

UGANDA'S SMALL BUSINESS RECOVERY FUND: Does it go far enough?





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BACKGROUND

The COVID -19 induced crisis has greatly affected many businesses in Uganda. Micro, Small and Medium Enterprises (MSMEs) have felt the largest pinch given their inherent fragility even before the crisis. As the Government imposed a lockdown and other measures to curb the spread of the pandemic, many small businesses were scrapped of their cash flows. The Economic Policy Research Center (EPRC), in May 2020, reported¹ a 50 percent decline in business activity within the country. According to the survey results, micro and small businesses reported experiencing a larger decline in business activity compared to medium and large firms. More than half of small enterprises (53 percent) reported a severe decline in demand for their products. This, as a result, led to huge numbers of employees being laid off for good. Many of them couldn't return to work even after the lockdown measures had been lifted by Government. As a matter of fact, the EPRC business survey did project a 7 percent decline in permanent employment. Worse still, several restrictions remain in place that continue to affect the income of MSMEs.²

The gravity of the situation was further compounded by a limited access to affordable credit. A large share of these businesses could no longer access credit at affordable rates from financial institutions owing to the tightening of private credit. Overall, over 36 percent and 40 percent of micro and small enterprises respectively under survey³ reported a severe reduction in access to credit. This, according to the EPRC report was probably because lending institutions considered them to be highly risky and more likely to become insolvent in case COVID-19 persisted and restrictions were maintained. It should be noted that by the time of conducting the survey in 2020, 10 percent of small businesses foresaw their permanent closure if this situation persisted for more than a year, a prediction that did actually materialize with the outbreak of the 2nd COVID -19 wave in June this year.

To mitigate the impact of Covid 19, the Government of Uganda has launched a small business recovery fund in November 2021 to cater to the specific needs of small businesses and thus support their full recovery. The small business recovery fund is a government partnership with commercial banks and micro-finance deposit taking institutions and credit institutions to provide affordable financial loans to small enterprises that have experienced hardships due to the measures undertaken to control the spread of the coronavirus in the country. This policy brief examines the extent to which it cushions businesses, finding a number of weaknesses that must be immediately addressed to ensure that the Fund serves the intended purpose.

¹ <https://eprcug.org/publication/652-how-has-the-covid-19-pandemic-impacted-ugandan-businesses-results-from-a-business-climate-survey/#>

² For example, bars remain closed, and there are many businesses that depend on the operation of schools that also remain closed.

³ <https://eprcug.org/publication/652-how-has-the-covid-19-pandemic-impacted-ugandan-businesses-results-from-a-business-climate-survey/#>

OVERVIEW OF THE FUND⁴

The fund shall be administered by Bank of Uganda and to this effect, Government has committed an initial deposit of UGX. 100 billion shillings for use by the eligible participating financial institutions to extend loans to small businesses. The participating financial institutions will match the Government contribution by adding a UGX. 100 billion to form a consortium pool of UGX 200 billion. According to the finance ministry, this fund will provide financial loans to small businesses that have suffered financial distress arising from the effects of COVID -19 and have potential for recovery. As part of the eligibility criteria, the fund will cover all small businesses operated by individuals, groups, partnerships and companies, employing 5-49 people and with an annual turnover of UGX 10 million – UGX 100 million. It was highlighted by the Ministry that the maximum amount to a borrower under this intervention shall be UGX 100 million and there is no minimum. In addition, a borrower shall only access financing once under the fund.

As regards the cost of loans under the fund, the Ministry noted that the Government component of these funds shall be interest free while an interest rate not exceeding 10 per cent per annum shall be charged on the component of the funds made available by the participating financial institutions. This in simple terms means that for a borrower seeking 20 million from the bank, a 10 per cent interest charge will be placed on 10 million (half the entire amount borrowed), which is in this case the funding component from financial institutions. In addition, all loans to eligible borrowers will be extended for periods of a minimum of six (6) months and a maximum of four (4) years, which shall include a grace period of a maximum of one (1) year depending on the nature of the project as agreed upon with the borrower. It was further highlighted that the loan facilities under the fund will be secured by collateral of any form as agreed upon by the participating financial institution and the borrower.

Summary

How much: 200 billion (100 billion. Government +100 billion from commercial banks)

Eligibility: Small businesses operated by individuals, groups, partnerships and companies, employing 5-49 people and with an annual turnover of UGX 10 million – UGX 100 million. Businesses under Agricultural Credit Fund excluded.

How much can one borrow: Up to 100 million

Interest: 50% of amount interest free, 50% subject to a maximum of 10% interest per annum.

Repayment period: 6 months - 4 years. Grace period of up to one year.

Collateral: Any form of collateral as agreed upon between borrower and financial institution

⁴ <https://www.finance.go.ug/sites/default/files/press/PRESS%20STATEMENT%20ON%20THE%20GOVERNMENT%20OF%20UGANDA%20INTERVENTION%20TO%20PROVIDE%20AFFORDABLE%20FINANCIAL%20SUPPORT%20TO%20SMALL%20BUSINESSES%20TO%20RECOVER%20FROM%20THE%20EFFECTS%20OF%20COVID-19.pdf>

ISER welcomes this initiative given that it responds to the plight of many small businesses, many of which have been hard hit by COVID -19. An extra liquidity support for these businesses if well administered, will go a long way in boosting their financial resilience and further drive productivity, employment and consequent recovery for the entire economy. Furthermore, the allowable maximum loan amount of UGX 100m is large enough to plunge the funding gap for many of these businesses.

We however would wish to express our views over the design of the fund with the aim of having it suitably tailored for it to achieve its intended objective. These are highlighted below.

SALIENT CONCERNS

1. INSUFFICIENT TO COVER EXISTING SMALL BUSINESSES

Upon closely examining the small business landscape across the country, we've noted with concern that the fiscal allocation (UGX 200 billion) to the recovery fund still remains far less when compared to what might be needed and will thus likely not ably cater to the funding needs of all these businesses. Data from a recent 2021 report⁵ by the Federation for Small and Medium Enterprises – Uganda (FSME), an umbrella body that provides voice for small and medium businesses in Uganda revealed that, the total number of MSMEs in the country was estimated at 1,500,000 enterprises. Small enterprises with an annual turnover of 12 to UGX 100 million accounted for 18 percent of these which brings their number to approximately 270,000. Assuming each of these businesses contracted a loan just as low as UGX 10 million, only 20,000 of these would be covered by the time these funds run out,

essentially leaving the remaining 93 percent of small businesses to fend for themselves.

Furthermore, the initiative will leave out many small businesses operating within the informal sector. An online tweet⁶ by the Permanent Secretary to the Ministry of Finance Mr. Ramathan Ggoobi pointed to the fact that the small businesses must have been operationally registered before the pandemic. This then leaves the question on how struggling informal businesses will actually be supported by Government to recover. It should be noted that the country's informal sector employs over 87 percent⁷ people many of whom lost their jobs owing to the imposed lockdowns and the declining business activity. Yet still, the support measures that had been instituted (such as the Emyooga scheme) still fell short in supporting these businesses as reports from Parliament indicated⁸.

This therefore calls for the need to restructure the proposed fund in a manner that further encompasses informal enterprises or to design a new distinct scheme to support these businesses.

⁵ https://pdfhost.io/v/NO8C2Fwpx_IMPACT_OF_COVID_COVER_12_COMPRESSED

⁶ <https://twitter.com/rggoobi/status/146526324497786883?s=20>

⁷ https://www.ubos.org/wp-content/uploads/publications/05_20212018-19_ALFS_Report_FINAL.pdf; ANNUAL LABOUR FORCE SURVEY 2018/19 REPORT

⁸ <https://www.parliament.go.ug/news/5265/emyooga-was-poorly-executed-parliament>

This will actually incentivize these businesses to formalize. Several arguments' might be made on why these businesses aren't as deserving of much support from Government. However, the fact that they do contribute a significant share of Government revenue in the form of licenses and other forms of taxes should not be under looked.

2. THE INTEREST RATE STILL REMAINS A CHALLENGE TO SOME OF THESE BUSINESSES

According to Government, the interest rate charged by the participating financial institutions shall not exceed 10 percent per annum and this shall be charged on half of any borrowed amount. Borrowers will have to individually negotiate these rates subject to the above terms. However, a close examination of these terms reveals that the participating institutions will have no incentive to approve any rates lower than 10% which might in such a situation still remain unaffordable to some businesses. In this case rather, another better avenue might be to charge differential rates for each of the businesses within the 10 – 100 million shillings turnover range. Under such an event, the likely interest revenues foregone from them smallest businesses would be in turn compensated by the sizeable shares contributed by their larger counterparts.

3. THE REPAYMENT PERIOD IS STILL NOT ENOUGH TO ALLOW ADEQUATE TIME FOR MANY OF THESE BUSINESSES TO RECOVER

We have also noted that the repayment of loans provided under this fund will be on a reducing balance basis subject to a tenure of minimum 6 months and a maximum of 4 years. It is important that repayment terms allow enough time for these businesses to meet their repayment obligations under this arrangement without having to forego their recovery especially since the pandemic seems to be still unfolding with newer variants appearing. Longer repayment terms still remain ideal so as to cater to the needs of those small businesses that might require longer time frames for them to capture enough margins to be able to pay off their loans. It should be noted that much as this longer term period comes at a bigger repayment cost to these businesses, it might seem a better option to some of them that had already reached bankruptcy. The Central Bank's Agricultural Credit Facility has an 8-year repayment term, that could have been emulated for this newly launched fund.

We also wish to highlight that, with the exception of the provided grace period, the presented repayment terms have not provided adequate room for any contingencies that might arise in the event that these businesses have to sustain bigger shocks such as new COVID variants. In the event that these occur, many of these businesses could be left unable to pay off their contracted loans and hence risk losing their assets to the lenders. A closer assessment of the stimulus measures to small businesses by Uganda's neighbors reveals a daring example that the Government could replicate. In the case of Rwanda⁹, the Government has not only provided funds for credit to small businesses but also put in place an SME guarantee scheme to bail out those that would face repayment challenges.

⁹ <https://www.bnr.rw/browse-in/economic-recovery-fund/>

4. DISCRETION ON WHAT FORMS COLLATERAL WILL LIKELY RESULT IN EXCLUSION

The statement also notes that the loan facilities under the fund will be secured by collateral of any form as agreed upon by the borrower and the participating financial institution in accordance with the latter's lending policies. It should be noted that this will likely leave out many small businesses especially since the nature of collateral has been left to the discretion of the lending institutions. Most institutions only allow fixed collateral like land or buildings. While government has adopted a Security Interest in Movable Property Registry (SIMPRS) as mandated by the National Development Plan II to enable MSMEs to access credit by using their movable assets as collateral, few financial institutions use it. Many of these institutions have already indicated that they actually plan to tighten their collateral requirements (42 % of these i.e. close to half all the banks surveyed) within the current quota ending December. This is according to the latest bank lending survey released by the Central Bank¹⁰.

Requiring financial institutions to accept collateral beyond the traditional fixed time would enable a lot more businesses especially women led (which account for 22 percent of all small businesses)¹¹ to benefit. Most SMEs have movable assets such as machinery, equipment, or receivables as opposed to fixed assets, such as land or buildings and they account for most of the firms' capital stock. Government should also have used this as an opportunity to popularize SIMPO by requiring that SIMPRS.

5. LIMITED ACCESS TO INFORMATION

Beyond a few press releases, there has been no commendable effort by Government and the relevant financial institutions to publicize this initiative to the general public. Government is yet to reveal the list of participating financial institutions which will likely leave several small businesses without taking advantage.

6. LIMITED MONITORING AND ACCOUNTABILITY

During the last year, the lack of transparency, limited participation, and clear accountability mechanisms were key challenges in the utilization and disbursement of the economic stimulus package. It is important any package being designed thinks through modalities to address this.

¹⁰ https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/statistics/Bank_Lending_Survey_Reports/2022/Sep/Bank-Lending-Survey-Report-FY2021_22.pdf

¹¹ <https://www.nathaninc.com/wp-content/uploads/2017/10/National-Small-Business-Survey-report.pdf>

RECOMMENDATIONS

We therefore recommend the following to Government;

- Increase funding for the initiative for it to cover a larger number of the affected small businesses.
- Institute a mechanism that allows for differential rates to be charged for the varying business sizes within the 10 – 100 million shillings turnover range.
- Provide for longer repayment terms within this new credit facility.
- Setup contingency measures to protect those businesses that might fail to pay off their loans in the face of unexpected events e.g. such as a credit guarantee scheme. Specific terms should be put in place to deter any foreseen moral hazard.
- Expand the recovery fund to support micro-enterprises affected by COVID -19.
- Institute a recovery fund to support MSMEs within the informal sector.
- Government should set-up regulations to guide the use of collateral by lending institutions as a means to secure their loans than rather leave this to the discretion of the latter. These should be loose enough to allow for many small businesses to acquire loans under the fund.
- Government should step up efforts to publicize this initiative through all available avenues including the media and further compel all the respective financial institutions to do the same.
- Beyond this initiative, Bank of Uganda should place a cap on lending rates by financial institutions so as to keep the cost of credit affordable to all businesses.
- Measures should be undertaken to publicize other ongoing initiatives by Government such as the credit relief extension for borrowers within the hospitality and education sectors.



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