Work in progress

Rural Credit Markets in Uganda: Evidence from the 2005/6 National Household Survey.

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Abstract

Although the financial sector has tremendously expanded in Uganda, access to financial services by rural households remains very low. This study examines the rural credit markets in Uganda using the 2005/06 Uganda National Household Survey data. Specifically, we investigate the extent to which both formal and informal service providers meet the borrowing needs of rural farmers. Also, we examine the factors associated with the likelihood of a household applying for loan. We find that rural areas have limited access to financial service providers despite being home to more than 80 percent of the Ugandan population. As such, most rural households obtain credit predominantly from informal sources—mainly friends or relations. Other household characteristics indicate that households who do not applied for credit have a poverty headcount more than twice that of households that have applied for credit at least once, in the past 12 months. Regression results point to having a savings account as key determinant of credit applications by rural households. Consequently, it is not only the accumulation of assets but also the extension of financial services to rural areas—they by enabling rural households to open and operate accounts, that is necessary for the growth and promotion of rural financial markets in Uganda.

1.0 Introduction

Limited access to financial services remains a huge challenge in much of SSA. However, given that the use of financial services goes beyond physical infrastructure to issues such as costs of services, there is little knowledge of how individuals/households would respond to increased access to financial institutions. One issue discussed in the literature is the effect of distance on the demand for financial services. Long distances are held as a key constraint behind the limited use of financial services in SSA. Furthermore, high cost of operations—serving a geographically dispersed population, is a major cause of the limited outreach of financial providers in SSA (Gulde et al, 2006).

During the recent past, as the Ugandan economy prospered so did the demand for credit by the private sector. Indeed, the national net stock of private credit increased from 497.2 billion (US$ 329 million) in June 1999 to 1,486 billion (US$ 814 million) by June 2006 (Bank of Uganda, 2006). However, the proportion of these loans advanced to agriculture remains low—increasing from 5.6 percent in June 1999 to 9.1 percent in 2006. Worse still, an even much smaller proportion is targeted towards rural farmers.

During the implementation of macroeconomic reform programs in Uganda, the Government of Uganda (GoU) has both directly and indirectly encouraged the extension of financial services to rural households. Directly, since the mid 1980s, the Government of Uganda (GoU) has experimented with various modes of extending financial services, especially to rural households. These include the Rural Farmers Scheme (RFS) introduced in 1987 to provide credit to agricultural farmers. However, this scheme administered through the then largest parastatal financial institution—Uganda Commercial Bank, was plagued by high operation costs leading to its failure. Subsequent attempts by the GoU to intervene in provision of financial services have used non-bank institutions such as local governments (LGs)—as means to reduce the costs of administration. For example, in 1996, the government introduced *Entandikwa* scheme—a revolving fund targeting rural households. This scheme was administered through community based organisation (CBOs) and the sub county local administration. However, due to inappropriate timing—the scheme was introduced at the height of a presidential campaign, and consequently interpreted as a gift, the scheme was plagued by very low recovery rates—only 55% of the loans advanced were repaid (Ssemwogere, 1999).

In order to improve the outreach to financial services by rural residents, the GoU has recently devised new schemes with different modes of delivery. During the 2006-7 financial year, the *Bonabaggawale*—"Prosperity for All" credit scheme was launched with Ushs 45 billion (US$ 26 million) earmarked for rural credit. Given that past attempts to provide credit to households by using district councils was not very effective, the GoU elected to channel the funds through a financial institution. The Post Bank—the institution with the most geographically spread branch network was chosen as the primary conduit. Under the proposed implementation arrangements, microfinance institutions (MFIs) and other informal financial institutions will borrow from the Post Bank at annual interest rate of 9 percent for onward lending to either agricultural farmer—at interest rates of 13 percent or to rural individuals not involved in agriculture—at a higher interest rates of 7 percent. Furthermore, rural households

will not be required to offer security as condition for access the loans. Although the proposed interest rates are about half the prevailing market rates for non-securitised loans, the uptake of the loans has been slow (Background to the Budget, 2007/8).

Thus, the most recent government initiatives consider informal financial providers such as MFIs and Savings and Credit Cooperatives (SACCOs) as a more effective means of easing the cost of financial services provider operations and there by increasing the outreach of financial services. Although, the importance of having financial services provider located at the lowest administration level is not questioned, there are concerns whether this address the needs of the poor. In particular, it is not known how rural households would respond to an increased proximity to informal service financial providers.

Apart from the public initiatives to expand financial services to the poor, a number of private actors—especially MFI non governmental organizations (NGOs) have set up operations to provide loans to small and medium entrepreneurs. Indeed, the number of MFIs has grown from about 30 in the mid 1990s to over 150 by 2003 (Bank of Uganda, 2003). At the same time, the number of MFI clients has dramatically increased—to about 1 million customers in 2005, some served by even formal commercial banks. As the operations of MFIs have increased so was the need for formal rules. In 2003, the Ugandan government passed the Microfinance Deposit Taking Institutions (MDI) Act which regulates MFIs in their operations of raising rural savings.

Notwithstanding such commendable efforts by both government and the private sector to improve access to financial services by rural households in Uganda and improvement in some financial indicators, access to credit and other financial services in rural areas remains low in Uganda. Based on the most recent national household survey only 17% of rural households have access to bank with 10kms while 40 % have access to MFI with in 10kms (Table 1). The corresponding rates for urban households are 90% and 96% respectively. Furthermore, there is inadequate knowledge of why some rural households take on credit while others decline. Past studies such as Kiiza and Perdenson (2002) have focused on the constraints to savings mobilization in rural areas rather than the determinants of credit access in rural areas. Consequently, this study attempts to examine the rural credit markets in Uganda using the 2005/06 Uganda National Household Survey data.

Table 1: Distances to financial institutions, 2005/06

	Proportion of households within 10km (%)		Bank (kms)		Microfinance (kms)	
	Bank	Microfinance	Mean	Median	Mean	Median
Uganda	29.5	49.6	26.5	22.0	18.2	11.0
Place of residence						
Rural	16.9	39.7	30.5	26.0	21.2	15.0
Urban	89.8	95.8	7.2	2.0	3.9	1.0
Region						
Central	42.6	57.1	20.9	14.0	13.1	8.0
Eastern	25.6	51.6	23.4	22.0	16.5	10.0

Northern	19.9	27.1	34.8	30.0	31.0	24.0
Western	24.2	55.2	29.9	25.0	16.5	9.0

Source: Ssewanyana et al (2007)

The broad objective of this study is to understand the functioning of rural financial markets in Uganda. As earlier mentioned we utilise the most recent national household survey, which is nationally representative, to undertake this task. Specifically, it is of interest to know to the extent to which both formal and informal service providers meet the borrowing needs of rural farmers. In particular, we consider household access to commercial bank branches and MFIs in 2005/6 as well as retrospectively in 2001. Also, for households that receive credit, we examine the source and amounts received based on intended use. Finally, we determine the factors associated with the likelihood of a household applying for loan through a probit model.

We find that rural areas have limited access to financial service providers despite being home to more than 80 percent of the Ugandan population. Specifically, only 6 percent of the rural communities have a bank branch located within the community while 21 percent have a MFI located in the locality. On the other hand, 80 percent of the urban communities have access to bank branch while 89 percent have a MFI with in the community. As such, most rural households obtain credit predominantly from informal sources—mainly friends or relations. However, the average loan amounts from this provider category are very small in comparison to banks or MFIs. Furthermore, the source of credit varies by the intended use—majority of funds received from banks or MFIs are mainly used as working capital for non-farm enterprises and purchase of assets such as land while funds borrowed from friends/relations are mainly used to meet consumption expenses. Other household characteristics indicate that households who do not applied for credit have a poverty headcount more than twice that of households that have applied for credit at least once, in the past 12 months.

When we estimate a probit model to determine the probability of a household applying for credit, we find that, at the mean, a household having at least one savings account increases the probability of having applied for credit by 39 percent among rural households. Other important determinants for credit demand include household income as proxied by household consumption per adult equivalent; specifically, increasing household income by 10 percent increases the probability of rural households applying for credit by 17 percent. Consequently, it is not only the accumulation of assets but also the extension of financial services to rural areas—they by enabling rural households to open and operate accounts, that is necessary for the growth and promotion of rural financial markets in Uganda**.**

The rest of the paper is organized as follows. In the next section, we describe the data and methods we use. This is followed by results in section four while the conclusions and policy implications follow in section 5.

2.0 Methods and Data sources

As earlier mentioned, this study makes use of the Uganda National Household Survey 2005/6 conducted by the Ugandan Bureau of Statistics (UBoS). This is a multi-topic survey modeled along the lines of the World Bank's living standards measurement survey. The 2005/6 survey was based on the two stage stratified random sampling. In the first stage, the principal sampling unit was the Enumeration Area (EA) based on the 2002 census as the sampling frame. In the second stage, households were the main sampling unit, with 10 households being randomly selected from each EA. Equally important, the sample size is large—at least 7,427 households were coved. This large coverage ensured that the data are also representative at the regional level and also allows for detailed analysis for rural areas. The survey was undertaken between June 2005 and May 2006 to capture any seasonal effects that may affect household welfare.

The survey provides a rich set of information at the household and community level. With regard to financial services issues, the socio-economic module provides detailed information on household application for credit, the use of loans advanced, and the amounts advanced. In addition, the survey inquires from households the reasons for not applying for credit from formal, semi-formal or informal sources. Also, the survey captures information on household consumption expenditures in addition to a wide range of variables such as health, education, and land holdings. Likewise the community module provides information on access to financial service providers in the locality.

Measures of household Welfare

In line with other studies analyzing poverty issues in developing countries, consumption expenditure is used as the household welfare measure. The preference is due to the fact that consumption is more stable than income that fluctuates from year to year. Also Uganda being a predominantly agricultural country, the likelihood of understating income is high. The consumption expenditures are adjusted for intra-household inequalities (household age and composition effects) using adult equivalence scales. The study used the poverty lines developed by Appleton (1999) and has since been adopted by authorities in Uganda. These poverty lines are estimated using the cost of basic needs approach, which takes into account both food and non-food household expenditures. The official poverty line was established at 16,443 Ugandan Shillings per adult equivalent per month or equivalent to US$44.56 per adult equivalent per month[1]. This consumption level corresponds to the minimum amount required to satisfy a daily intake of 3000 calories for an adult Ugandan. Finally, Appleton estimates separate lines for each region in the country depending on the urban-rural location. This accounts for the spatial cost of living differentials. Thus, there are 8 lines, two for each of the four regions in the country, one for urban and the other for rural areas. Further details of how welfare measures are generated can be found in UBoS (2007).

[1] According to Appleton (2001), this corresponds to US$34 per capita which is comparable with the World Bank's a dollar a day requirement for a household to be above the poverty line.

3.0 Results

3.1 Descriptive results

In the following sub-section—utilising bivariate analysis, we describe the access to rural financial service providers in Uganda. The description of rural financial services is combined with a comparison with the national average and a disaggregating of rural areas according to the four geographical regions where the data permits. First, we investigate access to commercial bank branches and MFIs in the locality. Second, we examine the trends in distance to financial service providers. Next, we describe the extent of credit applications in Uganda. This is followed by a comparison of characteristics of households applying and those not applying for credit. Other issues considered include the use of the loan and the loan amount. Finally, we investigated the reasons for not applying for credit from particular providers.

The community modules inquires from local leaders the access to financial service providers within the locality (Local Council—LC)[2] in 2005/6 and retrospectively in 2001. For households without any provider in the locality, the survey inquires about the distance to the nearest provider. Table 2 shows the availability and mean distance to the two most common financial service providers—commercial banks and microfinance institution (MFIs). In 2005/6, nationally 23 percent of the communities had access to a bank branch in their vicinity while 37 percent had a MFI located in the vicinity. Regarding trends in access, the table shows that the rates have only changed marginally since 2001. On the other hand, only about 7 percent of rural communities report having a commercial bank branch with in the community while 21 percent report having a MFI in the LC. Thus, MFIs are the most accessible financial service providers for rural communities.

Table 2: Availability and mean distance (kms) to either bank branch or MFI

	Availability with in LC (%)		Mean Distance, km	
	2005	2001	2005	2001
Uganda				
Bank Branch Office	23.5	23.1	27.7	28.9
MFI	37.1	34.4	20.9	25.2
Urban				
Bank Branch Office	79.7	78.5	11.9	13.6
MFI	89.3	84.7	7.8	12.6
Rural				
Bank Branch Office	6.5	6.3	32.6	33.7
MFI	21.5	19.5	24.9	29.7
Central Rural				
Bank Branch Office	7.9	7.9	31.1	31.3
MFI	22.7	20.5	19.6	20.6
Eastern Rural				
Bank Branch Office	5.8	5.8	27.1	27.2
MFI	25.8	25.2	22.2	22.7
Northern Rural				
Bank Branch Office	3.8	3.8	40.9	42.8

[2] This is the lowest level of local administration in Uganda's decentralized system of governance.

MFI	6.9	5.3	39.2	46.9
Western Rural				
Bank Branch Office	8.1	7.3	32.5	35.1
MFI	29.4	25.1	20.7	29.2

Source: Author's calculation from the 2005/6 UNHS.

Table 2 also shows regional disparities in access to financial service providers in rural areas. While about 8 percent of the rural communities of Central and Western Uganda report to bank branch in 2005, the corresponding rates for Northern Uganda is about half—4 percent. Also worth noting is the corresponding low rates of access to MFIs in Northern Uganda. The above patterns are partly attributed to civil conflict waging in Northern Uganda that has rendered large parts of region economically inactive.

With regard to distances, table 2 also shows that nationally the average distance to a bank branch has only marginally changed between 2001 and 2005—from 29 kms to 28 kms respectively. Similarly the average distance to a bank branch in the rural area has remained about 33 kms. On the other hand, the average distance to an MFI reduced by about 20 percent between 2001 and 2005. The above patterns may be explained by the difference in targeted populations between banks and MFI. While banks significantly expanded operations between these two periods, most of the commercial bank branch expansion was undertaken in urban areas. The limited expansion of bank branches in rural areas is partly attributed to the lack of infrastructure in rural e.g. electricity and telecommunication facilities, which are mandatory for the increasingly high tech commercial banking operations. At the regional level, the largest reduction in average distance to MFI was recorded in western Uganda—from 29 kms to 20 kms between 2001 and 2005.

Only a few Ugandans apply for credit from formal[3] and semi-formal financial[4] institutions; majority rely on informal[5] sources to access credit facilities. Table 3 shows that only 2.3 percent of households in Uganda had members who had applied for credit facilities from a regulated finance providers—commercial bank or regulated MDI. The corresponding rate for rural areas is 1.8 percent. The above pattern may be explained by a number of reasons. First, formal providers are predominantly accessible to urban residents. Second, the predominance of agriculture as the main economic activity—which however is considered less credit worthy, may explain the relatively low credit applications by households to formal financial providers. Finally, the fear of loss of assets—in case of loan defaults, leads to fewer volumes of loan applications. Overall, less than a third of households have any household member that has applied for credit in the previous 12 months prior to the survey. This invariably implies that most households are unable to exploit potential business opportunities—if at all there have not accumulated savings. In the next section, we contrast the characteristics of households who report at least one household member applying for some form of credit and contrast this with households making no applications.

[3] These are bank and other government agency subject to central monetary authority regulation.
[4] These are institution such as microfinance institutions, cooperatives, and non- governmental organizations.
[5] These are institutions such as friends and relatives, local money lenders, shop keepers, landlord/employer, village level associations (rotating savings).

Table 3: Proportion of households whose members have applied for credit in past 12 months (%)

Source	Uganda	Rural	Region			
			Central	Eastern	Northern	Western
Formal Financial Institution	2.3	1.8	1.2	1.9	0.9	2.8
Semi formal institutions	4.9	4.4	4.8	4.3	2.5	5.3
Informal institutions	23.4	23.7	24.8	19.6	6.6	39.3

Notes:

Source: Author's calculations from the 2005/6 UNHS

However, the failure to apply for credit from any of the above institutions may be partly attributed to the lack of capacity to borrow. In Table 4, we investigated the capability of the household head to borrow in 2005/6 and previously in 2001. It is indicated that nationally the proportion of household head capable of borrowing from either banks or MFIs has increased overtime. In tandem, the average amounts of possible loans also increased. As expected, the average possible loans amounts are lower in rural areas than in urban areas.

Table 4: Household Capacity to Borrow by source

	Can the household head borrow money from source (%)		Average possible amount for Household heads with capacity	
	2005	2001	2005	2001
			Uganda	
Bank	12.2	8.3	1,530,000	1,370,000
MFI	14.9	9.6	662,000	593,000
Employer	7.1	4.5	324,533	213,772
Money Lenders	10.6	8.1	343,122	255,751
Friends/Relatives	67.1	59.7	132,755	108,358
			Rural	
Bank	10.3	7.3	1,220,000	1,097,000
MFI	13.7	8.5	533,000	433,000
Employer	5.3	3.4	334,747	304,666
Money Lenders	10.4	8.1	270,401	223,488
Friends/Relatives	66.5	59.7	106,441	89,567

Source: Author's calculation from the 2005/6 UNHS survey

Next, we examine the characteristics of households applying for credit and compare these to the counterparts that do not incur any debt. Table 5 shows that households without any credit application over the past year exhibit lower welfare status. Specifically, the poverty headcount index of non-applicant households (37 percent) is more than twice that of applicants (17 percent). Furthermore, households with loan applicants are more financially "informed"—at least 25 percent of the applicant households have a savings account as compared to 11 percent for the latter. However, non-applicant households have considerably much higher land holdings—which again points to the fear of asset loss as the reason for not applying for credit.

Table 5: Characteristics of households by credit application

Characteristic	At least one household member applied for credit in past 12 Months	No household member applied for credit in the past 12 Months
	Uganda	
Poverty incidence (PO)	16.6	37.2
Household has at least one member with savings account	24.7	10.7
Average household size	5.4	5.1
Average number of adults aged18 years and above	2.3	2.1
Average years of Education of head	6.2	5.1
Average land holdings (acres)	20.3	30.6
Average distance to bank branch office(kms)	26.5	29.5
Average distance to MFI (kms)	17.7	23.2
Main sector of the household head is agriculture (%)	52.5	55.9
	Rural	
Poverty incidence (PO)	18.5	40.7
Household has at least one member with savings account	20.3	7.4
Average household size	5.6	5.2
Average number of adults aged18 years and above	2.3	2
Average years of Education of head	5.8	4.7
Average land holdings (acres)	18.4	30.9
Average distance to bank branch office (kms)	30.5	32.9
Average distance to MFI (kms)	20.6	26.3
Main sector of the household head is agriculture (%)	62	66.1

Source: Author's calculation from the 2005/6 UNHS survey

For the households with a member who applied for a loan, the survey inquires the purpose of the funds applied for. In table 6, we describe the purpose according to the financial provider sought. The two predominant uses of funds received from banks are for working capital/purchase of inputs and paying for education expenses. Similarly, individuals borrow from predominantly MFI (53 percent) and local groups (20 percent). On the other hand, most individuals borrow from friends and relatives to finance health expenses (22 percent) and consumption of other goods and services (21 percent). Thus, while over 60 percent of the loans from banks and MFIs are used to finance the acquisition of long term assets (e.g. land) and the purchase of working equipment and materials, only 30 percent of loans from friends are used for similar purposes. The latter pattern may be explained by the minimal risk of foreclose. A similar pattern for use of loan advances is observed in the rural areas.

Table 6: Reason for loan application by Source (%)

Reason	Banks	MFIs	Local Group	Friend/Relatives	Other
Uganda					
Purchase Land	10.4	3.5	4.5	2.4	0.5
Purchase farm inputs and tools	2.9	7.1	12.2	5.6	6.8
Purchase inputs/working capital for non-farm enterprises	27.8	53.2	20.3	19.7	16.1
Pay for building material	19.7	9.2	4.3	2.9	1.5
Purchase consumption goods and services	1.9	1.6	12.3	20.8	47.4
Pay for education expenses	26.9	17.4	17.5	12.5	10.7
Pay for Health expenses	1.4	1.2	19.7	22.5	7.6

Other	8.9	6.6	9.1	13.6	9.3
Total	100	100	100	100	100
# of loan application	204	344	395	1180	364
Rural					
Purchase Land	13.9	3.9	4.6	2.7	0.5
Purchase farm inputs and tools	3.1	9.1	12.8	6.6	7.2
Purchase inputs/working capital for non-farm enterprises	21.6	49.9	18.9	18.1	15.2
Pay for building material	14.9	10.1	4.4	2.9	1.5
Purchase consumption goods and services	1	2.1	12.7	19.2	47.5
Pay for education expenses	13.8	17.2	16.4	11.5	9.2
Pay for Health expenses	2.3	1.6	20.8	24.5	9.1
Other	11.3	6.1	9.3	14.5	9.8
Total	100	100	100	100	100
# of loan application	97	215	342	926	284

Source: Author's calculation from the 2005/6 UNHS survey

Again for individuals who report receiving loans, we calculate the average loan amounts. Table 7 shows that the average loan amounts from banks are more than three times those of MFIs. The table further shows that average loan amounts depend on the use of the loan—individuals requesting for funds to purchase inputs receive higher funds compared to all forms of consumption. Also worth noting is the fact individuals only borrow small amounts from friends or relatives. Finally, the amounts of funds received in rural areas are similar to the national average—the exception being the average amounts of funds from banks. Loans from informal sources are not only small in amounts but also majority do not have a fixed term for repayment. Table 8 shows that 69 percent of the loans advanced by friends have no term limits as opposed to only 24 percent for local SACCOs.

Table 7 : Average loan amounts applied for by use and source (Ushs)

Use	Banks	MFIs	Local Group	Friend /Relatives	Other
Uganda					
Purchase Land	1,044,906	840,162	212,120	268,406	540,189
Purchase farm inputs and tools	904,891	501,187	65,582	84,446	269,278
Purchase inputs/working capital for non-farm enterprises	4,204,630	633,034	222,238	285,614	345,361
Pay for building material	1,543,578	545,048	130,787	123,843	847,432
Purchase consumption goods and services	1,576,578	389,480	31,597	24,495	15,271
Pay for education expenses	866,305	459,030	134,008	86,683	278,426
Pay for Health expenses	149,971	132,717	41,429	47,673	32,101
Other	901,327	464,593	50,094	65,995	119,619
Average by source	1,953,183	571,606	108,301	106,853	140,086
Rural					
Purchase Land	1,023,029	519,537	214,195	285,121	477,064
Purchase farm inputs and tools	837,328	491,604	64,581	74,445	129,175
Purchase inputs/working capital for non-farm enterprises	4,657,092	691,216	228,899	210,533	277,232
Pay for building material	1,037,367	398,661	131,465	99,658	942,236
Purchase consumption goods and services	650,000	418,083	29,497	24,070	9,095
Pay for education expenses	795,181	303,276	120,069	79,027	237,592
Pay for Health expenses	149,971	141,060	41,414	46,967	32,101
Other	674,707	379,708	49,355	64,925	95,536
Average by source	1,668,765	536,791	104,021	88,163	106,500

Source: Author's calculation from the 2005/6 UNHS survey

Table 8: Loan Repayment period by source (%)

Months	Banks	MFIs	Local Group	Friend/Relatives	Other
Uganda					
0-1 Month	3.6	2.0	10.6	11.6	12.6
2-3 Months	2.3	7.1	34.3	10.4	7.1
4-6 Months	23.4	60.6	25.8	5.7	14.8
7-12 Months	50.9	16.9	4.0	1.9	5.5
More than 12 Months	18.2	11.9	1.5	1.6	3.1
No fixed Term	1.7	1.5	23.7	69.0	56.9
Total	100	100	100	100	100
Rural					
0-1 Month	4.9	1.5	10.3	11.6	12.7
2-3 Months	3.3	9.0	34.4	10.1	6.7
4-6 Months	24.1	61.5	25.3	6.3	14.1
7-12 Months	54.2	13.3	3.9	2.1	5.9
More than 12 Months	11.6	12.6	1.4	1.8	2.5
No fixed Term	1.9	2.1	24.7	68.1	58.0
Total	100	100	100	100	100

Source: Author's calculation from the 2005/6 UNHS survey

For households without any member applying for a loan, the survey inquires the reason behind such a decision. In Table 9, we describe the reasons for not applying from the three broad categories of providers. Inadequate security is the most frequently cited reason for not applying to formal financial institution although a significant proportion (17 percent) indicates that they have no use for the credit. The fear of debt is significant reason for not applying for credit services as alluded to earlier. Specifically, 17 percent, 19 percent, and 24 percent of households cite this as the major reasons for not accessing credit facility in banks, semiformal institutions, and informal institutions respectively. Finally, about 10 percent of the households report high interest rates as reasons for non credit application in either banks or MFIs.

Table 9: Reasons for not applying for credit during the past 12 months by source (%)

	Formal Financial Institutions	Semi-formal Institutions	Informal Institutions
Uganda			
No requirement for credit	17.1	16.1	27.9
No supply available	13.7	13.8	8.6
Inadequate security	24.6	22.5	8.6
High interest rates	9.1	9.6	2.5
Fear of Debt	16.8	19.1	33.8
Believed would be refused	10.3	9.3	15.4
Lack of sentisation	7.9	8.2	1.8
Other	1.3	1.3	1.4
Total	100	100	100
Rural			
No requirement for credit	16.6	15.3	26.8

No supply available	15.6	15.8	9.5
Inadequate security	24.3	22.7	8.8
High interest rates	8.4	8.7	2.4
Fear of Debt	16.1	18.2	32.8
Believed would be refused	10.3	9.3	16.3
Lack of sentisation	7.4	8.7	1.9
Other	1.3	1.3	1.4
Total	100	100	100

Source: Author's calculation from the 2005/6 UNHS survey

4.2 Determinants for household seeking credit.

In the previous section we describe how various indicators of access to financial service relate with household characteristics. However, bivariate analysis does not control for other household factors that may be driving credit demand. In order to control for the various household and locality factors that impinge on credit demand, we estimate a probit model to determine the probability of a household applying for credit and the results are presented in Table 10. We find that, at the mean, a household having at least one savings account increases the probability of having applied for credit by 26 percent. In the rural areas, a household having a savings account increases the probability of applying for credit by 39 percent. Other important determinants for credit demand include household income as proxied by household consumption per adult equivalent; specifically, increasing household income by 10 percent increases the probability of rural households applying for credit by 17 percent.

Table 10: Probit Model of at least one household member applying for credit, 2005/6

Variable	Marginal Effect[a]	t-value	Marginal Effect[a]	t-value
	Uganda		Rural	
Log of consumption	0.146	2.91***	0.175	2.36*
log of land (acres)	0.062	4.64***	0.071	4.38***
Log of value household assets	0.004	0.28	0.012	0.69
Household head main sector is agriculture	0.115	1.74	0.147	1.95
Household head is employed	-3.011	-5.4***	-3.546	-4.52***
Household Head's Education[b]				
Some Primary	0.107	1.4	0.109	1.3
Completed Primary	0.135	1.41	0.134	1.18
Some Secondary	0.044	0.51	0.054	0.52
Completed Secondary	0.208	2.26*	0.182	1.59
Household Head is female	-0.057	-0.92	-0.013	-0.19
Household size	0.027	3.08**	0.026	2.35*
Household located in an IDP camp	-0.216	-1.02	-0.185	-0.86
Regions[c]				
Central	0.513	4.53***	0.646	5.87***
Eastern	0.416	3.89***	0.454	3.94***
Western	1.041	9.58***	1.150	11.23***
Household has a land title	-0.095	-2.64**	-0.093	-2.26*
Household has a member with a bank account	0.259	3.15**	0.395	4.12***
Distance to nearest MFI	-0.001	-0.66	-0.001	-0.41
Number of observations	3362		2376	

Notes: [a] change in probability from a unit change in the independent variable. For discrete variables,

shows the difference in probabilities when the variable takes the value 1

[b] the excluded category is no education

[c] the excluded category is Northern Region

* Significant at 10%; significant at 5%; and *** significant at 1%.

Worth noting is the fact that a household having a land title is negatively associated with applying for credit. Specifically, the probability of a household applying for credit is reduced by about 10 percent is a household has a land title—the most common form of collateral. This may be partly explained by phobia towards debt as earlier mentioned and also the recent changes in credit administration with the on set of MFIs that rely less on assets as collateral and more on other methods of guaranteeing such as groups and loan insurance. Also, having a household head who is employed is also negatively associated with household loan application.

With regard to location variables, a household being resident in an IDP is negatively associated with loan applications; however, this is not significant. On the other hand the regional variables are highly significant. In particular, households in central Uganda have a 64 percent high chance of applying for credit as compared to the base category—Northern Uganda. However, the highest locational benefits are observed in Western Uganda—where the probability of applying for credit is more than 100 higher compared to Northern Uganda.

Contrary to earlier studies investigating access to financials services in Uganda such as Kiiza and Pederson (2002), we do not find significant effects of the household head's education on the probability that a member will apply for credit. Other variables we find insignificant include: household assets holdings, and distance to MFIs.

4.0 Conclusions and Policy implications

A number of conclusions can be made from the above findings especially with regard to limited use of formal and semi-formal financial institutions to access loans. First, informal loan sources despite their relatively favourable terms (e.g. no fixed loan duration) offer loans of very small amounts—too small to make meaningful investments. Secondly, the very low rate of ownership of savings accounts has implications for the functioning of overall financial sector. In particular, commercial banks are unable to intermediate low cost savings which impacts on the overall interest rate. In addition, this implies that most household either do not have any savings at all or keep savings in insecure environments. Consequently, it is not only the accumulation of assets but also the extension of financial services to rural areas—they by enabling rural households to open and operate accounts, that is necessary for the growth and promotion of rural financial markets in Uganda.

Financial service providers moving away for securitized loans has payoffs—households with valuable assets such as land are unwilling to use this as collateral to access credit. Thus, the innovation by commercial banks to use other form of guarantee and in the case of microfinance—the use of group savings as security is a welcome development.

Households are utilizing credit facilities for unproductive purposes—a substantial proportion of the borrowing is for consumption purposes. Although some forms of household consumption such as expenditure on education can be considered future investments, other forms of consumption loans constrain a household ability to pay. Furthermore, the economy as whole is unlikely to grow if substantial loan amounts are used for consumption expenditures as opposed to real investments that can create jobs.

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