Deepening

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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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"Best Practices" and Afriland Bank

Management guru Gary Hamel famously said that, by the time something is recognized as a "best practice", it usually no longer is one. Those who slavishly follow "best practices" learned in workshops or through imitation are condemned to work with aging business models in areas of fierce competition. The real innovators are moving in another direction, busy re-examining their market and the new possibilities that open up through technology or other means. They do not simply tinker with details of their products, but think of entirely new ways of doing business.

Microfinance in Uganda seems increasingly old-fashioned, mired in "best practices" developed and documented a decade or two ago. The business models of most MFIs and SACCOs consciously or unconsciously consist primarily of lending money - either from donors or intermediated savings - at high rates of interest, to customers who are encouraged to renew each loan, frequently for a larger amount of money. This model was dying out in much of the world by the end of the 20th Century. Financial services for the poor in *this* century will include a wide variety of revenue centres, products and services that are constantly updated to reflect current market information. In modern banks, the portion of income that comes from simple financial intermediation is steadily decreasing, while an increasing portion comes from selling products other than loans. Modern bankers are happy to have anyone walk in their door, because they have products for everyone. Unlike old-fashioned banks, and especially unlike credit-only MFIs, modern banks don't need to keep clients continually in debt in order to make money. Someone who gets free of expensive debt is not branded as a "drop-out", but as a client that the institution can continue serving in other ways.

The recent troubles of some of the credit-only MFIs in Uganda show that MFIs that depend simply on interest and fees charged on loans to poor people have a dubious future. This conclusion is reinforced by the flat growth in numbers of loans outstanding of the MDIs as a group over the last year and a half. The record of most SACCOs is no better, as both the Tier 4 Census, and our study on the *Effects of Wholesale Lending to SACCOs*, demonstrate.

Most Ugandan MFIs fail to look holistically at their business model, to try to understand how all the pieces fit together. How many really have examined their core competencies, their value proposition, their market definition, and their management model? More importantly, how many realize that these questions are all integrated, and are a question of choice, not inheritance?

Hamel says, "To create new markets and new wealth, managers need to begin thinking about innovation at the level of entire business concepts. ... Pioneers do not just make minor adjustments to established business concepts, They rethink them from the ground up in unconventional ways to create entirely new models. Dell, for example, launched a new business model. Starbucks was based on a new business model. Wal-Mart created a very successful innovative business model. These examples show that the greatest rewards go to companies that create new business models that create new sources of revenue based on changing technology, demographics, and consumer habits."

Last week, we were pleased to welcome three senior staff of Afriland First Bank and Appropriate Development for Africa Foundation (ADAF) in Cameroon, for a four-day visit to Uganda. They met with senior officials in the Ministry of Finance, Planning and Economic Development, the Bank of Uganda, and PostBank Uganda. Afriland and ADAF have developed a business model that fits Hamel's criteria, which they presented in a public presentation on 23rd October.

Afriland and ADAF work closely with a growing network of 65 SACCO-like institutions called MC2s. Their business model concentrates on fostering economic and human development; their commitment is to grow the pie, rather than simply compete for a larger slice of it. Afriland, ADAF, and MC2s make extensive use of cross-subsidies, co-branding and loss leaders to increase outreach, or market penetration. The 65 MC2s reach about half a million rural people, about the same as the 600 SACCOs in Uganda. The partners offer a wide variety of products going far beyond simple credit, including *FlashCash* local travellers checks, and transfer and payment services. These bring in income that allows about 60% of the MC2s to be profitable, with margins between the cost of funds and the interest rates charged that are a small fraction of those extracted in Uganda. Their bottom of the pyramid mentality calls for patience, as MC2s work towards profitability, and poor clients work their way up the economic ladder to become more profitable MC2, or Afriland, clients.

At the public presentation, Afriland surprised many of the participants by stating that they had internally capped interest rates at the MC2s at 15%. They argued that most agricultural projects have a ROI of no more than 20%, so they have to charge a lower rate to make the project viable. In Uganda, this would be far from a "best practice". We all have heard a thousand times that small loans require much higher interest rates than larger loans, that clients don't mind paying effective rates that often run into triple digits, and that the profitability of small investments is so high that the interest rate is irrelevant. The only problem with the existing definitions of "best practices" is that they are not working very well in Uganda. As one moves down market, to poorer and more rural people, savings get less secure, institutional failures come embarrassingly often, interest rates are higher, seizures of defaulter's goods are more frequent, and pricing is more opaque. It is time to question our business model, and we hope that Afriland and ADAF can help us do that.

FSDU is eager to support partnerships among innovative and effective African institutions. Afriland, ADAF and their new Ugandan friends are now working on proposals that would do just that. We will keep you posted.

PS: Gary Hamel, whom I cited above, is cursed with the lifetime embarrassment of having heaped lavish praise on the ENRON business model. I think he would now be the first to stress the importance of looking carefully at the details, even when the surface looks wonderful, a good lesson for all of us to remember.

Tiers 4 Census and Missing SACCOs Study

The Census of Tier 4, that is, legal but non-regulated, financial institutions is complete, although we have not put the final touches on the report.

We received a list of 1274 SACCOs from the Office of the Registrar. Of these, the researchers were able to find 628 active SACCOs; we plan to do a follow up study to find out why there are so many missing SACCOs. Including all the Tier 4 institutions, including NGOs and companies, as well as the SACCOs, there are 797 Tier 4 institutions, which have, in total, 1064 "outlets" – branches or other places where they carry out financial transactions. This is notably less than numbers that have been widely quoted elsewhere. For instance, the 2001-02 study that led to the Outreach Map, which is hung on the walls of many donor and MFI offices, came up with 1340 institutions. The differences seem to be largely due in part to differences in the definition of MFI and to differences in research methodologies. It would be fascinating to know if in fact the number of outlets is declining or increasing, but it does not seem possible to determine this with presently available information. At FSDU, we have argued long and hard that a decrease in MFIs might well lead to an increase in coverage, as a smaller number of larger institutions is likely to serve people better than the plethora of MFIs that now exists. Similarly, we believe the dramatic growth of VSLAs provides rural poor people with better services than they could get anywhere else, and, so far, the VSLAs are not included in the survey statistics.

We have spoken with AMFIU and with the Registrar of Cooperatives, about conducting a follow up study on a sample of the “missing” SACCOs, to probe in the field to find out exactly what has happened to them. We are reviewing TOR for this study prepared by AMFIU, and hope to launch the study within two weeks. AMFIU would also like to study the fate of non-SACCO MFIs which have disappeared.

VSLAs

The creation of Village Savings and Loan Associations continues at a good pace. CARE reports that there is great demand for training, and that the local partners are not able to satisfy it all. As of the most recent report, 12 local partners have created 908 groups, with 22,102 members. It should be noted that much of the effort to date has gone into selection of partners, contracting, and training of the partners and their Community Based Trainers. It is only now that in most cases the institutions are moving into effective production mode.

Consumer Education Expansion

The second phase of the Consumer Education project, involving a national roll-out, new languages, and new delivery channels, is beginning. An important first step is to get buy in from industry stake-holders, and validate and update the messages. To do this, our consultants CDFU/StraightTalk Foundation have planned a two day workshop during the first week of November.

The second phase will include an important addition: specific information for SACCO members and potential members, dealing with their rights and responsibilities. SACCO experts insist that member education is a key factor in SACCO success.

Also, AMFIU has invited Washington DC based Microfinance Opportunities to carry out a training of trainers workshop for local institutions that will then be able to deliver modules in financial literacy. This is expected to be a high-impact program, but also, regrettably, high cost. The challenge for AMFIU will be to make a convincing case that the impact of financial literacy training is great enough to entice people to pay for it, or to entice institutions to find a way to offer it at an affordable price. I have long argued that effective training programs for poor people should be just a marketable as financial services for the poor. Just as Nobel Laureate Muhammad Yunus and others caused a breakthrough in volume delivery of small loans, which allowed millions of people to gain access to them, so there could be a breakthrough in the pricing and delivery of training and other information that will allow millions of people to have access to information that can change their lives. Will AMFIU be able to engineer this breakthrough, or will this become another donor-supported dead end, that stops when the money runs out? I make this challenge publicly to AMFIU to spur them to success in this important endeavor. AMFIU has shown remarkable commitment to the interests of the clients of their members, and is to be commended for constantly reminding the industry that there will be no industry if the interests of the clients are not well served.

Linkage Banking Initiatives

Under the Consolidation Challenge Fund, FSDU placed newspaper adverts for regulated financial institutions to implement linkage-banking arrangements in Northern and Central Uganda. After a competitive process, we selected Centenary Rural Development Bank for the Central Region, and PostBank Uganda for the Northern Region, to be our partners in this initiative; we will be negotiating MOUs with them, and will invite them to participate in the process of selecting consultants to help them identify gaps and challenges in the delivery of financial services, and look for ways to work with Tier 4 institutions to expand outreach to rural areas.

Under a previous contracting mechanism, we have agreed with DFID and PostBank Uganda to procure two mobile vans on a test basis to PBU. These were originally intended to be used in a linkage banking arrangement with FOCCAS. FOCCAS fell into receivership, but simultaneously, PBU was named to be the principal linkage banking institution for the Government of Uganda's plan to increase rural outreach. PBU therefore redesigned the plans so that it can more easily link with SACCOs in underserved areas.

Transformation

In response to our newspaper advert soliciting expressions of interest from potential transformation candidates, we received communications from three credit-only MFIs, which also sent basic information about their outreach, financial performance, and strategic plans. We will discuss the options for assisting them in a meeting of the Transformation Steering Committee on 15 November.

FSA Study

Our consultants, JKB Finance and Management Consultants, completed the field work of examining the former network of affiliates of FSA International Uganda (FSAIU), which was funded by FSDU and other development partners to build a network of "Financial Services Associations" or FSAs. When funding to FSAIU ended, the company stopped providing services to the network, and in some cases sold off assets. The FSAs registered as SACCOs, and some of them found new affiliations. The consultants found that, of 32 FSAs, ten were either closed, or essentially moribund. Eleven were weak, still making some financial transactions, but with poor loan recovery, and essentially all income immediately being spent for recurring costs. Finally, eleven more, including half of those in the Kampala area, were judged to be strong, both profitable and growing. The full report will soon be posted on the FSDU website.

With best wishes,

Paul Rippey
Manager