How Micro-Finance Managers' Ethical Orientation Affects Business Success: Anecdotal Evidence From Uganda

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ABSTRACT

Uganda's micro-finance industry has been attracting many new entrants, thereby registering one of the highest entrepreneurial drives. Indeed, 1,592 microfinance enterprises were attracted between 1990 and 2008, representing a numerical growth rate of 1,688.8 percent. However, no sooner had the institutions been established than over 91 percent of them failed to survive in the market. Uncertainty is also hovering in the industry about the ability of the remaining institutions to survive in the business in a sustainable manner. This paper discusses anecdotal evidence regarding how the ethical orientation of the institutions' managers contributes to this failure.

1. INTRODUCTION

The micro-finance business enjoys government policy support because it is considered as a strategic accelerator of economic growth and development in Uganda. The favourable policy environment demonstrated in various initiatives and strong commitment by government, donors and practitioners towards supporting micro-finance activities, attracted much of the entrepreneurial drive displayed in Uganda to the micro-finance industry, thereby leading to its rapid expansion (Bank of Uganda Governor, 2010). The industry, for instance, registered 1,592 microfinance enterprises between 1990 and 2008, thereby posting a growth rate of 1,688.8 percent in the number of attracted institutions (Kwagala, 2012). The attracted institutions comprised of Savings and Credit Cooperative Societies (SACCOS), credit only NGOs, Savings and Loan Associations and Groups, and private companies (Kwagala, 2012).

Unfortunately, no sooner had the institutions entered the industry than over 91 percent of them failed to survive in the market. Majority of the micro-finance institutions failed to live up to the expectations of their stakeholders who particularly included clients and Government (Ministry of Finance, Planning and Economic Development, 2008). Instead of playing the role that they were envisaged to play, most of the institutions did quite the opposite, thereby losing government and public confidence (Karekaho, 2009). They did not provide affordable start-up capital to clients as had been anticipated. Most of their clients became discontented due to the negative effects that the loans provided by these institutions brought to the clients' businesses (Karekaho, 2009). The profits made by clients started to be eroded by the high loan servicing and repayment rates charged by these institutions. In fact, the effects of the charged rates were so adverse that they ended up eating into the very capital that the extended loans were supposed to boost (Karekaho, 2009). Consequently, clients started failing to realise the business goals for which they had borrowed (Mubangizi, 2009). Instead of promoting mutual goal attainment between clients and themselves, micro-finance institution were more interested in achieving their own business goals (Barnes, Gaile & Kibombo, 2001), most of Uganda's micro-finance institutions are, in effect, benefiting themselves only. As a result, most clients have lost confidence in these institutions.

Press reports started to be awash with illustrations of micro-finance institutions that performed so poorly that they closed down prematurely (Businge, Bugembe & Mugabe,2008). Some of the cited institutions include the Micro-Finance Department of the defunct Uganda Commercial Bank, the Cooperative Bank Micro-Finance Department, Baliyo Agricultural Micro-finance, Kabubbu Building Society, Rural Farmers Micro- finance, Bwaise Traders Micro-finance, FrontPage Micro-finance Ltd, and a host of SACCOS (Micro-Finance Forum, 2004). Many of these institutions closed down so abruptly that they left their depositors utterly devastated by the sudden loss of their hard- earned savings and eventual investment plans (Mubangizi, 2009). The cause of the closures was however, not clear.

Accordingly, the purpose of this paper is to discuss anecdotal evidence attributing the cause of the failure to the ethical orientation of the managers of the micro-finance institutions in Uganda. The evidence is provided after a presentation of the methodology used to compile it and a brief review of literature on ethical orientation.

2. METHODOLOGY

This paper was developed based on anecdotal evidence compiled using document review. A number of conference papers, journal articles, dissertations, media reports, and other records regarding the management and operations of micro-finance institutions in Uganda were reviewed.

3. BRIEF LITERATURE REVIEW ON ETHICAL ORIENTATION

Business and trade organizations develop ethics, which their members are supposed to follow in order to conduct their business functions, operations and activities, including management, in a sound and generally acceptable manner (O'Fallon & Butterfield, 2005). According to Investopedia, ethics refer to values, principles, standards, guidelines or a moral code established to direct behaviour acceptable to a given group, organization, community, profession, or society in general. In business, ethics refer to guidelines and principles that guide sound business management and practice. The main aim of ethics is to help business operators conduct the management of their businesses professionally, with integrity and in a reliable and fair manner. Ethics are important because they lay the rules and standards for honesty and integrity that should be followed in order to demonstrate behaviour, which is conventionally predictable or acceptable to a given professional body, business community or society in general (Schweitzer, Ordonez & Douma, 2004).

Luzadis and Gerhardt (2011) observed that ethics are defined depending on what is judged as acceptable, moral, fair or good to a given individual, group or community and within a given context, worldview or ideology. Chen and Liu (2009) noted that ethics represent the beliefs and values of individuals or groups and provide a guiding framework with which to make judgments. They therefore underlie the ethical orientation of individuals (O'Fallon & Butterfield, 2005), including business managers generally and those of micro-finance institutions in particular. Ethical orientation refers to the behaviour aroused in and demonstrated by business managers as a result of their beliefs and values (Allmon, Page & Roberts, 2000). This behaviour may be in terms of decision-making, business activities or other behavioural attributes defining the way people relate to or treat others (Luzadis & Gerhardt, 2011).

Prozesky (2005) examined the ethical behaviour of business managers using a global perspective. The researcher found out that the ethical behaviour of business managers fell in any of the following ethical orientations: enterprising ability, competitiveness, individualism, material success, sustainability, good governance, and social investment. In the African context, this scholar identified the following ethical orientations of managers: cultural and ethnic tradition, Christian versus secular business values, and self-serving orientation, where managers do not seem to care for the community. Prozesky's (2005) study indicates that some managers seek "to take", not "to give or share".

It should be noted that the literature cited above defines ethics, ethical behaviour and ethical orientation. It also identifies different ethical orientations demonstrated by business managers. The literature, however, did not clarify which orientations applied to the managers of micro-finance institutions in Uganda and how the orientations affect the success of these institutions in the market. This is gap addressed in the forthcoming section of this paper.

Ethical Orientation of Managers and business failure of Uganda's Micro-finance institutions: Anecdotal Evidence

Evidence gathered from different scholarly sources, working papers and media reports indicates that the ethical orientation of many of the managers of Uganda's micro-finance institutions, particularly those operating as SACCOS, leaves a lot to be desired. The evidence suggests that the ethical behaviour of most of these managers borders on the ethical orientation that Prozesky (2005) referred to as the self-serving orientation, where managers do not seem to care for the community.

Indeed, Ngabirano (2003) observed that the unfortunate characteristic of most of the SACCOS in Uganda is that most of their operators resort to cheating their clients, instead of conducting honest business. Ngabirano (2003) found out that SACCO managers or operators first lure unsuspecting members of the public to open savings accounts. The operators go about the luring by using all sorts of media advertisement to encourage small-scale business entrepreneurs to open saving accounts with their (operators') newly established institutions. A review of the Annual Media Report (2010) reveals that the managers use mainly brochures, FM radio adverts, including short term sponsorship of popular community-based radio programmes, online advertising, and the recently introduced street sound promotions and campaigns to conduct the luring. The unsuspecting low-income earners are persuaded into opening the accounts by being told that after depositing a certain amount of savings, they can apply for loans (usually three times the total amount of money in the depositor's savings account) (Businge, Bugembe,& Mugabe, 2008.

Thereafter, continued Ngabirano (2003), the managers extend loans to the attracted clients at very high interest rates. The borrowers are then allowed very short grace periods (on average, one month). Loan repayments are then enforced as the campaigns to attract more members of the public to open savings accounts continue. In the process, and as Kamugisha (2008) observed, the deposits keep on increasing, until such time when the managers of the SACCO close down abruptly and disappear, leaving the unsuspecting depositors utterly devastated. This behaviour suggests that the managers of the concerned SACCOS were not concerned about their lured clients. They were only interested in attaining selfish business interests. They therefore demonstrated ethical behaviour that underlies the self-serving orientation. The studies of Ngabirano (2003) and Kamugisha (2008) were conducted in Rujumbura County in Rukungiri district and Pallisa district, respectively. The areas of these studies were therefore in countrified (rural) districts of Uganda. This implies that SACCO managers are ethically not even concerned about the economic plight of the community members lured to be cheated for self-aggrandisement. They therefore demonstrate pure self-serving ethical orientation.

A review of media reports both in the press and over radio stations indicated that such behaviour was not confined to only the rural districts of Uganda. The New Vision of 12th May, 2008 revealed that a growing number of clients are expressing discontent about the high priced and quite exploitative loans extended by the managers of the micro-finance institutions. This press source corroborated the community-based radio programme aired on Radio Two on the 8th of December 2004. Clients of Bwaise Traders Micro Finance who had been hosted in this programme complained that instead of conducting a business by which both the operators of this micro-finance institution and its clients were achieving the goals for which they respectively extend and secure loans, the micro- finance institution was in effect lending to benefit itself alone.

Similar sentiments were echoed in a community-based programme aired on Top Radio between 6pm and 7pm on the 9th of January 2009. In this programme, clients of a micro- finance institution called Baliyo Agricultural Micro-Finance complained that the loan servicing and repayments charged by the managers of this institution eroded all the profits that the clients were making using the borrowed money. The study of Karekaho (2009) confirmed all these complaints based on data collected from the managers, employees and clients of micro-finance institutions in Wakiso district, one of the largely urban districts in Uganda. This study showed further that the loan terms fixed by many managers of the micro-finance institutions in this district reduced even clients' capital base to the extent that at the end of the agreed repayment period, clients do not have the money required to repay, even when they have been recording effective business performance. Clearly, this scenario demonstrates the highest level of the self-serving ethical orientation displayed by the managers of these institutions.

According to the Ministry of Finance, Planning and Economic Development (2010) and Micro Finance Forum (2011), most of the micro-finance institutions that government supported so much to be established have not performed to government and client expectations. The operators are not concerned about the goal for which government supports them. The loans they lend do not help but fail low-income earners in business, thereby making these small-scale entrepreneurs lose confidence in the institutions. Lack of concern for the goal for which government promotes micro-finance institutions in Uganda suggests that the operators of these institutions use government support as an opportunity to exploit the public. This boils down to the self-serving ethical orientation.

It is important to note that such ethical orientation does not favour the managers of these institutions as far as success in the market is concerned. In fact, it is one of the reasons explaining why most micro-finance institutions were not successful in business. They failed to attain the performance indicators that they planned to enable them to survive and succeed in the business in a sustainable manner. Their performance indicators were so poor that 84.4 percent of the 445 institutions established by 2000 closed down by 2003 (Bank of Uganda, 2003). The Ministry of Finance, Planning and Economic Development (2009) indicates that over 91 percent of the 1,592 micro-finance institutions that had entered the business by 2008 were already closed in 2009. Examples of the institutions that closed down are: Baliyo Agricultural Micro-Finance, Rural Farmers Micro Finance, Bwaise Traders Micro-Finance, Cooperative Micro Finance, FrontPage Micro-Finance Ltd. and the defunct Uganda Commercial Bank Micro Finance Department that collapsed with shillings 115 billion in irrecoverable loans (Bank of Uganda, 2003; Micro Finance Report, 2004; Ministry of Finance, Planning and Economic Development, 2010). There was also uncertainty about the ability of the remaining micro-finance institutions to survive in the business in a sustainable manner (Mubangizi, 2009; Oketch, 2009).

The preceding scenario is largely explained by the ethical orientation of the managers of the institutions. Indeed, the self-serving ethical orientation encourages managers to abandon sound business management practice and concentrate on exploitative behaviour. Instead of following ethical standards expected of managers of micro-finance institutions when dealing with clients, most of the operators of Uganda's micro-finance institution prioritised exploitation, thereby failing to appreciate the fact that the clients they were exploiting were the very pillars of their sustainable success in business. The orientation made the managers fail to pay attention to the fact that attainment of their planned business success depended entirely on clients' attainment of the business goals for which they (the clients) borrowed. According to Micro-Finance Forum (2003), the success of any financial business depends very significantly on the extent to which the business' managers consider importance of clients as a core factor in its survival and growth in the market.

It is quite clear that it is only when clients attain their business goals that they are in a position to service and repay loans (Karekaho, 2009). Client failure to attain intended goals means that clients are not realizing any return on investment, which in effect implies that they are servicing and repaying the loans using capital invested, including the very finances borrowed from the micro-finance institutions. When all the borrowed money is eventually remitted back to the micro-finance institutions, the clients run out of enough capital and close down. This means that even if the micro-finance institution may recover any remaining amounts through the guarantee system, it loses the client. When most of the clients are lost in a similar manner, the micro-finance institutions' portfolio at risk becomes high. The net consequence is therefore ultimately felt by the managers of the micro-finance institutions in form of failure to attain planned portfolio performance. This increases the likelihood of the micro-finance institutions to run out of business and quit the market eventually.

The self-serving ethical orientation therefore, defeats the business purpose of micro- finance institutions as put forward by the Micro-Finance Forum (2003) and Mullineux and Murrinde (2002). That is, to provide finance that supports small-scale clients to achieve their business goals in a manner that enables the institutions to operate profitably. The failure to appreciate this fact is like putting a cart before a camel. Uganda's micro- finance institutions, therefore, needed to wake up to the ultimate purpose of their businesses.

It is imperative to note that the managers of most of the micro-finance institutions in Uganda promote the self-serving ethical orientation because their institutions are thinly regulated by Bank of Uganda (Nannyonjo & Nsubuga, 2004). In fact, a micro-finance institution can be established and operated when its legal status is not clear. Therefore, as the managers are encouraged to abandon the self-serving ethical orientation, there is also need for Bank of Uganda to effectively regulate the financial operations of these institutions.

4. CONCLUSION

There is anecdotal evidence suggesting that one of the factors that explain the failure of Uganda's micro-finance institutions to succeed in business is the ethical orientation of their managers. Most of these institutions' managers display the self-serving ethical behaviour. Coupled with thin regulation by Bank of

Uganda, most of the managers over- exploit their unsuspecting clients to the extent that clients fail not only to achieve the business goals for which they borrow but also service and repay the loans. This gets back to the micro-finance institutions by exposing them to high portfolio at risk and eventual closure. There is therefore need to change the ethical orientation of the managers of the institutions.

5. RECOMMENDATIONS

1. The managers of the micro-finance institutions in Uganda should change from the self-serving ethical orientation by taking up training in professional management of a micro-finance business. This will help curtail wrecking the success of these institutions in business.

2. Bank of Uganda should effectively regulate the financial operations of micro-finance institutions in Uganda.

Acknowledgment: This research paper was funded by Ndejje University, Kampala, Uganda

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Prozesky (2005) approached ethical orientation as way of behaviour demonstrated by business operators in handling a given course of action.