Market Research on UNSECURED LENDING for MSMEs
Introduction:

Micro, small, and medium enterprises (MSMEs) (including smallholder farmers) struggle to access formal credit due to a lack of collateral and poor record keeping preventing them from making productive investments. FSD Uganda works to build inclusive credit market infrastructure to address the retail and business credit gap. FSD Uganda commissioned a study about unsecured lending to MSMEs in high density markets in Kampala, aimed at understanding the demand and supply challenges in accessing working capital. Examples of high-density markets include: Owino, Nakawa and Kalerwe markets.
1 Demographics of respondents and profiles of their businesses.

Majority of retailers in the high-density markets are female and aged below 40 years.

Demographics by gender

- Female: 60%
- Male: 40%

Age Distribution

- 18-30 years: 33%
- 31-40 years: 49%
- 41-50 years: 36%
- Above 50: 9%

Low levels of education among non-FMCG retailers potentially means low adherence to maintaining business records, hence the need for alternative methods to assess credit worthiness.

- Completed Tertiary education: 12%
- Completed Secondary education: 34%
- Completed post ordinary level specialized training: 12%
- Did not Complete Secondary education: 5%
- Completed post primary specialized training: 8%
- Completed primary school: 20%
- Did not complete primary school: 8%
- None: 4%
- Not free to share the education level: 1%

Most business owners (80%) enthusiastically intend to grow their businesses and are looking for affordable financing mechanisms or opportunities.

- To expand my business: 81%
- Education of children: 48%
- Build a house: 38%
- Buy land: 37%
- Construction of rentals: 26%
- Buy a car: 14%

End retailers predominantly view businesses as a means of achieving their financial goals.

Whereas most businesses are registered with the market authority (81%) and local government (18%), few businesses (8%) are formally registered with URSB. This poses a challenge for businesses in accessing credit from providers who require formal registration.

- Market authority: 81%
- Local Government: 8%
- URSB: 19%
- Others: 2%
Profit margins for most businesses are positive and range from 10% for alcohol to 25% for beverages, implying a healthy capacity to repay.
Emerging business models and implications for market entry and regulatory interventions.

Model 1: A financial services provider partnering with a strong distributor with monopoly powers over the given territory to provide working capital credit to retailers. This is typical of an FMGC financing model.

Inventory purchases account for between 75% to 90% of the business cost structure and therefore any working capital solutions should seek to address this challenge.

The monopoly power of the distributor makes them the only source of inventory for the retailers and an easy access point. Repayment rates are higher for this model.

Model 2: A Financial Service Provider partnering with a strong market association legitimately representing the interests of the members (retailers). An example of this is where a financial institution partners with a SACCO in the market place.

The need for continued membership of the association ensures the retailers meet their obligations, thereby reducing default rates. Group guarantees are possible, hence increasing access to finance.

Model 3: A financial service provider dealing directly with end-retailers for lack of a strong and legitimate association in the high-density market and lack of a strong distributor with monopoly powers. An example of this is individual loans disbursed conventionally or digitally.

Delinquency levels are highest in this model due to the lack of any leverages since the retailers are mobilized directly by the FSP.

Disbursement and recovery is done digitally. In some cases MNO provides client data to FSP.

Conventional disbursement and recovery.
## Risks and Mitigants

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<th>Challenges</th>
<th>Risks</th>
<th>Solutions</th>
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<tr>
<td>Lack of proper oversight over the digital credit service providers due to absence of regulations resulting in low public confidence.</td>
<td>High delinquency rates of the digital products</td>
<td>Comprehensive regulation of the financial sector is urgently required</td>
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<td>Limited awareness of digital credit • 86% of the respondents had never accessed a mobile loan • 97% of respondents had a registered mobile phone line.</td>
<td>Low level of penetration and uptake of digital credit</td>
<td>Heavy investment in persuasive adverts, Fintechs supported with development of appropriate products for the targeted rural population and adding a human face in the credit process (telephone call and SMS)</td>
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<td>Relative exclusion of the underserved and rural customers from digital credit - 30% of respondents did not know how to read and write in English due to: • a high cost of data (internet access) • low-end smart phones • low level of education.</td>
<td>Low level of uptake of digital loans especially by women and low-income earners.</td>
<td>• Government’s effort to provide internet access to rural areas needs to be fast tracked. • Standard regulation requiring translation of terms and conditions from English to local language</td>
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<td>Digital credit consumers not sufficiently protected against insufficient disclosure of terms and conditions. Over indebtedness due to multiple loans by digital credit consumers (low repayment rate). High potential for fraud due to identification gaps and ease of access to personal data.</td>
<td>Risk of financial losses due to non-performing loans • Underfinancing of customers which triggers multiple borrowing and consequently increases default risk.</td>
<td>• Regulation compelling all lenders to share customer credit data with the CRBs to support credit scoring • Improve product features - digital loans are generally one size fits all products.</td>
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<td>High interest rates - the lowest interest rate of a digital loan in Uganda is 60% p.a. by commercial banks and goes as high as 180% p.a. by Fintechs.</td>
<td>Low uptake of digital loans • High default rates due to the quality of borrowers whose sensitivity to price is low hence ignoring affordability</td>
<td>• Harness technology so that the promise of lower cost of digital credit is realized • Consider risk-based pricing where low risk customers are priced better than high risk ones.</td>
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Conclusions

Market entry and penetration is made possible through the different models: the make or break points primarily relate to integrity of the actors in each model.

On the demand side, limited awareness, high interest rates, limited access to internet due to cost and connectivity are hindering growth of digital credit.

On the supply side, lack of a strong regulatory framework and high delinquency rates are significant factors that need to be addressed in order to spur unsecured credit growth in Uganda.

The solution to these issues includes enhancing regulation, improving product features and developing better credit scoring to mitigate high delinquency.

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