Deepening

The eNewsletter of

DFID's Financial Sector Deepening Project in Uganda

FSDU

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Dear Friends and Colleagues,

Welcome to this penultimate issue of *Deepening*, the email newsletter of DFID's Financial Sector Deepening Project in Uganda - FSDU. FSDU, funded by DFID, is managed by ECI*Africa*, whose contract ends on 14 September, 2007. Because of twists and turn in the contracting mechanism, the FSDU project itself continues until 31 December 2007. Between 14 September and 31 December, some on-going activities will continue to be managed directly by DFID. We are actively negotiating ways that certain of our key activities can be carried forward into subsequent years, and hope to be able to inform you of how this will happen in the next, final, issue.

If you would like to be added to or removed from the mailing list, please let us know, although *everyone* will be removed from the mailing list in six weeks so you might as well stick around.

Prior issues, and much more, are available on the FSDU website at www.fsdu.or.ug .

How to fight poverty with microfinance

A colleague sent me an article called *Escaping Poverty and Becoming Poor in 36 Villages of Central and Western Uganda* published in the *Journal of Development Studies*. I quote from the article:

Twenty-four per cent of households in 36 village communities of Central and Western Uganda have escaped from poverty over the past 25 years, but another 15 per cent have simultaneously fallen into poverty. ... Progress in poverty reduction has slowed down as a result. Multiple causes are associated with descent into poverty .... For nearly two-thirds of all households in both regions, however, ill health and health-related costs were a principal reason for descent into poverty. ....

Here's a new way of looking at things: the poverty alleviating aspirations of microfinance shouldn't be limited to helping people escape from poverty, all the more so because many people climb out of poverty by themselves anyway. (In one of the two regions studied, the principal route to escaping from poverty was simply having someone in the family find a job in the public or private sectors.) Microfinance should as much, or more, help people **stay out of poverty**. While expensive debt may help people escape from poverty, it is famously a two-edged sword. An equally promising strategy might be to keep people from falling into poverty, and the best ways to do that would likely be by helping them build a cushion by promoting savings, or, since health related costs are a principal reason for descent into poverty, by promoting microinsurance.

Not for the first time, let us propose that once and for all we bury the notion that widespread expensive microdebt is going to alleviate poverty. It is time to start designing products based on our increasing knowledge of the real economy of poor people.

FinScope Uganda

Since the last issue, we have held two well-attended meetings of the FinScope Uganda Steering Committee. Some members have put in substantial time reviewing the final report, and suggesting clarifications to be made in the printed bound edition. At the advice of the Steering Committee, we have engaged the Steadman Group to be in charge of dissemination. Their contract calls for them to make 20 presentations of the FinScope Uganda findings to various branches of the government, financial institutions, apex organizations, the press, researchers and other groups between now and the end of the year.

We have also scheduled a high-profile launch for 16th August, which – befitting the importance that we attach to this study – will be the only event we ever hold at the Serena Hotel.

Linkage Banking Initiative

FSDU has contracted with Deloitte to work with PostBank Uganda, and with Aikan Associates to work with Centenary Bank, to help the two financial institutions undertake pre-feasibility studies to identify linkage banking options and and specific opportunities within geographical zones – PostBank in the North, Centenary in the Central.

Both consultants have completed their work and presented it to their respective banking partners. We will share the findings of these two studies in a workshop on Tuesday 15 August 2007 at the Kampala Sheraton Hotel.

Meanwhile, the mobile branches that we have procured for PostBank Uganda are being remodeled at a workshop in Kenya. We postponed the launch of this mobile banking initiative to 31 August, due to delays in harmonizing structural requirements by all the stakeholders.

MDI Regulatory Impact Assessment

Since the last issue, members of the Transformation Steering Committee met to review bids to carry out a regulatory impact assessment of the MDI law. The winning bidder, Friends Consult, started work immediately, and on 1st August was able to present preliminary findings to a group of 60 stakeholders.

We all recognize that it is early to try to determine the impact of the MDI law. Nonetheless, the findings of the consultants were illuminating. There is no doubt that all four registered MDIs (FINCA, PRIDE Uganda, Uganda Microfinance Ltd, and Uganda Finance Trust) have strengthened their systems, diversified their product line, and become more responsive to customer needs. As for the impact on consumers and on the sector, the results are more murky. Some of the questions raised by participants at the presentation concerned:

<u>Mission drift</u> – average loans have gotten substantially larger over the last two years, but does that mean the MDIs have abandoned their traditional clientele, or added new clients with new products, or made larger loans to the same people?

<u>Outreach</u> – the expectations of some that the MDI act would lead to a vast and rapid expansion of services have not been met. Were those expectations at all realistic? Are some positive indicators now indicators of rapid growth to come?

<u>Need for a special microfinance law</u> – some questioned whether the existing financial institutions statute might have been sufficient to incorporate the transforming MFIs, in which case, the MDI law might have been unnecessary.

<u>Tweaks</u> – some parts of the MDI act (e.g. high provisioning requirements compared to banks, and prohibitions against the intermediation of compulsory savings) are perceived as onerous by the MDIs. Could they be eased, without increasing risk?

Please note that these really are questions, not veiled conclusions. The consultants will address these and many other questions raised in the workshop We were pleased that the Bank of Uganda and representatives of the four MDIs were active participants in the workshop, and the BOU reiterated its willingness to work constructively with the MDIs to find the best way to oversee the MDIs, while carrying out the Bank’s responsibilities of assuring stability.

Transformation Steering Committee (TSC)

The life of the TSC will come to an end on Wed 16 Aug 2007 when its last meeting will be held. Members of the TSC agreed that there was no need for its continuation due to lack of mature transformation candidates, and donors with an appetite for this investment, in the near term.

One key additional activity that has been ably carried out by Godfrey Ssebukulu, the Transformation and Consolidation Consultant, was the benchmarking of MDIs. This quarterly exercise, much appreciated by the MDIs, consisted of preparing individualized analyses of the MDIs (and, later, of one of the Tier 4 institutions) based on inter-institutional comparisons of key ratios and totals, with some references to worldwide standards coming from the MicroBanking Bulletin. AMFIU has agreed to take this activity over and continue it.

Consumer Education or TNT

Our contractors StraightTalk Foundation and Communication for Development Foundation Uganda (CDFU) continue to develop and disseminate information under the TNT (Transparency – Negotiation – Trust) program. They are working closely with the Rural Business Culture programme in dissemination.

We have presented 220 radio shows on eleven topics in six languages, made and distributed 200 flipcharts, some 22,000 posters, tens of thousands of leaflets, and also 460,000 copies of MoneyWorld, in English and four local languages. MoneyWorld is a four page document on newsprint, with stories, readers' questions and answers, exhortations to good financial behavior, and information about types of financial institution in Uganda.

We have cut down a lot of trees for all these publications – have they died in vain? We hope not, and have commissioned a local firm, REEV Consult, to conduct a learning exercise on the consumer education programme. A *learning exercise* is broader than an evaluation – we want to learn everything we can about what worked and what didn't work, and especially we want to facilitate other programmes, in Uganda and elsewhere, to stand on our shoulders and bring information to consumers of financial services more efficiently and effectively. Among the consultant's tasks will be to assemble all the materials already produced on one CD, so we can distribute it to participants at the 3rd African Microfinance Conference, New Options for Rural and Urban Africa, August 20-23 2007.

In parallel, AMFIU is conducting rapid field exercises to assess the impact of the music, dance and drama campaigns, and the consumer financial literacy campaign. Stand by for results.

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 24 July, CARE reported that during the quarter, the institutions it assists had formed about 876 new groups, bringing the total groups formed to 3,681. Of these, 276 groups have graduated, and presumably no longer need or receive assistance. Total membership is 84,124, with about 70% of members being women.

Portfolio utilisation (the amount of collected savings and interest that are lent out) has risen slightly to 76%, and the average loan size is UGX 26,330, roughly USD 15.

Generally, things are going well, with scattered problems, which seem to me to be due to training lapses, tied to the rapid expansion. Demand for group formation is very high. In some cases, people confuse VSLAs with the government's plan to increase rural outreach, which many rural people have incorrectly interpreted to involve handouts of free money. Clearing things up requires patient explanation by the community based VSLA trainers, but – although it is easy to turn a poor person's head with promises of free money – people warmly endorse the concept of VSLAs once they understand what they are.

In parallel, our smaller grant to UWESO, the Uganda Women's Effort to Save Orphans, appears to be going well, with few reported problems, and great demand for group formation. UWESO has adopted the simplified no-ledger system, which we have strongly supported.

Our partners are both concerned about how to continue their programme after the end of FSDU assistance, and both are looking at various sources for additional funding with, I believe, reason for optimism.

Group to Individual Lending Study

Just about a year ago, we commissioned a study of the experience of three Ugandan microfinance institutions – FINCA, Commercial Microfinance Ltd, and Uganda Finance Trust – in moving from group lending to individual lending. FINCA has been introducing individual loans to new clients while keeping their group lending activities largely intact; the other two made rapid transitions of a substantial part of their existing portfolios, phasing out group loans while phasing in individual loans.

Our study had been handicapped by the short time that we had the services of the consultant, and some difficulties in getting portfolio reports from extremely busy institutions that were in some cases in the process of changing their MISs, and in two cases were in the midst of adapting to BOU reporting requirements. After some debate, we decided to take the principal lessons from the report and squeeze them into a four page flyer. The result is available in soft copy on the FSDU website, and in hard copy in our office.

It is, I think, an important document for any institution contemplating switching to individual loans.

Climate Change and Microfinance

We are working with a local consulting firm, a supplier of solar lighting equipment, and a local financial institution to develop a package that would bring LED lighting to large numbers of rural Ugandans.

The first rule in designing a solar lighting product is that it must save money for the consumer; that is, the amount he or she pays per month for the solar product must be less than what he or she is already paying for whatever combination of paraffin lantern, candles and batteries are now being used.

The second rule is that the installation should have paid for itself by the time the battery needs to be replaced. Solar panels, wiring and lights last a very long time, almost indefinitely, but the battery is the weak link; when it gives out, typically around four or five years, the entire system should be paid for. Otherwise, the customer is burdened with having to pay for the new battery, before the old one has been amortized.

Some years ago, I worked on developing a solar lighting product for rural Morocco, and even with a hefty state subsidy, it was difficult to make the numbers come out right. Acquisition cost were simply too great.

The situation has improved, though, due to the advent on the market of affordable small LED lights. These give light for much less electricity than earlier options, primarily compact florescent bulbs. Their greater efficiency has positive impacts all through the system, because an LED system requires a much smaller panel, and much smaller battery, than earlier systems. This brings the cost of an installation well under USD100, and that changes everything. The numbers are better here.

Green products – whether for clean energy, forestation, or any other area – are simply *products*. Their greenness should not make them mysterious. We have all read the books on product development. What is needed is good design and testing, appropriate pricing, good information flow and buy-in within the organization at board, management, ICT, accounting, and sales levels, appropriate marketing, and a committed product champion.

Compared to Morocco, Uganda has some advantages (a huge non electrified and dense population) and some disadvantages (poorer customers, higher prevailing interest rates, no government subsidy, and the lack of a service and installation infrastructure). Can this work here? I think the odds are good, but this is not a sure thing. We will be working closely with our partners over the next few weeks to see if this can be made to happen.

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 available at www.amfiu.org.ug.

The Conference promises to be a great success, with a good turnout and, dare I say it, an excellent programme. It is not too late to register, and I urge you to do so!

With best wishes,

Paul Rippey

Manager

FSDU