Examining the levels of financial literacy and outreach of microfinance institutions in Uganda

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Microfinance Institutions (MFIs) have become a major player in the Ugandan economy through provision jobs and most important, bringing financial services close to the people. However, there are challenges such as low levels of literacy among clients of MFIs. MFIs also have problems in running of their outreach programs. This study was conducted to establish the relationship between financial literacy of clients and outreach of microfinance institutions in Uganda. A total of 286 employees of the microfinance institutions from eastern Uganda participated in this study through filling-in questionnaires. Data were analyzed using descriptive statistics, correlation and regression methods. Findings reveal that there is no significant relationship between financial literacy of clients and outreach of microfinance institutions in Uganda (r=0.85, P>05). The study recommends that microfinance institutions should increase on their outreach to cover further areas. This will enable them to increase on their breadth, depth and number of clients.

Key words: Financial literacy, outreach, microfinance, financial knowledge

INTRODUCTION

Around the globe, microfinance has captured the attention of development practitioners and policy makers mainly for its usefulness and simplicity. Consequently, many diverse forms of microfinance services (Credit, Savings, Insurance, Remittance, Health care, Awareness building, Legal aid and so on) have now flourished in almost all over the world Ashim (2010). However, as the microfinance industry has evolved and rapidly expanded both globally and in Uganda, questions regarding sustainability and outreach have come to the fore Okumu (2007). Microfinance institutions have continued to register limited outreach, 62% of Ugandans not served by any form of Financial Institution and only 3% of those having access to credit are served by Microfinance institutions (Kaggwa, 2010). Geographically, the MFIs are not evenly distributed. Kampala alone hosts 5 % of MFIs, but the whole Northern region has only 9 % of them (this probably being the result of the civil war), and the Eastern region 19 %. MFIs seem to be concentrated in the Western region (The Steadman Group, 2007). There exists a huge amount of research covering the diversified aspects of the microfinance revolution. Among numerous others, Hoston et al., (2010), impact of microfinance on poverty eradication, Sengupta and Aubuchan (2008), growth and development of microfinance and micro-credit, Goldberg (2005), outreach of microfinance programmes, Christen with Drake (2002), commercialization and transformation of Microfinance. In Uganda few studies focusing on outreach have been done over the last 10 years (Almeyda, 2002; Kiiza et al., 2004; Okumu, 2007). However, the level of serious and rigorous empirical data concerning financial literacy and outreach is still low in academic literature. Thus this study set out to examine the levels of financial literacy and outreach programs in Ugandan microfinance institutions.

Literature review

Financial literacy

While some researchers view financial literacy as a broad concept, encompassing an understanding of economics and how household decisions are affected by economic
conditions and circumstances (Worthington, 2006), others maintain a more narrowly defined focus on basic money management tools such as budgeting, saving, investing and insurance (Mandell, 2001). According to Mason and Wilson (2000), financial literacy can be defined as an individual’s ability to obtain, understand and evaluate the relevant information necessary to make decisions with an awareness of the likely financial consequences.

Financial literacy involves both the understanding of basic financial concepts and the ability and discipline to use that information to make wise personal and financial decisions. These decisions include when to spend, when to save, effectively managing a budget, choosing the right financial products and readiness to address other life events, such as financing our own or our children’s education and planning for retirement (Kefela, 2010). The ambiguity of the term financial literacy and a lack of measurement benchmarks make any form of measurement or assessment difficult Kathryn (2010). However, this study has attempted to investigate all three key components defined by this study as necessary to be considered financially literate.

Skills as a component of finance literacy

People also need the ability to apply their knowledge and understanding in order to manage their money and to make appropriate financial decisions. This calls for a range of specific skills, which need to be underpinned by basic levels of literacy and numeracy (SEDI, 2008). Consumers should be able to choose the products that are right for them; this requires the ability, to compare costs and returns; an ability to assess risk and to identify risky products; and an ability to look at products holistically (Widdowson et al., 2007). These skills include such generic cognitive processes as accessing information, comparing and contrasting, extrapolating and evaluating – applied in a financial context (Connell, 2007).

Additionally, financial literacy involves skill in managing the emotional and psychological factors that influence financial decision making (Mandell, 2001). A certain level of numeracy (or mathematical literacy) is regarded as a necessary condition of financial literacy. Huston (2010) argues that “if an individual struggles with arithmetic skills, this will certainly impact his/her financial literacy. However available tools (e.g. calculators) can compensate for these deficiencies; thus, information directly related to successfully navigating. It is therefore common for financial literacy assessments to include items with a mathematical literacy aspect, even though that aspect is not the primary focus of the whole measure.

Breadth in outreach programmes

The breadth of outreach measures the number of clients—both borrowers and savers. Breadth is important because of budget constraints— the wants and the needs of the poor exceed the resources they have (Rosenberg, 2003). Breadth of outreach counts the number of clients of a given depth who are supplied with a microfinance product of a given quality (worth) and a given cost. Because only a small proportion of the target group have access to formal and semi-formal services, the more numerous the clients reached, the better (Adams, 1998).

As breadth and sustainability are positively related, then both are inversely related to depth, so the larger the number of clients, the lower the depth or the larger the loan size. But in absolute terms, institutions with wide breadth may reach as many of the very poor as poverty-oriented organization with narrow breadth, even when presenting high average loan balances. Therefore, wider breadth offsets depth (Polanco, 2003).

Depth in outreach programmes

Depth of outreach tells us how valuable it is to extend the supply of microfinance products to a particular target group, not from the point of view of a given client, but from the point of view of society. The political consensus is that it is socially more valuable to expand the frontier of finance for the poor than it is to further expand the frontier of finance for the rich (Morduch et al., 2005; Gulli, 1998).

Average loan size, defined as the average gross loan portfolio divided by the number of active loan borrowers, is a proxy of depth of outreach; it can also be defined as the value that the society attaches to the net gain of a given client, following the terms (Luzzi, 2006).

It is only when the average loan size is very small that the MFI touches the really poor since direct measurements of depth through income or wealth are not readily available, indirect proxies for depth are sex (women are preferred), location (rural is preferred), education (less is preferred), access to public services (lack of access is preferred), among others (Schreiner, 1999). Average outstanding balance is roughly related to client poverty, because better off clients tend to be uninterested in smaller loans or deposit accounts (Rosenberg 2009). The average outstanding balance includes only loan amounts that clients have not yet repaid, or savings that clients have not withdrawn. This point-of-time number should not be confused with total amounts loaned or deposited during the reporting period, or with the average initial amount of the loans in the portfolio (Cambier, 2010)

Financial literacy and outreach

Microfinance institutions have developed a variety of financial products and services many of which are much beyond the comprehension of the target clients. Most of these target clients have limited awareness, knowledge and skills to enable them to differentiate between the products’ appropriateness, costs, and risks (Andah, 2008). Financial
education provides clients with a better understanding of the processes and benefits of accessing financial services making it easier for MFIs to gain new clients. People are more willing to access financial services when they fully understand what it is all about (Ernesto, 2010).

Even if people are given access to financial services, it is no guarantee that they start using it. People exclude themselves because they do not trust the financial system, they do not understand the way it works in the official financial institutions – made harder by the high illiteracy rates in some developing countries – or the products they seek are not offered (Reintje, 2007). Without basic levels of financial literacy, it is hard for the poor to use financial services appropriately and with confidence. Furthermore, empirical evidence suggests that lack of financial education is a key contributing factor to over-indebtedness, which when it reaches an unmanageable level can push poor people even deeper into poverty (Financial Inclusion Strategy, 2010).

Financial literacy can be an important determinant of access to finance (Cole & Fernando, 2008). Low levels of literacy may prevent the take-up of more complicated financial products such as insurance, since clients may be hesitant to buy a product whose utility they do not fully comprehend. Even for a less complicated financial product, such as a bank account, a financially illiterate person may not understand the importance of formal savings. Lack of financial literacy may also be compounded by a lack of access to a range of financial products (Godfrey et al., 2007). Financial literacy also has a significant part to play in influencing how financial institutions – such as banks, non-bank deposit takers and insurers – manage their affairs and what products they provide. Because financial literacy influences people’s investment decisions, including risk/return tradeoffs, it also affects how resources in the economy are allocated (Widdowson et al., 2007).

Financial knowledge

This is the ability to make sense of and manipulate money in its different forms, uses and functions. Financial knowledge and understanding allows people to acquire the skills they need to deal with everyday financial matters and make the right choices for their needs (SEDI, 2008). People require a basic body of knowledge and understanding, upon which they can draw when managing their financial affairs. This knowledge will be acquired in different ways: through experience; through education and training; and through passive receipt of information from different sources such as family and friends, the media and information materials produced by the financial sector (Widdowson et al., 2007). This process is engaged when the individual searches and accesses sources of financial information, and identifies or recognizes its relevance (Nhlanhla, 2011).

Solid knowledge on finances enables consumers to choose financial services most suitable to their needs and financial capabilities, moreover it influences the right assessment of risk connected with a given product (Szafranska, 2011). The knowledge of basic financial terms is important because it allows citizens for a better understanding of financial products and making rational decisions about their personal finances (Godfrey et al., 2008). There are various sources of financial information available to students, including friends, parents or other family members, the media and financial institutions. It is useful to know which sources of information are accessed most frequently and to ascertain whether higher levels of financial literacy are associated with particular sources of information (Chiara, 2011).

Financial actions

Actions are the ability to take effective decisions in managing their finances in the areas of basic money management, financial planning and investments (Morawcywki et al., 2010). A financially capable person is one who has the knowledge, skills and confidence to be aware of financial opportunities, to know where to go for help, to make informed choices, and to take effective action to improve his or her financial well-being (Kempson, 2008). Financial literacy can set the stage for the positive actions which are so important to wealth creation and preservation – actions such as careful consideration of costs of financial services, avoidance of scams and fraudulent schemes, knowledge and understanding of financial products and services, and saving for a rainy day and for the longer term, such as for retirement (Nhlanhla, 2011).

Financial capability is a broad concept, encompassing people’s knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading greater participation in the financial service market (Chiara, 2011). On the other hand, while action is the ability to take effective decisions in managing finances in the areas of basic money management, financial planning and investments (Morawcywki et al., 2010).

MATERIALS AND METHODS

Research methods used

Quantitative research methods were used in this study. A self-administered questionnaire was the main data collection tool, were by the research pretested it for reliability and validity and thereafter implemented it. A total of 286 respondents were purposively selected from 30 microfinance institutions in eastern Uganda to participate in the study. These included clients, supervisors, managers, loan officers, heads of products and credit administrators.
Table 1. Study sample

<table>
<thead>
<tr>
<th>Title</th>
<th>No of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers</td>
<td>34</td>
</tr>
<tr>
<td>Credit administrators/supervisors</td>
<td>25</td>
</tr>
<tr>
<td>Loan officers</td>
<td>115</td>
</tr>
<tr>
<td>Product heads</td>
<td>17</td>
</tr>
<tr>
<td>Clients</td>
<td>95</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>286</strong></td>
</tr>
</tbody>
</table>

Table 2. Validity and reliability results

<table>
<thead>
<tr>
<th>Variable</th>
<th>No of items</th>
<th>CAC</th>
<th>CVI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial literacy</td>
<td>9</td>
<td>.716</td>
<td>.771</td>
</tr>
<tr>
<td>Outreach</td>
<td>6</td>
<td>.628</td>
<td>.719</td>
</tr>
</tbody>
</table>

Table 3. Financial skills

<table>
<thead>
<tr>
<th>Variable</th>
<th>Majority opinion</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>We have the ability to compare costs and returns before making decisions on loans to take</td>
<td>Agree</td>
<td>50.5</td>
</tr>
<tr>
<td>We have basic numeracy skills</td>
<td>Agree</td>
<td>49.0</td>
</tr>
<tr>
<td>We can read, interpret and understand contracts that we enter in with financial institutions</td>
<td>Agree</td>
<td>43.8</td>
</tr>
<tr>
<td>We have the ability to assess the risks of products available before making the right decisions</td>
<td>Agree</td>
<td>47.4</td>
</tr>
<tr>
<td>We are aware of the costs of the financial product/s we take</td>
<td>Agree</td>
<td>54.2</td>
</tr>
</tbody>
</table>

Source: Primary Data

Table 4. Financial actions

<table>
<thead>
<tr>
<th>Variable</th>
<th>Majority opinion</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>We are confident in making financial and investment decisions</td>
<td>Agree</td>
<td>68.2</td>
</tr>
<tr>
<td>We prepare budgets and plan for our finances accordingly</td>
<td>Agree</td>
<td>37.6</td>
</tr>
<tr>
<td>We have investments in our own names</td>
<td>Disagree</td>
<td>41.2</td>
</tr>
<tr>
<td>We have concrete and well laid out financial goals towards which we work</td>
<td>Agree</td>
<td>79.8</td>
</tr>
<tr>
<td>We use the financial knowledge and skills acquired in making investment decisions</td>
<td>Agree</td>
<td>72.8</td>
</tr>
<tr>
<td>We are guided on how to use the money we get from the different financial institutions around us</td>
<td>Disagree</td>
<td>51.8</td>
</tr>
<tr>
<td>We use facilities attained for their intended purposes</td>
<td>Agree</td>
<td>46.3</td>
</tr>
</tbody>
</table>

Source: Primary Data

Table 1 above shows the sample breakdown:
The researcher used Cronbach Alpha Reliability Coefficients and Content Validity Index to test the validity and reliability of the research instrument. Table 2 shows validity and reliability results:
The results in Table 2 indicate that the research instrument was valid and reliable since all variable measured CAC and CVI > 0.6.

Research findings

Financial skills
Data were gathered to examine the financial skills of respondents. The results in the Table 3 highlight the percentage distribution of respondents’ financial skills: Findings in Table 2 showed positive results concerning the clients’ financial skills in that majority of them were in agreement about their possession of financial skills such as; having ability to compare costs and returns before taking loans (50.5%), having basic numeracy skills (49.0%), ability to read interpret and understand financial contracts with financial institutions (43.8%), having ability to assess the risks of products available (47.4%) and awareness of the costs of the financial products (54.2%).

Financial actions
In addition, data were gathered to analyze the financial actions of respondents in the microfinance institutions. The results in the Table 4 below highlight the percentage distribution of respondents’ financial actions: For majority of the financial actions of clients, Table 4
Table 5. correlation results

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Literacy</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outreach</td>
<td>.085</td>
<td>.525**</td>
<td>1</td>
</tr>
</tbody>
</table>

*Correlation is significant at the 0.05 level

Table 6. Regression results

<table>
<thead>
<tr>
<th>Outreach</th>
<th>Unstandardized Coeff.</th>
<th>Standardized Coeff.</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.834</td>
<td>.507</td>
<td></td>
<td>3.616</td>
</tr>
<tr>
<td>Financial literacy</td>
<td>.006</td>
<td>.027</td>
<td>.019</td>
<td>.214</td>
</tr>
<tr>
<td>R Square</td>
<td>.294</td>
<td></td>
<td>F Statistic</td>
<td>32.921</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>.275</td>
<td></td>
<td>Sig. (F Statistic)</td>
<td>.031</td>
</tr>
</tbody>
</table>

Source: Primary data

revealed that most of the clients agreed to having good financial actions, including; being confident in making financial and investment decisions (68.2%), preparing budgets and plans for their finances accordingly (37.6%), having concrete financial goals (79.8%), using financial knowledge and skills acquired in making investment decisions (72.8%) and using facilities attained for their intended purposes (46.3%). On the contrary however, most clients disagreed to; having investments in their names and getting guidance on how to use their loans (51.8%).

**Relationship between financial literacy and outreach**

Using Pearson’s correlation, the researcher tested determined whether there was a relationship between financial literacy and outreach in microfinance institutions in Uganda. Table 5 presents the results: Results in table 5 show that there is no significant relationship between financial literacy of and outreach of MFIs (r=.085, p>05).

**Regression Analysis**

Regression analysis was used to establish the nature of relationship that existed between financial literacy and outreach of MFIs. Table 6 shows the results: Regression results in Table 6 reveal that literacy of clients had no significant effect on the outreach of financial institutions of the clients (Beta = .006, p>.05).

**DISCUSSION OF FINDINGS**

The researcher observes that financial literacy of clients were not significantly correlated with outreach of MFIs (r=.085, p>05). Table 5 indicates that there is no strong relationship between financial literacy of clients and the transaction costs of MFIs, implying that high levels financial literacy were not at all associated with outreach of MFIs. Clients’ financial knowledge, financial skills and financial skills were found not have a significant impact on the level of outreach of MFIs. Equally, the findings in Table 6 further revealed that literacy of clients had no significant effect on the outreach of financial institutions of the clients (Beta = .006, p>.05).

This is in agreement with the finding of (Lusardi, 2008) who finds little or no effects of financial education programs on savings. Indeed Sherraden and Boshara (2008), also point out that it is not necessarily the case that people first become financially literate and then save and accumulate assets. It may also be that, when people begin to accumulate assets, they become more interested in improving their literacy. MFIs should therefore focus on other areas that can enhance outreach as it was found out by the researcher that financial literacy has no effect on outreach.

**RECOMMENDATIONS**

MFIs need to increase on their outreach to cover further areas as this will enable them to increase on their breadth, depth and number of clients. Most MFIs restrict the number of sub group members to five and the big groups to fifty members, but this limits a number of potential clients as it makes it hard for the group members to recruit more members if they are already fifty in the group. Small managerial trainings for the group leaders are also recommended.

Group leaders can be trained in financial and other managerial skills as this will enable them to manage their groups. This will in the long run increase the financial literacy of the clients and also reduce on the group development and monitoring costs incurred by MFIs.
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