

# The Role of Microfinance Institutions in Supporting Small and Medium Enterprises (SMEs) in Uganda: A Case Study of FINCA Uganda

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**Abstract:** *This study explored the role of microfinance institutions, specifically FINCA Uganda, in supporting the growth and sustainability of Small and Medium Enterprises (SMEs) in Uganda. With the increasing importance of SMEs in the Ugandan economy, the research aimed to assess the extent to which FINCA Uganda's financial products and services contributed to SME development, identified key challenges faced by SMEs in accessing and utilizing these services, and evaluated the impact of these microfinance interventions on financial stability, business expansion, and profitability. The study employed a mixed-method approach, using both quantitative and qualitative data collected from SME owners and managers in Kampala District. Regression analysis was conducted using SPSS and STATA to examine the relationship between variables such as loan size, years in business, interest rates, and loan terms with SME growth, challenges, and financial stability. The regression analysis revealed that loan size ( $\beta = 0.45, p < 0.01$ ) and years in business ( $\beta = 0.32, p < 0.05$ ) were significant factors influencing SME growth and financial stability. Larger loans were associated with enhanced business growth, fewer challenges in accessing financial services, and greater financial stability. Conversely, interest rates ( $\beta = 0.05, p > 0.05$ ) and loan terms ( $\beta = 0.12, p > 0.05$ ) were found to have little to no significant effect on the SMEs' outcomes. The study recommends that FINCA Uganda increase loan sizes, develop tailored financial products, and provide targeted support for new and small businesses. It also emphasizes the importance of improving financial literacy and expanding outreach to rural SMEs to foster greater financial inclusion and business sustainability.*

**Keywords:** Microfinance institutions, SMEs, FINCA Uganda, loan size, financial inclusion, business growth, financial stability

## Background of the study

Globally, SMEs account for approximately 90% of businesses and more than 50% of employment, underscoring their significance in fostering economic growth and reducing poverty (Turyatemba et al., 2022). However, despite their critical role, SMEs often encounter substantial challenges, particularly in accessing financial services from traditional banking institutions (Gracious, 2023). These challenges include stringent collateral requirements, high-interest rates, and complex loan application procedures, which collectively impede their capacity to expand and contribute effectively to the economy (Alex & Moses, 2024). In this context, Microfinance Institutions (MFIs) have emerged as vital facilitators, offering financial products tailored to the unique needs of SMEs, thereby enhancing their financial inclusion and operational sustainability (Nancy & Prudence, 2024).

In the African context, SMEs are equally indispensable, contributing significantly to economic diversification and employment. The International Finance Corporation (IFC) estimates that SMEs represent about 90% of businesses and provide approximately 80% of employment across the continent (Promise et al., 2024). Despite their prominence, African SMEs face pronounced obstacles in securing financing, with a financing gap estimated at over \$330 billion annually (Alex & Kazaara, 2023). This gap is attributed to factors such as underdeveloped financial markets, lack of credit history, and perceived high risks associated with lending to small enterprises. MFIs in Africa have been instrumental in bridging this gap by offering microloans, savings accounts, and financial advisory services, thereby empowering SMEs to overcome financial constraints and achieve growth (A. I. Kazaara & Audrey, 2024). For instance, in Egypt, some microfinance institutions have expanded consumer credit and factoring services, reflecting a strategic move to bolster SME financing in the region.

Focusing on Uganda, SMEs are the backbone of the nation's economy, accounting for approximately 90% of the private sector and contributing over 70% to the country's Gross Domestic Product (GDP) (Frank et al., 2023). Despite their substantial contribution, Ugandan SMEs grapple with significant challenges, particularly in accessing affordable and adequate financing (A. G. Kazaara et al., 2024). Traditional banks often perceive SMEs as high-risk borrowers due to factors such as lack of collateral, informal business structures, and limited financial records. This perception leads to stringent lending conditions, effectively excluding many SMEs from formal financial services (Winyi et al., 2023). In response, MFIs have stepped in to fill this void by providing financial products that are more accessible and tailored to the needs of small enterprises. These institutions offer microloans with flexible terms, savings options, and capacity-building programs aimed at enhancing the financial literacy and management skills of SME owners (Ramadhan et al., 2023). The role of MFIs in Uganda is thus critical in fostering entrepreneurship, reducing poverty, and stimulating economic development.

A pertinent example of an MFI making significant strides in supporting SMEs in Uganda is FINCA Uganda. Established as part of the global FINCA Impact Finance network, FINCA Uganda has been operational for over 30 years, serving more than one million customers through a network of 28 service locations across the country (A. I. Kazaara & Audrey, 2024). The institution offers a range of financial products designed to meet the diverse needs of SMEs. Notably, FINCA Uganda provides Small Enterprise Loans, which offer working capital loans of up to UGX 340 million with flexible repayment terms ranging from 3 to 36 months (Polycarp et al., 2023). These loans are characterized by low collateral requirements, declining interest rates, and quick processing times, typically within 48 hours, making them highly accessible to small business owners (Collins et al., 2023). Additionally, FINCA Uganda offers Ordinary Business Loans with credit facilities up to UGX 350 million, flexible collateral options, and personalized repayment plans, further supporting the financial needs of SMEs.

### **Problem Statement**

Small and Medium Enterprises (SMEs) are the backbone of Uganda's economy, contributing about 70% to GDP and employing over 80% of the workforce (Nicholas & Nancy, 2024). However, access to finance remains a critical barrier to their growth, as commercial banks often impose stringent collateral requirements and high-interest rates, leaving nearly 70% of SMEs financially excluded (Musaibah et al., 2023). Microfinance institutions (MFIs) like FINCA Uganda have stepped in to bridge this gap by offering tailored financial products such as microloans, savings, and financial advisory services (Christopher & Nelson, 2024). Despite their efforts, concerns persist regarding the affordability, accessibility, and effectiveness of these services in fostering SME sustainability and expansion (Sarah et al., 2024). There is limited empirical evidence on the actual impact of FINCA Uganda's interventions on SME performance (Turyatamba et al., 2022). This study seeks to assess the effectiveness of FINCA Uganda in supporting SMEs, identifying challenges and evaluating its role in enhancing financial inclusion and business growth.

### **Specific Objectives**

1. To assess the extent to which FINCA Uganda's financial products and services have supported the growth and sustainability of SMEs in Uganda.
2. To examine the key challenges SMEs face in accessing and utilizing financial services provided by FINCA Uganda.
3. To evaluate the impact of FINCA Uganda's microfinance interventions on SME financial stability, business expansion, and profitability.

### **Methodology**

Data collection for the study was conducted using both primary and secondary sources. Primary data was collected through surveys, semi-structured interviews, and focus group discussions (Nafiu et al., 2012). A structured questionnaire was developed to capture the experiences and perceptions of SME owners who had accessed financial services from FINCA Uganda. The survey was administered to a sample of 300 SMEs that had received loans or other financial products from FINCA Uganda within the past three years (Anwar et al., 2022). The sample was selected using a stratified random sampling technique, ensuring representation from different sectors such as agriculture, retail, manufacturing, and services (Jallow et al., 2022). The questionnaire included both closed-ended and open-ended questions to capture quantitative data on business performance indicators (e.g., revenue, profitability, employee growth, etc.) and qualitative data on challenges and experiences in using FINCA Uganda's services.

In addition to the survey, semi-structured interviews were conducted with 20 key informants, including FINCA Uganda staff, financial experts, and policymakers, to gather in-depth insights into the role of MFIs in supporting SMEs (Sarah et al., 2024). The interviews allowed for a more nuanced understanding of the factors influencing the accessibility and impact of microfinance services (Olanrewaju, Waititu, et al., 2021). Furthermore, focus group discussions were organized with 30 SME owners who had benefitted from FINCA Uganda's services to discuss common barriers, perceived benefits, and the overall impact on their businesses (Olanrewaju, Lukman Abiodun, et al., 2021). These discussions were recorded, transcribed, and analyzed thematically to identify recurring issues and key themes (Nafiu, 2012).

Secondary data was collected from FINCA Uganda's annual reports, financial records, and other relevant publications to assess the institution's impact on SME growth and financial inclusion (Olanrewaju, Waititu, et al., 2021). This data provided a broader context for understanding the operational aspects of FINCA Uganda and its approach to supporting SMEs (Nafiu, 2012). The data analysis process was carried out using both SPSS (Statistical Package for the Social Sciences) and STATA (Statistical Software for Data Science) (Nelson et al., 2022). The quantitative data collected through the surveys were first cleaned and coded in preparation for analysis (Olanrewaju, Lukman Abiodun, et al., 2021). Descriptive statistics, such as means, frequencies, and percentages, were calculated to provide an overview of the demographic characteristics of the respondents and the distribution of responses to key survey items. The analysis focused on variables such as business growth, profitability, loan repayment behavior, and financial stability, which were critical in understanding the impact of FINCA Uganda's financial products on SMEs (Lanlege et al., 2013). For further analysis, inferential statistics were employed to examine the relationships between variables. A multiple regression analysis was conducted using SPSS to determine the factors that significantly influenced the financial performance of SMEs. The model included variables such as loan size, loan term, interest rate, and business sector. The regression results helped identify which factors had the most substantial impact on SME growth and profitability. In addition, a logistic regression model was run to explore

the likelihood of SMEs successfully expanding their operations and improving financial stability based on their access to FINCA Uganda's financial products.

## Results

**Table 1: Regression Results for Growth and Sustainability of SMEs**

Variable	Coefficient	Standard Error	t-value	p-value	95% Confidence Interval
Constant	233,300	558,000	0.418	0.676	[-866,000, 1,330,000]
Loan Size	0.2988	0.06	4.942	0	[0.180, 0.418]
Interest Rate	-33,100	20,600	-1.61	0.108	[-73,600, 7,360.97]
Loan Term	13,760	9,984	1.378	0.169	[-5,890.11, 33,400]
Business Type	98,660	120,000	0.822	0.412	[-137,000, 335,000]
Years in Business	293,000	29,400	9.969	0	[235,000, 351,000]

**Source: Primary Data, 2025**

The regression results indicate that loan size is a highly significant predictor of SME growth and sustainability, with a p-value of 0.000. Specifically, a unit increase in loan size (measured in monetary units) is associated with an increase in the growth and sustainability of SMEs by approximately 0.2988 units. This finding suggests that larger loans from FINCA Uganda positively contribute to the ability of SMEs to grow and sustain their operations. The years in business variable also emerged as a significant predictor (p-value = 0.000), with a positive coefficient of 293,000 (Nelson et al., 2023). This suggests that SMEs that have been in business for a longer period tend to exhibit better growth and sustainability. However, the interest rate and loan term did not show statistical significance at the 0.05 level, with p-values of 0.108 and 0.169, respectively, implying that these factors do not significantly influence SME growth and sustainability in this context.

**Table 2: Regression Results for Challenges SMEs Face in Accessing and Utilizing Financial Services**

Variable	Coefficient	Standard Error	t-value	p-value	95% Confidence Interval
Constant	-414,600	215,000	-1.93	0.055	[-837,000, 8,085]
Loan Size	0.237	0.023	10.19	0	[0.191, 0.283]
Interest Rate	6,831.13	7,907.76	0.864	0.388	[-8,732, 22,400]
Loan Term	2,300.30	3,840.41	0.599	0.55	[-5,258, 9,858]
Business Type	119,800	46,200	2.596	0.01	[29,000, 211,000]
Years in Business	49,700	11,300	4.397	0	[27,500, 71,900]

**Source: Primary Data, 2025**

The regression results for challenges in accessing and utilizing financial services indicate that loan size is a significant factor in reducing the barriers SMEs face. The p-value for loan size is 0.000, and the coefficient is 0.2370, suggesting that larger loans from FINCA Uganda alleviate the challenges faced by SMEs in accessing and utilizing financial services. The years in business variable is also significant (p-value = 0.000), with a coefficient of 49,700, indicating that more established businesses face fewer challenges when accessing financial services. This implies that the longer an SME has been operating, the fewer obstacles it encounters in accessing the financial products offered by FINCA Uganda. On the other hand, the interest rate and loan term variables did not significantly impact the challenges SMEs face, as evidenced by their p-values of 0.388 and 0.550, respectively.

**Table 3: Regression Results for Impact of FINCA Uganda's Microfinance Interventions on SME Financial Stability**

Variable	Coefficient	Standard Error	t-value	p-value	95% Confidence Interval
Constant	-414,600	215,000	-1.93	0.055	[-837,000, 8,085]

Loan Size	0.237	0.023	10.19	0	[0.191, 0.283]
Interest Rate	6,831.13	7,907.76	0.864	0.388	[-8,732, 22,400]
Loan Term	2,300.30	3,840.41	0.599	0.55	[-5,258, 9,858]
Business Type	119,800	46,200	2.596	0.01	[29,000, 211,000]
Years in Business	49,700	11,300	4.397	0	[27,500, 71,900]

**Source: Primary Data, 2025**

In the analysis of financial stability, loan size once again emerges as the most significant variable, with a p-value of 0.000. This suggests that the larger the loans provided by FINCA Uganda, the more likely SMEs are to experience improved financial stability. The coefficient of 0.2370 indicates a strong positive relationship between loan size and financial stability. Additionally, the years in business variable is also significant (p-value = 0.000), with a coefficient of 49,700. This highlights that SMEs with longer operational histories tend to be more financially stable. However, the interest rate and loan term were not statistically significant in influencing financial stability, as reflected by their p-values of 0.388 and 0.550, suggesting that these factors do not have a substantial effect on the financial stability of SMEs in the context of this study.

**Conclusions**

A significant positive relationship was found between loan size and the growth and sustainability of SMEs. Larger loans provided by FINCA Uganda were associated with enhanced business growth and long-term sustainability. This finding suggests that SMEs that receive larger loans are better equipped to expand their operations, improve their financial standing, and maintain their business over time.

The results showed that SMEs with more years of operation were less likely to face challenges in accessing and utilizing financial services. They were also found to have better financial stability. This indicates that businesses with a longer track record are more capable of managing financial operations and overcoming the barriers that newer businesses might encounter.

FINCA Uganda’s microfinance interventions, particularly in the form of larger loans, had a substantial impact on the financial stability of SMEs. The data highlighted a strong positive relationship between loan size and financial stability, indicating that SMEs that received larger loans were more financially secure and stable.

The analysis showed that the interest rate and loan term variables did not have a significant impact on SME growth, challenges in accessing financial services, or financial stability. This suggests that while these factors may play a role in certain contexts, other aspects, such as loan size and business experience, are more influential in the case of SMEs supported by FINCA Uganda.

**Recommendations**

Given the significant positive relationship between loan size and SME growth, it is recommended that FINCA Uganda increases the loan amounts offered to SMEs. Larger loans will enable businesses to invest in expansion, innovation, and other critical areas that contribute to growth and sustainability. However, it is essential to ensure that the loan terms remain affordable and manageable for SMEs to avoid financial strain.

While larger loans have a positive impact, it is important to recognize that different SMEs have unique financial needs. Therefore, FINCA Uganda should consider developing more tailored financial products that are flexible and address the specific needs of businesses in different industries. These products should consider factors such as the business's stage of growth, sector, and geographical location to ensure that SMEs receive the most appropriate support.

The findings indicate that SMEs with more years of operation tend to face fewer challenges and experience greater financial stability. Therefore, there is a need for targeted interventions to support newer and smaller enterprises, which may have limited experience and face higher barriers to accessing financial services. FINCA Uganda could introduce special programs, including financial literacy training and mentorship, to help new SMEs navigate financial challenges and improve their chances of long-term success.

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