Deepening

The Monthly eNewsletter of

DFID's Financial Sector Deepening Project in Uganda

FSDU

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Dear Friends and Colleagues,

Welcome to this issue of *Deepening*, the email newsletter of DFID's Financial Sector Deepening Project in Uganda - FSDU.

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Survival of Middle Size Firms

I've been reading the book *Collapse* by Jared Diamond, which addresses the question of why some civilizations make it through the seemingly inevitable crisis that occurs when population growth and resource exploitation run into their natural limits. Historically, many civilizations that have endured this collision have collapsed, including the Maya, the Anasazi and the Easter Island civilization, which all turned to anarchy, rapid population loss, starvation and (frequently) cannibalism. Others, however, notably the tiny Tikopia Island in the Pacific, and the Tokugawa Shoganate in Japan, faced the same challenges of overpopulation and environmental degradation, but managed to get through them and survive.

There are many reasons for the differing survival performances. These include changes in the weather, competition from stronger neighbors, and so on. One factor that seems to drive survival is simply size: the very small and the very large have much better survival rates than middle size rates. Diamond says that in the smaller civilizations, like tht Tikopia Island civilization, everyone feels responsibility for the actions of everyone else. If a someone over-fishes in common waters, then the neighbours will intervene, and insist that the person stop.

At the other extreme, large civilizations, like the Tokugawa Shoganate have strong central authorities which, if the citizens are lucky, enforce reasonable rules around land use and resource use. They have ministries, scientists, and enforcement mechanisms to make sure that policies based on science are respected.

It is, largely, middle sized societies that have collapsed. They are large enough that citizens feel removed from the acts of other citizens, but not large enough to afford the expensive overhead of central administration and enforcement.

This led me to reflect on the successes and failures of financial institutions mobilizing the deposits of the poor. In general, the same pattern holds true – that it is the smallest and the largest institutions that are the strongest – and, it seems to me, for the same reasons. In the countries I have seen, the smallest institutions – village groups, where everyone knows everyone else, and members hold other members responsible for their actions – work well, relying confidently on social capital to assure good governance, transparency, and respect for contracts. At the other end of the scale, the largest institutions also usually work well, because they can afford to put in place systems that fulfill those same functions: internal control, annual audits, legal departments, and management information systems.

At the risk of a too-broad generalization that will offend half the readers of this newsletter, it does seem that most of the problems that absorb people's time, energy, and financial resources are in the middle-sized financial institutions, those that have grown large enough that they are serving people who are strangers to one another, but not so large that they can afford all the necessary internal systems of a modern bank, and not so large that the government worries that their failure would upset the financial system of the country, and thus that they need to be regulated. It is where acts of individual malfeasance can go unknown and unpunished, that problems lie.

In Uganda, it is certainly the case that the problems that keep people awake at night are in the middle-sized deposit-mobilizing institutions, the Savings and Credit Cooperatives. According to the as yet unreleased but frequently leaked FinScope Uganda results, the distribution of savers by institutional type follows a "bathtub curve" – high on the sides, with 22% of savers in formal banks and 26% in informal groups, and low in the middle, with only 7% of savers in MFIs and SACCOs. And yet most of the problems and the worries concern that middle group.

This issue of *Deepening* leads with seven initiatives designed to help protect the institutions and the customers in that middle-sized group. They are:

- FinScope Uganda, working to provide better data about what poor people really want and need, among many other things.
- Linkage Banking Initiatives
- Regulation of SACCOs and the Coordination of Capacity Building
- The Tier 4 Census and the Missing SACCOs Study
- Consumer Education
- Group Empowerment Tools
- The Local Rating Service

We will close the issue with updates on two important cross-cutting initiatives, the Third African Microfinance Conference, and work being done on Microfinance and Climate Change.

FinScope Uganda

On April 25th, we hosted a meeting of invitees to a FinScope Uganda Steering Committee, to replace the earlier Advisory Committee, which had done an extremely useful task in helping us design the questionnaire and launch the study. We were pleased that thirteen institutions were present, including commercial institutions, donors, the Government of Uganda, and research and academic institutions.

FSDU presented a brief history of the project, and Uganda Bureau of Statistics described their role in designing the sample and the weighting of the results, and reviewing the questionnaire. Then the contractor Steadman Group presented an overview of preliminary findings. The members seemed to find the results as interesting as I do. We then moved on to an agenda addressing the functioning of the committee, the dissemination strategy, the research agenda, and the question of institutionalization.

We read through a proposed letter of mutual understanding, and appreciate the useful remarks of participants. We looked at the proposed dissemination strategy, and once again, the participants had a number of useful suggestions, which were accepted. Finally, we mentioned some ideas about possible ways of drawing more information about the data set, and some preliminary contacts with researchers who want to exploit the data. We postponed the question of institutionalization until some missing key people could be present.

This meeting was followed up two weeks later by a smaller sub-group on May 2 which met to deepen the discussion of the committee structure (FSDU agreed to serve as interim chair, and GTZ as interim secretary); a policy for data dissemination (it was agreed that we would allow the broadest possible access to the data); analysis (we discussed at more length four initiatives already in place to "mine" the data; and a data dissemination plan (addressing detailed aspects of the terms of reference for dissemination consultants). The subject of institutionalization was broached in more detail, but still waits for the results of on-going conversations with some key players.

Linkage Banking Initiatives

FSDU has contracted with Deloitte Touche to work with PostBank Uganda, and with Aikan Associates to work with Centenary, to help the two financial institutions develop linkage banking strategies and identify specific opportunities within geographical zones – PostBank in the North, Centenary in the Central.

We have received draft reports from both consultants, and had debriefings with the consultant and the institutions. More work remains to be done in both cases, but there are some promising ideas in both cases, which we will only report on here in the broadest terms, leaving it to our institutional partners to report in more detail should they so choose.

Finally, two mobile vans that we are supplying to PostBank Uganda have finally arrived in the country, transiting via Patagonia by the length of time it took for them to get here. We were disappointed to learn that the vans did not completely match the specifications, and also that the specifications did not completely match the needs. There will be some more work to be done, and we are working closely with the supplier on this. The launch will be postponed until after June. We are working with PostBank to plan the launch of the mobile banking service, and also to make sure that they are used for the purposes for which they were acquired, while supporting the objectives of the government's program to expand rural finance.

Regulation of SACCOs and the Coordination of Capacity Building

We are strongly supportive of the efforts of the Ministry of Finance, supported by GTZ/Sida, to develop an appropriate regulatory framework for Savings and Credit Cooperatives. A consultant, Dean Mahon, has now made several trips to Uganda to work with the Ministry on this project. It is premature to announce the outline of the framework, but not too soon to stress its importance, ant the good will and great interest that this effort is generating. We are happy to leave the details of regulation to specialists in this area.

Our contribution has consisted in stressing that this is an excellent time to include in any legislation a provision mandating the regulator to require basic pro-consumer practices of transparency as a condition for licensing. These can include a mandatory, standardized method of computing an APR; requirements for communicating the APR in branch offices and contracts; prohibitions against unreasonable seizure of assets in case of default; some means of redress and arbitration; provisions for member training in SACCOs; and some allowances for people who are not literate in English.

In parallel with the effort at regulation, the Capacity Building Steering Committee continues to work to put in place measures to reduce duplication of effort, and focus capacity building efforts where they will be most useful, on the basis of standardized assessments of MFIs against agreed upon standards or norms. We cheerfully acknowledge that in an ideal world, the coordination of capacity building would happen <u>after</u> SACCO regulation had been put in place. However, we are terribly far from that ideal world. Various institutions continue to give advice and equipment to SACCOs and MFIs with little knowledge of what they actually need, or of what other institutions are already giving them.

Missing SACCOs and Tier 4 Census

The Tier 4 Census report has been available for weeks and informally circulated to many people. We planned to launch the final study, and the new Outreach Map, at the informal information exchange on 23rd April. However, we have done the Tier 4 study as a joint project with the Ministry of Finance, which still wants to complete an internal review before publishing the study. Therefore, the event on the 23rd was more of a "leak" than a "launch". FSDU simply presented some headline findings from the report, to wit:

Of 1207 outlets of financial institutions, 56% are SACCOs (informal groups are not included, or the number would be ten times larger). These institutions report 8771 employes, and here, commercial banks have the largest share, with 43%. These institutions report 1,810,810 accounts – it is at present impossible to control for multiple accounts, so the number of account holders is assumed to be substantially lower. Regulated institutions have by far the greatest share: Banks have 55% of the accounts, MDIs 13%, and Tier 2 institutions 11%. SACCOs for their part report 12% of the accounts.

Of the 564,743 loans outstanding, banks again have the largest number, with 27%, followed by MDIs with 23%. SACCOs report 14% of the total, although they generally have less rigorous write-off policies, so the 14% no doubt includes many loans that would have been taken off the books in regulated institutions. Of the UGX 910,203,138,256 in loans outstanding, the regulated institutions again take the lead, with 73% being with banks, 9% with Tier 2's, and 7% with MDIs. SACCOs report 3% of the total, and other MFIs another 7%.

Again, regulated institutions have among them 93% of all the savings in Uganda, good news for savers.

At the same event, AMFIU and Friends Consult presented the results of the "Missing SACCO Study", a research effort to determine what had happened to the approximately 600 SACCOs that someone thought were out there, but which turned up missing during the Tier 4 Census. The Consultants went out to look for a random stratified sample of 70 SACCOs in four regions. A headline result was that the largest group (57%) of the 70 missing SACCOs in the sample were those which were dormant, or had collapsed or disappeared. Another 30% , concentrated in the Western and Eastern regions, had been missed for various reasons by the researchers, but discovered by the sleuths of Friends Consult. Shame on the researchers who had the contract to conduct the Tier 4 Census in those two regions. You know who you are.

Consumer Education, or TNT

TNT continues to develop and disseminate information. During the month, we held a meeting of the Consumer Education Steering Committee on 11 April. We were pleased that the Rural Business Culture programme was present, and appreciated their remarks. Coordination has been good, but way less than perfect, and some people who are expected to distribute materials in some cases had not had a chance to review them.

We did review the flip charts, posters and flyers developed by CDFU, and gave extensive feedback especially on the flipcharts; version 2.0 is almost perfect, and will soon go to press. We also had the pleasure of reviewing several iterations of the first issue of Money World newspaper, developed by Straight Talk Foundation; this is soon to be translated and distributed around the country. Finally, I attended a bit of a workshop for radio journalists held on 9 and 10 May, and organized by StraightTalk and AMFIU. I was impressed with the quality of the animation, and the dedication of the journalists, who were eager to participate in materials development, who had a good understanding of the messages, and who were concerned with the importance of carrying the program forward after our funding runs out.

Group Empowerment Tools

These are now being rolled out in dozens of SACCOs by the Uganda Cooperative Alliance – we'll wait until next issue when we have some results to share.

VSLAs

CARE's work with a score of local partners continues, and we are impressed and pleased with the remarkable output they have attained. In a VSLA Steering Committee meeting on 15 May, CARE reported that the fifteen institutions it assists through its SUSTAIN project now have formed 2527 groups, with 61,984 members.

In a parallel effort, we have made a modest grant to the Ugandan Womens Effort to Save Orphans (UWESO) to improve their existing VSLA programme. Under this grant, George Mkoma from Hisa Microfinance in Tanzania carried out a weeklong training to UWESO staff, concentrating on improving performance, and introducing innovations, especially ledgerless bookkeeping. George also prepared UWESO to introduce daily savings to well-functioning groups, initially on a test basis.

To prepare for this training, we facilited Mr Mkoma and Grace Majara from CARE to go to a rapid review session with Hugh Allen, in Germany.

Ratings

On 27th April, the Local Rating Fund Steering Committee received a visit from Ms Girogia Carloni of the rating agency Microfinanza. We discussed our interest in increasing the offer of ratings, and urged Microfinanza to come and work in the promising Ugandan market.

A number of new ratings have been posted, and interested readers should check the local rating fund website at www.ratingfund.or.ug

MDI Regulatory Impact Assessment

The Transformation Steering Committee met on 16 May, in what is believed to be its penultimate meeting. We discussed institutionalization options, the progress of the MDIs, and prospects for future transformations. At least two of the possible future MDI candidates, SMS and HOFOKAM, are now being rated, and we look forward to seeing the results.

We also met to discuss bids to carry out the planned MDI Regulatory Assessment. We expect an announcement of an intention to sign a contract soon.

Third African Microfinance Conference

On the 20th to 23rd of August 2007, Uganda's Ministry of Finance, Planning and Economic Development will host the Third African Microfinance Conference: New Options for Rural and Urban Africa. The conference will have six sub-themes: Segmentation, Client Costs and Risks, Financial Institution Costs and Risks, Value Chain Analysis and Financing, Innovations, and the Contribution of the Public Sector. The conference programme is now final, and includes some exciting presentations, that will we hope will leave participants knowing that this was not just another conference. The programme will be widely circulated soon.

Climate Change and Microfinance

FSDU presented a special presentation on Climate Change and Microfinance on May 15 at the Sheraton Hotel. In addition to the usual information on the causes and effects of climate change, we launched a small initiative inviting financial institutions to partner with us in "designing a product that will bring light emitting diode (LED) lighting to large numbers of Ugandans. The product will be a package of a renewable lighting solution, financing, and installation and maintenance. We are looking for a product that has the potential of reaching at least 200,000 households among the poorest 80% of Ugandans. We presented the same offer at the MicroSave CEOs workshop in Jina, on 22 May. We are more than a little curious to see if any institution accepts the offer.

We also launched a new flyer on Climate Change & MicroFinance, that incorporates ideas that we have developed with some very useful input from Elisabeth Rhyne of ACCION. I'll be happy to send anyone a PDF version of the flyer. Write to paul@fsdu.or.ug

With best wishes,

Paul Rippey

Manager, FSDU