson of SPEED to follow up with the Deregulation Project of Ministry of
Finance to get the report on deregulation of leasing activities in Uganda.

iv) Initiate an educational campaign to raise awareness of tax entitlements and responsibilities

This matter should have been discussed with the Uganda Revenue Authority (URA) to see what action had been taken and if any more was needed. However, no action was taken and it was agreed to defer the reporting to the next meeting.

Action: TF Leader to select a TF member to visit URA and member to report back at next TF meeting on 6 September 2002.

v) Consider together with the Bank of Uganda the reactivation of a development bank

Bank of Uganda should have reported to the meeting about the status and functions of the re-opened development bank. Mr. Wadembere, however, reported that the Director, DFD was in a better position to give a report on this matter. The meeting agreed to defer the matter to the next meeting.

Action: Bank of Uganda to report progress about the status and functions of the new development bank at the next TF meeting on 6 September 2002.

vi) Accelerate the pace of reform of the legal and financial framework necessary for an enabling business environment

Mr. Emmanuel Kikoni, UBA should have visited the commercial court and evaluated how it is working and what more is needed in terms of dispute settlement, bankruptcy and insolvency procedures, and reported back to the meeting. The meeting deferred the issue because of Mr. Kikoni's absence.

Action: Enterprise Uganda to follow up with Mr. Kikoni and report at next TF meeting on 6 September 2002.

vii) Establishment of a credit rating verification system for financial transactions.

Mr. Emmanuel Kikoni, UBA and Ms. Esther Mugarura, UNCCI had been requested to establish progress in the establishment of a credit rating system and service in Uganda. The meeting deferred the reporting due to absence of both members.

Action: To report at next TF meeting on 6 September 2002. It was however noted that the current Financial Statute gives "secrecy right" to banks not to disclose client information. There is need to amend this section, if credit rating services are to succeed in Uganda.

viii) Improve information flows among SMEs, banks and business development service providers by creating a roster of certified consultants

Enterprise Uganda had been requested to form a roster of consultants and to visit the Institute of Certified Public Accountants of Uganda to discuss improving the image of the profession by ensuring adherence to their professional code of ethics.

Action: Enterprise Uganda to report at the next TF meeting of 6 September 2002.

ix) Review and prioritization of recommendations in the Plan of action under "Commercial banks" and "International community"

Due to lack of time, it was not possible to complete discussions of the above recommendations.

Agreed: To complete review of the recommendations at the next TF meeting of 6 September 2002.

3. Report From Subgroup One (SG1)

Mr. Wadembere presented a progress report of the Group on behalf of the group leader. The group had been mandated to set a meeting with the Minister of Finance, Planning and Economic Development to discuss the 7 recommendations that were forwarded to him by the Deputy Governor of the Bank of Uganda.

He reported that the group met on 4 July 2002 to internalize the recommendations so as to develop strong arguments to support each recommendation to the Minister. Mr. Mbaguta was mandated by the committee to secure the appointment with the Minister before the end of July 2002. However, Mr. Mbaguta went on leave without securing the appointment.

Enterprise Uganda subsequently sent a letter to the Minister on 22 July seeking an appointment. The appointment is yet to be secured.

Comments:

- The group should develop a draft SME definition for discussion with the Ministry of Finance, Planning and Economic Development as a means of speeding up the process.
- There may be need to adopt a bottom-up approach in dealing with the Ministry of Finance, Planning and Economic Development. It was suggested that the taskforce deals with the Director, Economic Affairs, before moving on to the Minister himself.

Action: Enterprise Uganda to continue following up with Minister's office to secure appointment before the next TF meeting of 6 September 2002.

4. Report From Subgroup Two (SG2)

The subgroup was formed to design a strategy for strengthening the ability of business development service providers to make SMEs more creditworthy through special support measures.

The group leader, Mr. Mulagwe reported that the group held two meetings on 4 July and 31 July, respectively. A strategy paper was prepared by Enterprise Uganda that covered

- The Generic needs of SMEs.
- Proposed Financial Management course content.
- Proposed list of Business Development Service providers.
- Suggested cost of services and institutions to approach.

The group made the following recommendations;

i) The need to strengthen cooperation and information sharing between Enterprise Uganda, SPEED and BUDS in supporting SMEs so that the target beneficiaries can full utilize these services.

ii) In the medium term, Enterprise Uganda should draw up a comprehensive resource mobilization strategy and approach a number of donors to provide grants to subsidize the cost of the various business development services provided to their clients. Some of these services include: business counselling and advisory services; financial management training; business plan preparation; client accounting & book-keeping services; and management skills development.

iii) Enterprise Uganda to obtain SPEED's roster of 250 reputable consultants in Uganda. This should address the general concern of lack of reputable consultants that can hand-hold SMEs.
iv) Enterprise Uganda to liaise with SPEED and Uganda Institute of Bankers to encourage more banks to attend the training program developed by SPEED. The training program on "Lending to SMEs" which was developed by SPEED is being used by Uganda Bankers Association to train their loan officers.

5. <u>AOB</u>

- The meeting observed that the representative from the Association of Micro Finance Institutions of Uganda (AMFIU) had vast experience in lobbying government, having worked with Ministry of Finance, Planning and Economic Development and unanimously agreed to include AMFIU in Subgroup One.

- The meeting was informed on the existence of Private Sector Donor group whose mandate was to review private sector related issues/requests for funding. The group consisted of UN bodies and the international community. Such a group would have an important contribution in the discussion of the Action Plan for the international community.

Action: Ms. Ongom of European Community to establish the details of the group and its chairmanship and pass on the information to Enterprise Uganda.

The fourth meeting was set for 6 September 2002 in Enterprise Uganda starting at 10:00 am.

The meeting ended at 12:55 pm.

LETTER SENT TO THE MINISTER OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT FROM THE SME TASK FORCE ON FINANCING

OFFICE OF THE DEPUTY GOVERNOR

37/43 KAMPALA ROAD
P.O. BOX 7120,
KAMPALA.

Tel:
341223
258441

BANK OF UGANDA

Ref: DG.12.1

7 June, 2002

Hon. Gerald Ssendaula
Minister of Finance, Planning &
Economic Development
P.O. Box 8147
Kampala

Hon. Minister,

RECOMMENDATIONS OF THE 1ST MEETING OF IMPLEMENTATION COMMITTEE FOR FINANCING SMALL AND MEDIUM SCALE ENTERPRISES (SMEs)

On 30 April 2002, UNCTAD and Enterprise Uganda together with Bank of Uganda organized a one-day symposium on Modalities for Financing SMEs. The symposium took place at the International Conference Centre, Kampala and was attended by about 260 people from the Government of Uganda, the private sector and international community. One of the outputs of the symposium was a proposed Action Plan to implement the recommendations made during the symposium. To operationalise the Plan, an Implementation Committee was constituted, drawing membership from key stakeholders in the SME sector.

Bank of Uganda offered to call and chair the first meeting of the Implementation Committee, which took place on 31 May 2002 at the Bank, and attached are the Minutes of the 1st meeting for your information.

The purpose of this letter is to communicate to you Sir, the resolutions of that meeting for inclusion in the Budget Speech due on 13 June 2002. The Meeting resolved that the Ministry of Finance, Planning and Economic Development, on behalf of Government:

(a) Establishes a special Small and Medium-Scale Enterprise (SME) guarantee facility supervised by the Bank of Uganda but managed by the principal stakeholders including commercial banks, microfinance institutions and leasing companies in a manner that avoids moral hazard. Funding for the guarantee facility would come from domestic sources and international financial institutions;

(b) Urges the Uganda Bankers Association (UBA) to encourage their members to design policies on SME lending and disclose them to the Bank of Uganda and other stakeholders. The banks should also be encouraged to report the composition of their loan portfolio by loan size and gender of client to the Bank of Uganda. For financial institutions, which are not under UBA, the MFPED is requested to urge them to do the same;

(c) Government, together with the international donor community, should undertake support measures to promote partnerships between commercial banks, other financial institutions and business service providers and to promote capacity building to make SMEs more creditworthy;

(d) Designates Private Sector Foundation as the focal point for SME information dissemination and development and for coordination of SME programmes at the national and international level;

(e) Begin work on setting a national definition for SMEs; and

(f) Analyze the impact of the current tax system on SME development, including the impact on financing SMEs via equity capital funds, commercial credit, microfinance and leasing (See Annex for an example of such an analysis).

In addition those recommendations to be included in the Budget Speech, your Ministry together with the Bank of Uganda is being requested to formally give mandate to the Implementation Committee/special Task Force on SME financing to consider ways and means of implementing the recommended policies and measures. The Committee/Task Force is expected to conclude its work in April 2003 and will be responsible for monitoring progress on a regular basis and reporting to the relevant stakeholders.

Yours sincerely,

Louis Kasekende (PhD)
Deputy Governor
