POLICY PROPOSALS ON ALTERNATIVES TO INCREASING MSMES' CASH INFLOW TO ADDRESS THE CHALLENGE OF ACCESS TO FINANCING

Policy briefing paper,

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Policy Proposals on alternatives to increasing MSMEs' cash inflow to address their challenge of access to investment financing

Introduction

Micro, Small and Medium Enterprises (MSMEs)[1] form approximately 80% of the country's entire private sector, majority of which are MSMEs. Of these, 49% operate within the service sector, 33% in commerce and trade, 10% in manufacturing and 8% in other fields. They account for 95% of the business establishments; they employ approximately 2.5 million people/ 42% of the country's total employment; and they generate 80% of the country's manufactured output. According to the Global Entrepreneurship Monitor (GEM), 28% of adults own or co-own a new business. Young entrepreneurs in particular have "generally low" growth expectations; few innovate or vary product lines. In fact, while almost 10% of Ugandans started a business last year, a fifth of them have discontinued a business in the past year. Creating an additional business is more common than expanding an existing one.

Consequently, their competitiveness has remained very limited. This state of play for a majority of MSMEs has in many cases been linked to their limited access to investment finance owing to a number of difficulties. One of the major challenges most entrepreneurs struggle with is maintaining a substantial cash flow. Moreover, cash flow is the blood life of any enterprise. Although the most common source of investment financing that is often considered is loans from banks and lending institutions, the high cost of loans and the difficulties associated with accessing or servicing them has made access to finance become one of the most discussed challenge facing MSMEs today. Loans in Uganda generally require high value collateral and interest rates of over 20% at banks and other lenders. It is worth noting that an entrepreneurs' ability to access loans is often tied to a number of factors including, but not limited to: the consistency of the business' cash flow; and the economic conditions in which the business is operating. Banks tend to favor MSMEs that have a steady revenue stream and consistent cash flow coming in every month. MSMEs that can't demonstrate this consistency are often denied loans. In addition, banks or lending entities simply do not lend money to a business if they feel that the current economic conditions are unfavorable for getting the money back in a timely manner.

This policy brief, which is developed out of SEATINI Uganda's engagement with a number of MSMEs and MSME membership organizations[2] through a series of consultative meetings and a research on the impact of an unfair tax regime on MSMEs' growth and competitiveness, seeks to offer alternatives to addressing the challenge of limited access to finance by elaborating proposals to address policy related challenges that affect cash inflow of business enterprises, but are seldom discussed in this context. These factors include, among others, an unfavorable trade policy environment, an unfavorable tax and licensing system, and high production costs (energy, transport).

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[1] National Trade Sector Performance Review 2017/18 by Ministry of Trade Industry and Cooperatives

[2] Uganda Small Scale Industries Association, Federation of Small and Medium Enterprises, Uganda Women Entrepreneurs Association Limited, Product of Uganda, Uganda Chamber of SMEs,

The 10 key proposals elaborated below, if adopted could provide alternative ways to addressing some of the fundamental challenges impeding cash inflow which would be a key source of investment financing for many MSMEs today. These entrepreneurs therefore propose that:

1. **The Local Content law should be enacted to make the BUBU policy binding**

A legally binding framework should be put in place for enforcement of the Buy Uganda Build Uganda policy. Although attempts were made to draft a Local Content Bill, this process has not been pursued further. For the BUBU policy to meaningfully work for MSMEs, it must be legally binding. The effective implementation of the BUBU policy will require deliberate effort by the Government of Uganda.

Although the BUBU policy provides an important regulatory foundation for the support of the production, purchase, supply and consumption of locally made goods and services, it is largely best endeavor, and therefore none binding. It should be noted that when the BUBU policy was developed, the policy targeted that upon its implementation by the end of the five year period i.e. 2014-2019, 20% of Government procurement by value would be of local products and services; 50% of shelf space in supermarkets would be populated by local products; all MDAs strictly would abide by PPDA Amendment Act during procurement processes; 50% of local products would conform to national standards; and 50% local resources and raw materials would be utilized in production.

However, five years later, this is yet to be realized. In fact, until today, there is no supermarkets that has met the requirement to have 50% of their shelf space populated by locally manufactured/ produced products. Some hotels on the other hand still employ the services of foreign suppliers even for services such as security and front door operations. Regarding government procurement, the requirement for the 20% by value is too low even compared to other partner states for example Kenya, which requires that 40% of public procurement budgets for local products and services.

Therefore, in order to enforce these requirements, a law should be enacted to make it mandatory and subject them to a penalty upon failure to adhere to these requirements.

2. **The VAT exemption on imported agricultural processing machinery should be reviewed to benefit more MSMEs**

The MSMEs should be supported to benefit from the VAT exemption on agricultural processing machinery by reviewing the way it's granted. A majority of MSMEs rely on contractors for importation of their agro-processing machinery. However, Contractors are excluded as beneficiaries from the VAT exemption. As a result, the tax is often transferred to the MSME making the cost of the machinery much more expensive than they can afford. In fact, many MSMEs have failed to import machinery because of this anomaly. There is therefore need to design a specific mechanism through which such enterprises can benefit from the exemption.

3. **The government financing programs should be made more flexible, more accessible and supportive of value addition efforts**

The requirements for access to finance through the government designed financing programs for MSMEs should be more flexible. The current requirements are very stringent and discriminatory, and have been described by many MSMEs are mainly open to entrepreneurs with large businesses.

4. **Certain sub sectors should be ring fenced for local investors only**

A legally recognized framework should be put in place to enforce the ring fencing of certain sub sectors or value chains for local investors only. Such policies have successfully been implemented in countries like Nigeria in which the government in the early 2000s banned the importation of textiles and designs. Similarly, countries like South Africa regulate the importation of finished garments and fabrics by limiting such importations to formal procedures only in a bid to promote the growth of the local textiles and tailoring industry. In Uganda, MSMEs dominate the fruit and food processing, apiculture, horticulture and retail trade subsectors and value chains. Therefore, ring fencing a selected number of these subsectors/ value chains would go a long way in boosting these entrepreneurs' competitiveness in the domestic market.

5. **District Commercial Officers (DCOs) should be facilitated to enhance their support to MSMEs**

Most notably, the DCOs should be facilitated and monitored to implement the directive of Minister of Trade, industry and Cooperatives to secure shelf space for MSMEs' products in supermarkets within their districts. In order for the DCOs to effectively deliver on their mandate and further deliver on the directives of the Minister, they require effective facilitation. Currently, only 25 of the 127 districts have DCOs, following the recently concluded District Commercial Services Support (DICOSS) project. We therefore recommend that in order to support increased access to domestic markets for MSMEs products, non-wage financial allocations to support their effectiveness in delivering on their different roles as DCOs. MSMEs emphasize the need for specific support in accessing foreign owned supermarkets which constantly reject their products largely because they are importing similar products from their home countries.

6. **Uganda National Bureau of Standards (UNBS) should provide more incentives for MSMEs to standardize and certify their products.**

Standards and certification is critical in enhancing the market access potential for any product. However, the costs associated with attaining this milestone have in many cases limited many entrepreneurs from being able to access certain markets, even at the domestic level. Therefore, there is need for a tailor made incentives structure to be designed for MSMEs to meet these market requirements. Notably, these could include, subsidizing the costs of gaining and renewing of a certificate, among others.

7. **Uganda Development Corporations (UCD) should establish Common User Facilities[3] to enhance MSMEs' value addition efforts.**

UDC's central role of making long-term investments in strategic sectors of the economy in order to stimulate industrial and economic development and thus spur private sector growth. It would therefore be strategic if its investment approach is designed around the Common User Facility arrangement. A Common User Facility operates on the basis of an open access policy for multiple users in which infrastructure to facilitate industrialization on a sector by sector basis. It can be designed to be of sufficient size to allow for a number of different companies to manage their projects at any one time. Companies using the Common User Facility provide their own management and workforce; and are accountable for their project execution within a specified period of time. Under this arrangement, UDC can help to contribute towards lowering set-up costs with competitive rates. Subject to availability, the interested MSMEs can select the facilities they require and determine the duration of their use of the facilities.

8. **Uganda Investment Authority (UIA) should create clusters with varying minimum capital requirements for domestic investors in order to increase the number of MSMEs registered and benefiting from its services.**

9. **Uganda Revenue Authority (URA), Uganda Investment Authority (UIA) and Uganda Development Corporations (UDC) should strengthen the aftercare services support to MSMEs.**

10. **A MSMEs Policy forum to enhance policy engagements between MSMEs and policy makers, and government Ministries, Departments and Agencies in policy processes at national, regional and global levels should be established.**

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[3] http://waworksdirectory.cciwa.com/business/595a5ea04b00cb0ab978db7e Australian Marine Complex - Common User Facility