



## Impact of credit counseling on the entrepreneurial behavior of Ugandan youth

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### Key messages

- Credit counseling should be part of youth-focused entrepreneurship programs to ensure youth acquire a better understanding of financial management.
- Vocational programs should include courses on credit and financial management as well as soft skills such as planning, communication, negotiation and risk management.
- Financial institutions offering credit to young entrepreneurs must comply with the regulations of the credit program, yet avoid imposing conditions that discourage potential beneficiaries.

### High unemployment for Ugandan youth

Uganda's population is one of the youngest and most rapidly growing in the world with more than half under the age of 15, and three-quarters of the population under 30.

Unemployment continues to pose a serious challenge in the country, particularly among youth. In 2012, the Uganda Bureau of Statistics revealed that 64% of the nation's unemployed are between the ages of 18 and 30.

Furthermore, while the number of Ugandans living below the national poverty line has more than halved over the last 20 years there is still a way to go, with 19.5% still living in poverty in 2012, according to the World Bank.

The Ugandan government has recognized these issues and initiated a number of interventions including business and management skills training for youth, integrating vocational education into primary and secondary level courses, developing industrial and service parks, and promoting agricultural commercialization and agro-processing through business incubators.

The government also launched the **Youth Venture Capital Fund** in the 2011-2012 financial year to provide credit to projects proposed by young

entrepreneurs as well as mentoring via participating financial institutions.

However, there has been low uptake of the resources available and a high default rate, which creates problems for operating the initiative as a revolving fund.

A team of local researchers in Uganda set out to **investigate how entrepreneurial risk tolerance determines credit demand amongst young entrepreneurs, and the impact that credit counseling has on their borrowing decisions.**

Their study aims to provide a deeper understanding of the personal factors associated with risk tolerance and the effect that credit counseling has on young entrepreneurs' willingness to use credit.



## Data and methodology

The research team set up a randomized control trial involving 555 young people aged 18 to 35 from five districts in the major geographical regions of Uganda and who owned a business at the time of the study. From the group, participants were chosen at random to attend specialized two-day business clinics designed to help young entrepreneurs avoid common pitfalls during the credit application process and organize their enterprise in a way that would enhance their business credit eligibility. The clinics provided guidelines on how to use credit resources (such as the Youth Venture Capital Fund) to expand and improve business while managing business finances so as to be able to pay back the borrowed funds.

The researchers administered two surveys to both the business clinic participants and those who were not chosen to participate, with the first survey administered before the intervention, to provide baseline data, and the final survey three to four months after the intervention. To measure the level of risk tolerance, all individuals in the evaluation sample participated in a laboratory experiment where they were asked to make a choice between 10 different combinations of safe and risky investment options, with both the potential payoff and the uncertainty of returns on investment increasing as the participant progressed.

## Key findings

The results of this study indicate that **the level of credit demand is closely linked to personal entrepreneurial risk tolerance**, which can be modified through credit counseling.

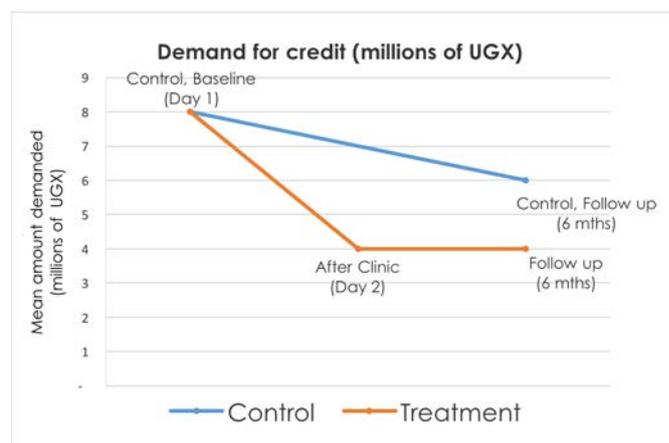
Participants were more cautious (i.e. less risk tolerant) with their credit choices when they were made aware of the real uncertainties of a risky investment. **Youth who had attended credit counseling were inclined to request significantly lower amounts of credit, compared to those who did not receive credit counseling (Figure 1).** They also exhibited a better understanding of financial management and the risks associated with borrowing funds without a clear business plan. Similarly, individuals with higher education levels were found to have a lower tolerance of risk and demand less credit.

Those who attended the clinic understood the need to ensure resources were used responsibly. This group were also more likely to explore alternative funding sources such as supplier credit, grants, and loans from family and friends. In some cases, they chose to use their own equity or savings, thereby looking beyond formal sources of business credit.

These results suggest that **providing financial risk education as a complement to credit provision for youth reduces the default rate while also reducing unemployment levels**, as the Youth Venture Capital Fund is intended to do.

The researchers did not find any significant difference between men and women in terms of risk tolerance. This finding is consistent with that of Mel, McKenzie and Woodruff (2008) who found no gender gap in risk aversion or entrepreneurial attitudes. However, as the number of women who participated in the PEP study is much lower than the number of men and due to the influence of cultural roles in Uganda, this finding cannot be reliably attributed to credit counseling.

**Figure 1: Average demand**



## Implications for policy

The findings of this study indicate several key areas where the Ugandan government, and other institutions designing youth entrepreneurship programs, can better tailor their policies and programs so that entrepreneurial activities are sustainable and accessible to the target beneficiaries, with the aim of reducing poverty.

Generally, the training helps youth entrepreneurs understand the importance of better business practices such as preparing and following a business plan, book keeping, managing credit and managing profits. The networking opportunity presented by the clinics also provides a platform for youth to share business ideas and experiences, allowing young entrepreneurs to seek continuous support from business mentors.

**Providing credit without ensuring that beneficiaries adequately understand the expected risks is unlikely to lead to higher uptake, business expansion, or reduced unemployment.** The government should therefore ensure that credit program beneficiaries understand the conditions and requirements to access the programs before implementation. One way to support this would be to **incorporate credit counseling, financial management and soft-skill training** (planning, communication, negotiation, risk management, etc.) **into all vocational courses and into all entrepreneurship programs that target and aim to empower youth.**

While enterprise education is a very welcome strategy in the National Youth Policy, without a focus on the specific aspects of training mentioned above, results are likely to remain varied and the programs will have little impact. Establishing credit facilities with counseling services included would help perpetuate the benefits of creating and sustaining these kinds of youth-loan schemes. To encourage potential beneficiaries, the participating institutions need to comply with the requirements of the credit programs without imposing additional conditions.



In 2012, with support of the UK Department for international Development (DfID) and the International Development Research Centre (IDRC) of Canada, PEP launched a new program to support and build capacities in “Policy Analyses on Growth and Employment” (PAGE) in developing countries.

This brief summarizes the outcomes of [PIERI-12451](#) supported under the 1<sup>st</sup> round of the PAGE initiative (2013-2014). To find out more about the research methods and findings, read the PEP [working paper 2016-22](#).

*The views and opinions expressed in this publication are those of the authors and do not necessarily reflect those of PEP.*