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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"Prosperity for All"

The President of Uganda and the government have launched a program called "Prosperity for All", widely known under its Luganda name, *Bona Bagaggawale*. There is much curiosity and discussion within Uganda and even around the world concerning this program, and I have had several emails from colleagues overseas saying in effect, "What on Earth is happening in Uganda?!". I do my best to address this question in the following section. Please note that the situation is evolving, that mine is certainly not the only point of view, and I apologize in advance for any errors.

"Prosperity for All" seeks to answer a series of questions that the new State Minister for MicroFinance asked at a meeting of the Microfinance Forum on 21 June. Some questions that I remember, in my paraphrase, are: "Why, with all these resources available for microfinance, is it taking so long to get outreach into rural areas?" "Why do we have so many different projects assisting pro-poor finance, and wouldn't it be more efficient to have fewer, larger programs?" "In a country that is 75% farmers, why don't we have more products available in agricultural finance?" "Why are interest rates so high?"

The Minister's questions got to the heart of important issues in Ugandan microfinance, and served as a rousing call to action, which I believe helped wake some of us up from a bit of complacent slumber. The Government's plan to address these issues was very direct:

First, assure that there is a Savings and Credit Cooperative (SACCO) in every one of the 1010 sub-counties in Uganda. There are now believed to be 412 Subcounties with SACCOs, so this entails the creation of about 600 new SACCOs.

Second, assure that there is an outlet of a BOU-regulated financial institution in every district, first to provide secure deposit facilities for the old and new SACCOs, and eventually to lend to those that are judged to be credit-worthy. Seventeen of Uganda's 70 Districts do not have a branch of a formal financial institution. Because the other institutions have been reluctant to go into every district, and because they are perceived by some to have high fees and an unwillingness to work with groups and poor clients, the institution of choice of the Government has been the State-owned PostBank Uganda, now in 17 districts. There has been considerable debate about the feasibility of PBU's proposed rapid expansion, and consideration of other options.

Third, merge three government programs into one. At present, SUFFICE, Microfinance Outreach Plan and its Matching Fund for Capacity Building (MCAP), and MicroFinance

Support Centre Ltd. provide overlapping services, both financial and non-financial. The Government plans to funnel all the financial services through PostBank Uganda or other formal institutions, perhaps as an interim measure, and wants to see a single institution provide the non-financial services.

Fourth, and most controversial to many people, place a cap on the interest rates charged by SACCOs that borrow government funds. Many people, including myself, think that this would inevitably lead to one of these unfortunate results: closure of participating SACCOs; extreme restriction of access to credit; or, cheating (by simply renaming elements of the cost structure of SACCOs so that "interest" becomes "fees" or "administrative charges"). I say this in great sympathy with the government's position. Interest rates are often higher than they need to be in Uganda, and they go to cover high arrears rates, occasionally generous salaries, sitting fees for boards, and general inefficiencies. Unfortunately, the overwhelming body of international experience mediates against the solution of simply legislating affordability. Here are two other factors that lead to high interest rates, which government intervention could go some way to combat:

<u>Opaque pricing</u>. Ugandan MFIs not only impose multiple charges and fees, but other features that are particularities of Ugandan microfinance, including "flat" interest rates, "forced savings", and, increasingly, "loan insurance", which the client pays, and which often includes a payment returned from the insurance company to the financial institution. I find it a huge challenge to calculate the cost of borrowing at Ugandan MFIs and I have a computer, which most microfinance clients do not have. People can't shop around for lower prices, if they don't know what the prices are.

<u>Too many institutions</u>. A large number of institutions does not automatically lead to efficient rural microfinance, any more than a large number of private vehicles on Kampala's roads leads to efficient urban transportation. Sometimes *Less is More*, and many of us have been urging consolidation within the microfinance industry as a way to lower the costs of doing business, which ultimately must be paid by the consumers.

FSDU and other projects have been engaged with the government to help find the optimum way to achieve their admirable goals. For our part, we have urged that the Government recognize the existence and importance of informal structures, such as VSLAs, that go a surprising way to meeting the needs of people in villages.

Finally, we note the different cultures of the Ministry of Finance, which is command-driven and wants results yesterday, and the technicians and donors, who have a deliberative culture of workshops, studies and gradually developing consensus. I hope no one will be offended if I suggest that the optimum approach lies somewhere in between these two extremes. I sincerely congratulate the government for stimulating a remarkable amount of serious reflection among projects, donors and financial institutions, and for the increasing level of healthy consultation with other stakeholders. We hope that all technical bodies, including donors, projects, Apex organisations, and the Bank of Uganda, will be actively involved in finding the best approach to increasing rural outreach, and helping bring Prosperity to All.

FinScope Uganda

Interviewers are in the field as this is written. We should expect no news for several weeks, and then the floodgates will open as we begin to analyse the data and release findings.

We were delighted, in the meantime, to discover that four commercial banks have independently approached the Private Sector Foundation to seek assistance in carrying out a market study whose research agenda significant overlaps that of FinScope Uganda. We have met with them twice to explore sharing of data (which is easy, because all of FinScope Uganda's findings will be public domain) and working with them to find an institutional home to carry out systematic demand-side studies in future.

African Microfinance Conference

A group of stakeholders has been working to plan the Third African Microfinance Conference, following in the footsteps of the second conference in Capetown, on August-September 2005. A formal announcement will be coming soon, but let me suggest that you mark these dates on your calendar: 27-30 August 2007, in Kampala.

Tiers 4 Census

Because of the great interest these days in the outreach of SACCOs, we have extracted these data from the Census, pending a final launch to be done with the Ministry of Finance of the study results:

The Tier 4 Census found 628 "eligible" SACCOs with 670 outlets, or branches. These outlets are located in 412 sub-counties (or, in a few cases, urban divisions, which have the same administrative codes as rural sub-counties, making the rural-urban split difficult to determine, except on a case-by-case basis.

The 628 SACCOs represent about half of the number of 1273 SACCOs on the list that we received from the Registrar's office in December 2005. The reason for this disparity is not fully understood. "Eligible" in this context meant that the SACCO had a fixed location, a certificate of registration, and some recent transactions. There is definitely some under-counting in the 628.

First, there are indeed SACCOs without fixed locations, and some of these function well.

In addition, the Census found about 40 ineligible SACCOs that either did not open once a week, or which had had no recent transactions.

Finally, there are a large number of SACCO-like institutions that function like SACCOs, and in some cases have "SACCO" in their name, but which did not yet have registration certificates at the time of the Census. A prominent example is the 63 SubCounty Integrated Development Associations - SIDAs - in the Toro-Bunyoro Region. The plan is that all of these would register as SACCOs, but at the time of the Census only four had received certificates. Some of these institutions may be on the roles of the Registrar of Cooperatives and simply have not yet received certificates of registration.

However, it is also clear that many of the missing SACCOs are indeed *missing*: they were formed, and then, for some reason, ceased to function. The extent of this phenomenon is important (each failed SACCO represents at a minimum thirty members who invested money and presumably got nothing for it before the SACCO failed). A study of a small number – perhaps 60 – of the missing SACCOs, chosen at random, could ascertain in what category they belong, and what has been the social cost of the failed SACCOs; FSDU invites other partners, local or international, to contact us if you would like to contribute, financially and technically, to such a study.

Finally, concerning the size of SACCOs, five SACCOs report that they have more than a billion shillings, about USD 600,000, in savings, and one has a loan portfolio of more than a billion. Four report more than 5000 members, 10 more than 3000, and 22 more than 2000 members. NB: these are self-reported figures.

VSLAs

The massive roll-out of VSLAs continues under CARE's competent management. At the VSLA Steering Committee meeting of 5th September, CARE reported that they have trained 195 Community Based Trainers (CBTs), plus 35 supervisors and managers. Given the large outreach of the programme, CARE will now be shifting its emphasis from direct involvement with CBTs, to assuring that supervisors can successfully maintain the quality of the CBTs work.

Generally, the implementing partners report overwhelming interest and demand for assistance in group formation. In some cases, groups have started saving before they were intended to according to the program that was presented to them. The roll-out of the MIS is going smoothly, and we will soon be able to present detailed outreach figures.

Local Rating Service

The Local Rating Agency team is now installed in Kampala, and carrying out a series of ratings, which are posted at www.ratingfund.or.ug . We think that there will be a continuous and strong demand for these services. However, recent events have underlined the obvious: ratings are only useful if they are read.

Recently, it has come to our attention that two large Ugandan credit-only MFIs had been rated by international rating agencies, and in both cases the rating agency correctly determined that without substantial reforms and improvement in performance, the MFI was not credit worthy. However, in both cases, the MFI received bank loans from local banks after the rating was complete. What's wrong with this picture?

Bankers, please, before lending to Ugandan MFIs, as part of your due diligence, don't forget to consult the ratings that have already been done.

Confident that my scolding will lead to instant results, I will be merciful and not name names.

Linkage Banking Initiative

Under the Consolidation Challenge Fund, we placed newspaper adverts for regulated financial institutions to implement linkage-banking arrangements in Northern and Central Uganda. Successful institutions will be paired with a consulting firm to analyse gaps and challenges faced in the delivery of financial services in these areas, after which, the consultants and the firm will undertake feasibility studies for agreed interventions. Interventions could include mobile banking, branch openings, sharing of back office functions, human resources and capacity building, and introduction of new information technologies. Interested banks have been invited to a stakeholders meeting at FSDU.

Second Round Transformation Candidates

At the request of the Transformation Steering Committee, FSDU placed a newspaper advertisement asking for expression of interest from potential "second-round" transformation candidates. The request was designed simply to obtain information about demand and interest in transformation, and made it clear that no funding was promised to candidates.

On 27 September, FSDU and MEDNet board and management met to receive the report from consultants engaged to develop a transformation plan for MEDNet.

Book Launch, and Gerhard Coetzee

On 25th September, FSDU hosted two complementary presentations for the Ugandan microfinance community.

First, Joanna Ledgerwood and Victoria White introduced their new book "Transforming Microfinance Institutions: Providing Full Financial Services to the Poor", a co-publication of the World Bank and the MicroFinance Network. This book is based in large part on the Ugandan experience of transformation. A panel assembled from among the MDIs discussed the presentation.

Then, Professor Gerhard Coetzee from the University of Pretoria, presented "An evaluation of the impact of the National Credit Act in South Africa - Approach and examples". He commented, "It is important to assess the possible impact of legislation with regulatory impact assessments (RIA) before legislation is enacted. It is however also important to monitor impact and consequences after promulgation. This will be a discussion of the possible approach and there will be some reference to an example of a similar overview of earlier legislation in South Africa that had to do with the impact of the microfinance regulatory council that was disbanded when the national credit regulator started to operate."

Three Studies Coming Soon

First, we are about to publish the final version of the study on the Effects of Wholesale Lending to SACCOs in Uganda, after the final sign-off from members of the Steering Committee. The study should be available on our website within ten days. Please keep checking.

Second, we have seen and commented on an early draft of the study being carried out by the Decentralised Financial Services project in Kenya on the Savings and Loan Associations in Zanzibar, which was carried out with some field support from Christopher Musoke of FSDU. It has been an article of faith among proponents of VSLAs that these groups learn to function independently of external assistance after a year of training, after which the assistance agency can pack its bags and go home. I have preached this good news myself with perfect confidence in perhaps a dozen public fora, despite that fact that there seems to be little or no evidence to back it up. In fact, assistance agencies tend to have their own agendas and perfectly good reasons why they do not abandon the infrastructure of groups they have assisted, even if their assistance evolves away from financial services and into other areas. Perhaps the closest example of groups that have been left to go their own way are those on the island of Zanzibar, which CARE declared independent in 2004, and left to their own devices. What happened to these groups? Did they wither and die? Did they grow and prosper? Did they mutate into something totally different? The researchers examined these questions very thoroughly, and I trust their comprehensive answers will be available in a month or two. The draft report was fascinating to read.

Finally, the second largest grant or contract ever made by FSDU was to FSA Uganda International (FSAIU). This for-profit firm was contracted to build a network of “Financial Services Associations”, or FSAs, in Uganda; develop a model by which FSAs would deliver a variety of financial services to rural areas; and, create a long-term business plan, expected to be based on some sort of franchising agreement or management contracts, which would enable the network of FSAs to continue and expand.

After external evaluations and internal assessments, DFID and FSDU decided not to renew the contract with FSAIU. Soon after the expiration of funding, in July 2004, FSAIU withdrew from Uganda, and all support to the FSAs ended. Most or all of the 31 FSAs converted to SACCOs, and while we have had sporadic and opportunistic contacts with some of them, and noted the demise of a few of them, we had not systematically followed up on the outcome of this important investment. We therefore contracted with JKB Finance and Management Consultants to visit each of the ex-FSAs (or in the case of those which have closed, with whatever staff, board or members could be located) to find out what happened after the end of FSAIU assistance, and note trends in financial performance and outreach. We are looking forward to seeing this report, which should be finalized by the end of October. We note that *Successful projects have many parents, while unsuccessful ones are orphans*. We feel an obligation to look in on these orphans, and share the findings of this study broadly.

With best wishes,

Paul Rippey
Manager