

Promoting Alternative Finance for SMEs in Uganda

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EXECUTIVE SUMMARY

This policy brief outlines policy actions the Government of Uganda, and other stakeholders, can take to help mitigate the perennial problem of limited access to finance by small and medium-sized enterprises (SMEs). It also outlines policy actions necessary to improve the SMEs' ability to forge effective business linkages with large FDI firms.

The policy brief concludes that policy change or action is required in four areas namely:

- 1) SME capacity development;
- 2) Increasing FDI firms' propensity to create business linkages with local SMEs;
- 3) Reducing barriers to business linkage between FDI firms and local SMEs; and,
- 4) Encouraging a greater use of B2B financing in existing business relationships

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INTRODUCTION

SMEs in Africa, and Uganda in particular, face the burden of limited access to formal finance from financial institutions. This hampers their emergence and growth. As a result, the structure of the private sector has remained 90 percent microenterprises and only 10 percent SMEs. In addition, there is rapid decline in competitiveness as shown by the high mortality rates of over 40 percent per annum. As a result, smallness and newness remain perennial features of the local private sector, which reduces the credibility of firms as potential business partners, increases financial insecurity and further constrains the competitiveness of local SMEs. At the same time, entry of better-financed regional and international firms in the Ugandan market is on the rise.

Business-to-business (B2B) finance is increasingly acknowledged worldwide as an alternative to formal finance, particularly in developing countries. To mitigate the problem of limited access to formal finance, there should be a deliberate effort to promote subcontracting, supply credits, prepayments and resource transfers, financial guarantees as well as export credit guarantees. This will help local SMEs grow, become competitive regionally and globally, and significantly improve the business environment – thus creating a general reduction in the cost of formal finance.

This policy brief emerges out of a study undertaken to assess the efficacy and potential of B2B financing in Uganda and possible options for increasing uptake. In the following sections, we highlight the objectives and methodology of the study, the results and evidence, and lastly options for promotion of B2B financing.

STUDY OBJECTIVES AND METHODOLOGY

The study was conducted over a period of 10 months (May 2012 – February 2013). The objectives of the study were to:

- 1) Establish the patterns of adoption of B2B financing and determine the factors responsible for levels of adoption;
- 2) Assess the potential for SMEs to leverage on FDI firms for increased adoption of B2B financing;
- 3) Assess the effect of entrepreneur perceptions and local business culture on adoption of B2B financing;
- 4) Determine the barriers to increased adoption of B2B financing; and lastly,
- 5) Determine and assess policy options to promote increased uptake of B2B financing.

Two surveys, one of transnational corporations (TNCs) and another of SMEs complemented with case studies, were conducted to obtain necessary data. Five sectors were covered namely: agro-processing, telecommunications, real estate and construction, iron and steel, and lastly petroleum and mining. Analysis of data employed both quantitative and qualitative techniques to determine correlation, effects and predictions, commonalities, trends and themes.

To mitigate the problem of limited access to formal finance, there should be a deliberate effort to promote subcontracting, supply credits, prepayments and resource transfers, financial guarantees, as well as export credit guarantees.

KEY FINDINGS

The study established that:

- Three B2B financing forms, namely subcontracting, supply credits and prepayments and resource transfers, were in moderate use, while there is non-use of financial guarantees and export credit guarantees.
- Potential for SMEs to leverage TNCs for increased use of B2B financing exists because TNCs are neutral on B2B financing to local SMEs. They find critical capabilities of SMEs to be average. TNCs want key SMEs capabilities upgraded, particularly their financial security.
- Individual entrepreneur perceptions and local business culture and workstyle have a strong

negative effect on B2B financing adoption, while TNC outsourcing selection criteria present strong hidden barriers to B2B financing adoption.

1. Implications and Recommendations for Increased Uptake of B2B Financing

The above results point to a number of areas where policy change or action is required for increased uptake of B2B financing. These areas are: SME capacity development; increasing TNC propensity to create business linkages with local SMEs; reduction of barriers to TNC-SME business linkage; and encouraging increased use of B2B financing in TNC-SME business relationships.

SME capacity development

Policy change or action is required with regard to:

- Integrating SMEs-TNCs Linkage Promotion in SME development;
- Reviewing the SME development policy to focus on B2B financing development between TNCs and large firms and SMEs;
- Promoting new areas of linkage between TNCs and SMEs beyond supply of raw materials and supply of professional services to cover supply of non-raw material inputs; strategic partnerships and alliances, distribution and clusters;
- Integrating TNC-SME promotion in SME advocacy work by SME sectoral associations; and
- Re-orienting promotion of horizontal cooperation among SMEs around specific areas of linkage with TNCs.

Increasing TNC propensity to create business linkage with local SMEs

Policy change or action is required with regard to:

- Encouraging competition among TNCs through deliberate reduction of entry barriers to sectoral markets;
- Strengthening policies to deepen the developmental effects of foreign direct investment;
- Strengthening National Content Policies by putting greater emphasis on technology and competence transfer to SMEs; and
- Prioritizing instituting or strengthening National Competition Policies, particularly for the service and high technology sectors.

Reduction of Barriers to TNC-SME business linkage

Policy change or action is required with regard to:

- Promoting a change among SMEs to eliminate speculative mindsets and cultivate visionary and long-term thinking for entrepreneurs using non-traditional approaches;
- Promoting a business culture and workstyle change to make it consistent with international practices; and
- Increasing awareness of the outsourcing choices and SME selection criteria of TNCs.

Encouraging increased use of B2B financing in existing TNC-SME business relationships

Policy change or action is required with regard to:

- Instituting explicit promotion programs focusing on increasing supply credits, prepayments and other resource transfers addressing the broad issues of awareness and operational efficacy.

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