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The Competitive Environment in Uganda:
Implications for Microfinance Institutions and their Clients

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The Competitive Environment in Uganda: Implications for Microfinance Institutions and their Clients

Graham A.N. Wright and Paul Rippey[1]

Executive Summary

Background

The Ugandan microfinance sector consists of a large number of competing institutions of varying formality, commercial orientation, and professionalism. These range from multipurpose NGOs, cooperatives (SACCOs) and informal organisations; more formal commercially oriented Microfinance Institutions; and, increasingly, a number of commercial banks, which have identified a new market in urban microfinance.

The Ugandan industry has a number of clear strengths. These include a strong commercial orientation among MFIs, and a regulatory environment that will soon allow for the transformation of larger MFIs into deposit taking institutions. Uganda also profits from a relatively high degree of cooperation and coordination among practitioners, donors and government, and a number of innovations, including a performance monitoring system for all MFIs, which has been widely accepted by practitioners and donors.

However, the growth of the industry has inevitably led to a number of challenges. The large number of MFIs mean that available human resources are spread thin, and capacity building is a priority. Microfinance is concentrated in urban areas, although three quarters of Ugandans are rural; expansion into rural areas will mean that existing MFIs will need new products, delivery systems, and business models. The sector is just beginning to move away from credit and into other products, but a number of major institutions still remain overwhelmingly loan-driven. While there is an excellent regulatory environment for the small number of larger formal sector institutions (banks and microfinance deposit-taking institutions), the majority of smaller institutions fall under a wide variety of laws, none of them particularly effective in providing appropriate regulation and safeguards. The industry suffers from information asymmetry, as many MFIs' products have complicated and confusing cost structures, which makes comparison of the cost of borrowing from them almost impossible for typical consumers.

Finally, it seems certain that the large number of financial service providers that now exist is more than the market will be able to support, and consolidation is inevitable. However, there is as yet no structure, authority or procedure to protect the interest of depositors, shareholders, and employees in the case of failure.

Study Design

In order to learn the lessons from this competitive marketplace, for microfinance institutions (MFIs) in Uganda and in the increasingly competitive environments across the globe, *MicroSave* designed a detailed study programme. The study programme built on *MicroSave*'s extensive demand-side analysis of the Ugandan market over the last four years (see for example Mutesasira, 1999, Wright et al. 1999 and 1999a, Rutherford, 1999 and Sander et al., 2001) comprised four complementary studies:

1. A longitudinal study updating *MicroSave*'s Competition Analysis Matrices and conducting a time series analysis of clients' use of financial services.
2. A qualitative study of clients' behaviour and perceptions in the competitive market.
3. A quantitative survey of 1,794 clients' profiles, needs and use of financial services.
4. Analysis of supply-side data on financial service providers and related qualitative analysis of clients' perceptions of these.

The study focused specifically and explicitly on areas where competition is intense – in Kampala and the major urban and peri-urban areas along the Mbarara-Mbale strip.

[1] The authors wish to thank Susan Johnson, David Cracknell, Henry Sempangi and Guy Winship for their comprehensive and thoughtful comments – but retain full responsibility for all the spelling mistakes and tortured grammar.

Clients' Choice
In a competitive environment MFIs will need to pay increasingly close attention to how clients get information about their services. The quantitative research suggested that word of mouth from family and friends was the dominating factor. 58% of respondents cited this as the key factor that influenced their decision to select a specific financial institution. Once clients have had recommendations, their reasons for choosing financial service providers give clear indications of what they are looking for. In both the quantitative and qualitative studies staff attitudes, interest rates, loan terms (including grace period) and collateral requirements figured prominently.

Moving between MFIs[2] is not undertaken lightly – it involves significant effort and inconvenience. Despite these inconveniences, the quantitative study indicates that 14% of those using savings accounts had changed financial service provider in the past two years. Approximately 16% of the 'loan users' had changed financial institution where their loan account is held in the past two years.

Multiple Usage of Financial Institutions
Some of the multiple usage of financial institutions amongst Ugandan MFI clients is driven by clients transitioning between two MFIs. But many are also "patching" loans together to achieve the size of loan that they believe their business requires. Others are driven to borrowing from several MFIs in the face of emergencies, to assist with consumption smoothing, to refinance existing loans or to maintain the level of capital in their businesses as they repay the initial loan from the first MFI.

This sensitive area of multiple borrowing was, perhaps unsurprisingly, one of the two areas where there was a significant dissonance between the quantitative and qualitative findings. The qualitative research suggested that the level of multiple usage of financial institutions was much higher than was reported to the quantitative survey enumerators. The quantitative study reports only around 15% of those using financial institutions for borrowing were using more than one institution. But only 12% currently had more than one loan outstanding, and of this 12% around a quarter have taken out one loan to pay off another.

The qualitative study noted that multiple borrowing was common and driven by (in order of importance):

- To make up the required capital (by "patching" loans together)
- To finance another loan (repaying the loan or obtaining required upfront savings)
- To finance critical demands and emergencies
- Consumption smoothing
- To take business opportunities
- To avoid fluctuation in business stock
- To finance different businesses or projects (without co-mingling loans)
- Greed, or the intention to defraud

From the above it is clear that, as in Bangladesh (Chaudhury and Matin, 2002), it is important for MFIs to distinguish between opportunity- and distress-driven multiple borrowing. If MFIs are able to develop effective assessment systems to make this distinction, the former presents the prospect of more business both for the MFI and the borrower. Conversely the distress-driven multiple borrowing represents a danger both to the MFI and its clients. But again, in the context of borrowing to finance emergencies (often driven by the need to finance school fees and health related expenditures), MFIs also have an opportunity.

The use of several financial institutions in order to save is less sensitive and more common (in around 28% of cases) – not least of all due to the prevalence of compulsory savings requirements as a prerequisite for obtaining a loan. Clients are generally unwilling to put more into a compulsory savings account (or indeed a voluntary savings account with the same institution) than the minimum required to access the loan. This is because they fear of losing the money under the group guarantee system – so they

[2] MFIs here is used in its broadest possible sense to include all types of formal and semi formal financial institutions that provide financial services to those lower-income customers who do not have access to the full range of financial services from formal sector commercial banks.

will often have a current or savings account with another financial institution instead. With the growing number of ATMs available to lower-income clients, many are opening accounts to use this accessible and flexible service.

Group v. Individual Lending
The pressures on group lending were highlighted in the quantitative study which found that while group lending practices still dominate the market (accounting for 63% of respondents' loans), the clients' preference is, in 81% of cases, for an individual loan. Indeed, the longitudinal study seems to suggest that clients are moving to individual-based lending over time. Individual loans are usually preferred because of the risk of members defaulting/being forced to rely on other persons and because clients prefer individual responsibility. Individual loans are, however, typically collateralised, and clients have very clear views on and issues with current collateralisation practices in Uganda. There was a common perception that MFIs took collateralised household assets far in excess of the value of the loan they were securing.

Many of the mainstream banks, non-bank financial institutions (including Housing Finance Company of Uganda), and indeed the NGO-MFIs are now offering loans to lower-income salary earners. This largely removes the need for collateral and, with the right agreements with employers in place, is a relatively low-risk lending opportunity. The rapid growth in this sector is likely to have important substitution effects on the MFIs traditional business since many of their traditional borrowers are finding it cheaper and more convenient to borrow through an employed relative than to take group-based or heavily collateralised individual loans.

Interest Rates Unaffected
In this work and past *MicroSave* studies, clients have repeatedly cited interest rates as one of the top determinants of their choice of the financial service provider from which they borrow. But the quantitative study reveals that only 11% of the sub sample of those currently borrowing had "shopped around" multiple institutions prior to taking their loan. Furthermore, less than 10% of those respondents that had loans at the time of interview have changed supplier in the past 2 years based on price". Clients feel that the prices they are paying for loans are high, but are be unable to "shop around". The lack of transparency or communication of pricing prevents clients from differentiating between suppliers on this basis.

Increasing Availability of Savings Services
With the entry of formal sector commercial banks into the lower-income market place, they have significantly reduced their minimum balances. In particular, having taken over Uganda Commercial Bank, Stanbic Bank appears set to capitalise on UCB's old branch network by using it to attract large numbers of savers and serve them using ATMs. As part of this effort, Stanbic has started an extensive re-positioning and re-branding campaign that is already paying dividends – UCB is beginning to lose some of its old negative associations and to be seen as a modern, fast bank. The implications of this, if Stanbic manages to roll out the new product and systems throughout the branch network, are likely to transform the market. With the financial strength and systems of Stanbic Bank and the UCB network, it is possible that Stanbic will both deepen and broaden access to savings services to a level where they will provide a very strong challenge to most other players in the market.

Conclusions
Commercial banks and, more recently, consumer lenders are entering the market place increasing the pressure on traditional MFIs in their usual markets. They are doing this by offering alternatives to usual MFI products, either directly (in terms of savings services and, in the case of Orient, group-based loans) or indirectly (through salary-based loans which are beginning to be used as a substitute for group or household asset-collateralised loans). The comparative and competitive advantages of banks (particularly in areas like salary-based lending) are likely to force NGO-MFIs into other markets. In particular, if Stanbic rolls out its low minimum balance savings account through its extensive network, it will change the face of the financial services landscape in Uganda. Furthermore, with the heavy penalties for bouncing cheques in Uganda, creative banks may well be able to lend against these savings accounts. But with 45% of people un-banked, and 84% of these keen to learn more about their options; as well as 71% of the 45% keen to access financial services, significant opportunities remain for creative MFIs.

The effect of competition in Uganda has been to the benefit of clients in terms of:

- The greater availability of individual loans and salary-based loans for lower-income clients;
- A greater diversity of loans above and beyond the standard working capital loan;
- Loans with longer repayment terms;
- Extended grace periods;
- Reduced compulsory savings balances;
- Reduced minimum balances;
- More ATMs; and
- Improving customer service.

However, competition is yet to benefit clients in terms of the cost of borrowing, and while they report taking price into account, few (if any) clients can get and process the information on the real underlying costs of borrowing from the different players in the market. Until significantly more transparency is introduced either by the MFIs themselves or by a third party, clients will struggle to make rational decisions based on the cost of borrowing. But as the competition heats up pricing is likely to become one important way of product differentiation.

The small business lending market continues to be under-served and is an area worthy of serious exploration by MFIs in Uganda. This calls for:

- Product redesign including repayment structure and longer term of loans; and
- Individual lending methods and skills, which MFIs will need to develop in a deliberate and systematic manner.

Multiple use of financial institutions is increasingly common and MFIs need to understand the underlying reasons for this on a case by case basis. In many cases this phenomenon is driven by opportunity rather than distress, and even in the case of multiple borrowing in response to distress, there may be important opportunities for MFIs to respond positively to their clients' needs. Fears of massive over indebtedness seem to be premature, but there are some households with this problem – certainly 39% of respondents noted that they had struggled or were struggling to repay their current loan.

In the main, however, the competition in the Ugandan market place remains a positive force that is challenging MFIs to improve their products and services and to seek out and serve market niches. This is likely to enrich, broaden and deepen the outreach of the MFIs over time. It appears to have galvanised the microfinance industry into a more market-responsive approach – to the benefit of the MFIs and their clients.

As Kaffu and Mutesasira, (2003) note, "The days of product-driven MFIs are numbered as more and more banks and MFIs are responding to the demands of their clients and moving towards a market-led approach. The winners in the Ugandan competitive market place will be those financial service providers with a strategic marketing focus … and the clients they serve".

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1. Background

1.1 Overview of the Ugandan Market

The Ugandan marketplace is evolving at a very rapid pace with new entrants, new products and practices; a rise in movement between and multiple membership of financial institutions; and a more demanding and discerning clientele. This has significant implications for the many and various financial service providers operating in this increasingly competitive market.

Perhaps as a result of the massive donor investment in Uganda, there are an estimated 600,000 microfinance clients scattered among more than one thousand institutions of varying formality, commercial orientation, and professionalism. These include a very large number of less formal institutions, frequently owner-managed, including multipurpose NGOs, cooperatives and informal organisations. The total number is unknown, but includes over 1,000 SACCOs.

The industry also includes a dozen more formal commercially oriented microfinance institutions (MFIs)[3] that have demonstrated remarkable growth in terms of outreach, recognition and professionalism since its beginnings in 1994. These larger MFIs operate across urban, peri-urban and rural areas, concentrate on the economically active poor, and are present in 40 of the 56 districts, and among them service about half the microfinance customers in Uganda.

Finally, a number of commercial banks have identified a new market in (mostly) urban micro finance. They have reduced their minimum deposit requirements and in some cases imitated the lending methodologies of MFIs to reach significant numbers of low-income people in Kampala, Jinja, and elsewhere.

Four noteworthy characteristics of the industry today are:

1. *Regulatory Niche for Larger NGO-MFIs*: To create a specific niche for NGO-microfinance institutions allowing them to intermediate savings from the general public, Parliament passed a microfinance law in November 2002. The MicroDeposit-taking Institutions bill allows eligible institutions to intermediate savings from the public under Central Bank supervision. As of this writing, no NGO-MFIs have been accredited to intermediate savings; it is generally expected that about three institutions will qualify within the next year.

2. *Commercial Orientation*: Ugandan MFIs have largely accepted the principal that they must pass on all their costs to their customers in order to ensure that they are able to sustain the provision of services indefinitely. This is a mixed blessing, as in some cases MFIs have had a monopoly mentality, raising costs to customers, rather than effecting internal economies.

3. *Coordination*: Uganda has profited from relatively good cooperation and coordination among practitioners, donors and government, through the MicroFinance Forum and other committees and working groups. The formation of district microfinance committees through the Government supported Outreach Plan is expected to further strengthen microfinance coordination in rural areas.

4. *Continuing Innovation*: A performance monitoring system for MFIs has been developed and accepted by the practitioners and donors in the industry; this system is gaining worldwide recognition and is likely to be adopted as a standard in other countries. Several strategic alliances of MFIs with commercial banks and insurance companies have been created. Finally,

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3 MFIs here is used in its broadest possible sense to include all types of formal and semi formal financial institutions that provide financial services to those lower-income customers who do not have access to the full range of financial services from formal sector commercial banks.

experiments in using new information technologies to bring services more efficiently to rural people, may lower costs and bring services to people who could not otherwise be reached.

The growth of the industry has inevitably brought with it new challenges:

- *Capacity building at all levels of MFIs remains a priority and a particular challenge in light of the large number of MFIs.* Patient human resource development and system strengthening should normally precede the infusion of new funds into institutions that do not yet have the ability to manage them well, but this is not always the case in donor-rich Uganda. This has also affected productivity and cost levels, in turn contributing to the generally high process charged by MFIs.

- *While urban areas are approaching saturation for some products, rural areas (where 75% of Uganda's population reside) are much less served. AMFIU, the Association of MicroFinance Institutions of Uganda, estimates that only 20% of clients are in rural areas, and even MFIs working in rural areas in most cases do not offer products appropriate to the specific needs of farmers and very poor people.* Expansion into smaller towns and the development of products adapted to the needs of rural Ugandans, including the very poor, will be a challenge for the industry over the coming years.

- *As has been the case in most other countries, credit has driven the expansion of microfinance. Ugandans have a low savings rate, and over reliance on debt will only exacerbate this problem.* The maturing Ugandan industry needs to move beyond debt and continue to expand its offer to include transfer and insurance products, and above all to make secure and easy savings facilities widely available.

- *The recently enacted MDI law will bring a handful of NGO-MFIs under the regulatory umbrella of the Central Bank. However, the overwhelming majority of MFIs will continue to operate without any mandatory regulation and supervision.* There is need for a carefully crafted law to regulate the operation of the other financial institutions, protecting consumers and preventing abuse, while not burdening small institutions with costly reporting or other requirements.

- *Poor and rural people are not always able to make intelligent choices among products and among MFIs, and often borrow when it might make more sense for them to save.* There is an urgent need for better consumer awareness, education and protection.

- *The proliferation of lenders has led to growing signs of multiple borrowing and in some cases to consumers falling into a debt trap, especially in urban areas, and especially among those with salary loans. It is difficult for MFIs to know whether their potential borrowers are heavily indebted elsewhere, in part because of the lack of a national identification system, which inhibits the development of a credit bureau system.* The creation of a credit reference facility to protect both MFIs and their customers is an urgent priority.

- *Finally, at the same time as new MFIs are still being created, it is likely that the industry will see significant consolidation over the coming years. There may possibly be mergers, partnerships, and there will, inevitably, be some failures.* Orderly consolidation that protects the interests of clients, staff and other stakeholders is essential for the customers' welfare and to protect the health and reputation of the industry.

1.2 Overview of International Experience

This increasingly competitive and varied marketplace is beginning to be reflected in a growing number of countries worldwide. This represents an important change, since until the late 1990's, most MFIs did not have to worry about competition. Many enjoyed near monopolies and saw huge untapped markets before them. The idea of competing for clients was very far from the mindset of early MFIs. This period of low competition allowed microfinance institutions the freedom to focus single-mindedly on making the breakthroughs in methodology and management necessary to reach scale and sustainability. However, recent years have seen competition amongst MFIs growing in many marketplaces round the world, with Bangladesh, Bolivia and Uganda acknowledged to have particularly competitive environments. These

market places offer an opportunity to learn about the effects of competition on microfinance institutions and their clients.

In a competitive environment, microfinance institutions must shift their thinking to respond to different challenges as outlined below[4]:

Figure 1: Concerns of MFIs before and during competition

Pre-Competitive Stage	**Competitive Stage**
Objective: to reach more people and to become financially viable	Objective: to retain or increase market share, while remaining profitable
Internal focus: developing the institution's internal capabilities	Internal issues remain important, but external focus is added: understanding the external environment and incorporating that understanding into business strategy
Driving motivation: access to funding	Driving motivation: attracting and retaining the customer
High growth possible. Some MFIs have doubled their portfolio annually for several successive years with no competition and abundant donor funds.	Low growth, stagnation, or even portfolio shrinkage possible, even for large well-managed MFIs, as the experience in Bolivia shows.
Little need to take the behaviour of other players into account	Must study the behaviour of the clients, prospective clients, and competitors, or suffer grave consequences.
Client demand taken as given. Institutions can grow and be profitable with unchanging, unpopular products.	Client demand can evaporate quickly if competitor provides better service. Institutions that think strategically, satisfy customers' needs and desires, and innovate intelligently are likely to do well; others are likely to have hard times.

It is reasonably clear that, in parts of Uganda, the "competitive stage" has been underway for several years now. The implications for MFIs and indeed their clients are significant. The following reviews the lessons learned in Bangladesh and Bolivia, and briefly considers the implications for Uganda. The main body of this report then reviews the lessons learned in Uganda.

1.2.1 Over Indebtedness?

The (typically) salary-based lending new entrants and apparent high levels of multiple membership has lead to fears that Ugandan MFI clients might be increasingly over indebted. In Bolivia, "The momentum of lending growth that propelled both the microfinance institutions and consumer lenders created a bidding war, with competitors vying for clients by offering larger loans, faster service, and lower interest rates. This momentum inflated the total amount of debt on the informal streets of the country. Once the economy stalled, it quickly became evident that thousands of clients held more debt than their reduced level of economic activities would allow them to service. Over indebtedness was rampant, particularly common among the high proportion of clients who had borrowed from multiple microlenders at the same time" (Rhyne, 2002).

But, as experience in Bangladesh shows, there are different drivers of over indebtedness. "It appears that for deficit households, distress management is the reason for multiple borrowing, while for better off households multiple borrowing is mostly opportunity driven. The main supply-side challenge is that the lending technology fails to distinguish between the two types of clients and offers uniform products" (Chaudhury and Matin, 2002). This has significant implications for the industry's response to over indebtedness. "Multiple-membership calls not only for creating arrangements such as credit bureaux, but also for more concrete advances in providing protective financial services while diversifying the range of promotional ones. In this sense, it is an opportunity as much as a challenge" (Chaudhury and Matin, 2002).

[4] Based on a presentation by Elizabeth Rhyne to the MicroFinance Network in July 2001

It is clearly important for MFIs in Ugandan to guard against distress-driven, or over-ambitious multiple borrowing, that leads to over indebtedness. At the same time, if there are cases of opportunity-driven multiple borrowing, this presents a great opportunity for MFIs to offer larger or a broader range of financial services from which they can generate income.

1.2.2 Demanding/Discerning Clients

As clients gain access to greater choice, so they become more demanding and discerning, and many chose to leave the group-based lending institutions in preference for individual lending-focused institutions. This was clearly demonstrated as crisis in Bolivia unfolded: "… Caja Los Andes and FIE, have grown and maintained profitability throughout the period. Their success is attributed primarily to their lending methodology and market niche, as well as to stable ownership and management. Both institutions have always made individual loans, not believing in group methodologies, and have a deep expertise in the processes of making such loans.

Figure 2. Regulated Microfinance Institutions, 1998-2002: Portfolio at Risk

	1998	**1999**	**2000**	**2001**	**2002 (June)**
BancoSol	4.5	7.0	12.3	14.7	13.4
Caja Los Andes	0.7	6.5	7.7	8.4	6.8
FIE	1.5	6.2	7.9	8.2	6.8

Once markets began to be saturated, with clients gaining access to a variety of providers, many clients moved from group to individual lenders" (Rhyne, 2002).

Furthermore, under stressful or highly competitive conditions, the operational principles of group guarantee may even increase portfolio at risk. Under stress, groups may "unzip". In Bolivia, Rhyne found that, "… in a recession group lending may actually be more risky than individual lending. When one group member encounters difficulties, her colleagues, already on the edge, may be unable to step in and the group as a whole may default. Accordingly, at BancoSol, delinquency was highest in the solidarity group portfolio" (Rhyne, 2002).

In Bangladesh, Matin's (1997) work in old Grameen *kendras* (established in 1980) in Madhurpur found, "In all the centres in these four villages the repayment rate has fallen drastically and the numbers of inactive borrowers have risen. ... Many of the borrowers who have overdue loans have stopped repaying altogether, some are repaying part of their dues as and when convenient, and a few remain good payers. Those who still remain good repayers are getting new loans. Staff pressure and concomitant peer pressure is almost non-existent. The whole system is now operating on the basis of individual liability. ... As numbers of on-time repayers decrease, an "unzipping" effect is likely" (Matin, 1997).

"The "unzipping" effect[5] Matin refers to is when the entire group, and indeed often the entire *Kendra* [the larger assembly of 6-8 groups of 5 members], burdened by excessive or multiple default, sees no further hope for continuing loans and elects to default *en masse*, thus causing the group or *kendra* (and the group guarantee that held it together) to "unzip". It is this risk that drives MFI field workers to continue to give loans to the good payers in the longer established groups or *kendras* - after all they have developed a long credit history - and thus to negate the group guarantee principle. And it is for this reason that, despite all the rhetoric, the effectiveness of the group guarantee principle is limited to the first few loan cycles" (Wright, 2000).

The short film that was produced as part of this study (and included on the *MicroSave* "Competitive Environment in Uganda" CD) shows Ugandan clients in focus group discussions. The film captures and unambiguously demonstrates the strong negative feelings that many Ugandan group members have towards group loans. The move of MFIs in Uganda toward individual lending-based methodologies, particularly for higher value customers, suggests that they are beginning to respond to the challenge and opportunity presented by these client preferences.

[5] A term first coined by Rutherford during 1992

1.2.3 Opportunities in Niche Markets
But for NGO-MFIs focused on using the group-based lending methods, evidence from Bolivia suggests that there is still a potential to serve niche markets. "Among NGOs, performance has been varied. The performance of two institutions, Pro Mujer and Crecer, has been noteworthy. These institutions have grown steadily while maintaining strong portfolio quality. Both institutions are village banking programs aimed at women. Crecer works in remote rural areas, while Pro Mujer works in urban areas. Their success may be attributable to two principal factors. First, they aim at a less hotly contested portion of the microfinance market, segmenting the market by gender and poverty level, and in the case of Crecer also by geography" (Rhyne, 2002). This approach may prove to be a necessary and important survival strategy for poverty-focused microcredit organisations in Uganda as the competition heats up in the urban environments – many more rural areas, and lower-income clients remain under-served.

Identifying and focusing on less contested market niches has proved a viable strategy is Bolivia, "At the same, time, the institutions are seeking new types of clients. One of the clearest trends is the move up-market to small business lending, where it is perceived that the competition is not as strong, particularly as commercial banks are assumed to be retreating from this market" (Rhyne, 2002). This move is beginning to be reflected in Bangladesh, as MFIs seek new approaches to serving both poorer clients and the small businesses previously excluded by targeting strategies. This move may also be reflected in Uganda as MFIs move increasingly towards individual-based lending.

1.2.4 Price-based Differentiation
When confined to the highly competitive market niche (typically working capital loans for market traders) perhaps the most obvious strategy for MFIs to adopt might be to differentiate themselves on the basis of price. This has indeed happened in Bangladesh where the interest rates on the standard one year MFI loans has been falling since the mid 1990s (Wright, 2000). Similarly, in Bolivia, Rhyne found that, "For the first time there was some evidence that at least some customers would switch institutions on the basis of price. For example, in 1994, a time of very low competition, BancoSol's yield on portfolio was 50 percent. By 1998, the yield had fallen to 33 percent and by 2001, it was 24 percent. At Caja Los Andes, yield fell from 40 percent in 1995 to 25 percent by 2001, and yields at Prodem and FIE in 2001 were even lower (22 percent). Not only did yields fall over time, they narrowed, as institutions priced their services on a competitive basis rather than on the basis of their own internal cost factors" (Rhyne, 2002). The implications for the Ugandan market, where most MFIs are still struggling to achieve basic operational sustainability, in the face of high cost structures, are significant.

Thus, it is clear that highly competitive environments present risks both for the MFIs and their clients. MFIs may adopt less stringent loan assessment or approval criteria or be forced out of their traditional markets into new one with higher risk profiles and cost structures or may be forced to reduce the prices they charge in the more competitive market niches. Clients may be tempted into a situation of over indebtedness either by using the competition to negotiate faster access to larger loans from their financial service providers or by accessing multiple loans from several providers. Clearly, this type of behaviour would be a source of great concern if it were happening in the Ugandan context.

1.2.5 Mergers and Acquisitions?
Under competitive stress in their traditional markets, one might expect MFIs to look at mergers as a business strategy, but this has rarely proved to be the case. Even distressed MFIs seem unwilling or unable to effect mergers. "Among the formalized institutions, there have been merger talks, as institutions consider whether they can survive over the long term in the marketplace. However, no mergers have actually been concluded, as in each case the difficulties of coming together have outweighed the perceived advantages" (Rhyne, 2002). The reasons for this vary from the personalities involved to the ownership structure, and one other simple business reality: successful MFIs are unlikely to want to take on the staff, clients and thus problems of failing MFIs.

The competitive environment poses complex challenges for MFIs and requires them to re-examine almost every aspect of their business model. Rhyne concludes, "… MFIs must devote time and energy to understanding how competition changes their situation. They must study the market and the competitors. This requires development of tools and internal processes that can help MFIs access the choices available" (Rhyne, 2001). In Uganda, this challenge, and indeed the response to it is already underway.

1.3 The Role of Donors
The other major influence on the MFI market-place is, of course, the donors. Donor interventions need to take into consideration the degree of competition in the market. There is always a danger that lag time in the donor funding cycle might lead to interventions being inappropriate for the state of advancement of the market. The market can, of course, be at different stages in different towns of the same country, or for different products in the same town, as is almost certainly the case in Uganda. Accurate market information is necessary not only on present conditions, but also on trends is essential to good decision-making.

Figure 3: Donor interventions appropriate to different degrees of competition.

Degree of Competition	Appropriate Donor Interventions
Monopoly	Encourage growth and competition. Assist individual MFIs to put in place the systems and products that will permit exponential growth.
Competition	Support regulation, cooperation, transparency, credit reference bureaus. Inform industry (not individual MFIs) of new ideas.
Saturation	Let market forces function. Facilitate consolidation if necessary, protecting interests of stakeholders. Assist individual MFIs only if they are bringing something new and valuable to sector.

In the light of the issues outlined above, this research programme was intended to produce the market intelligence that is required to support MFI strategic planning, and to enable donors to make more strategic interventions. The study was co-financed by *MicroSave,* DFID's Financial Sector Deepening Project (FSDU) and Imp-Act on behalf of the Ugandan MFI sector as a whole.

2. The Research Programme
The research programme built on *MicroSave*'s extensive demand-side analysis of the Ugandan market over the last four years (see for example Mutesasira, 1999, Wright et al. 1999 and 1999a, Rutherford, 1999 and Sander et al., 2001) comprised four complementary studies:

1. A longitudinal study updating *MicroSave*'s Competition Analysis Matrices and conducting a time series analysis of clients' use of financial services.
2. A qualitative study of clients' behaviour and perceptions in the competitive market.
3. A quantitative survey of 1,794 clients' profiles, needs and use of financial services.
4. Analysis of supply-side data on financial service providers and related qualitative analysis of clients' perceptions of these.

For details of these see Appendix 1.

The study focused specifically and explicitly on areas where competition is intense – in Kampala and the major urban and peri-urban areas along the south-eastern Mbarara-Mbale strip.

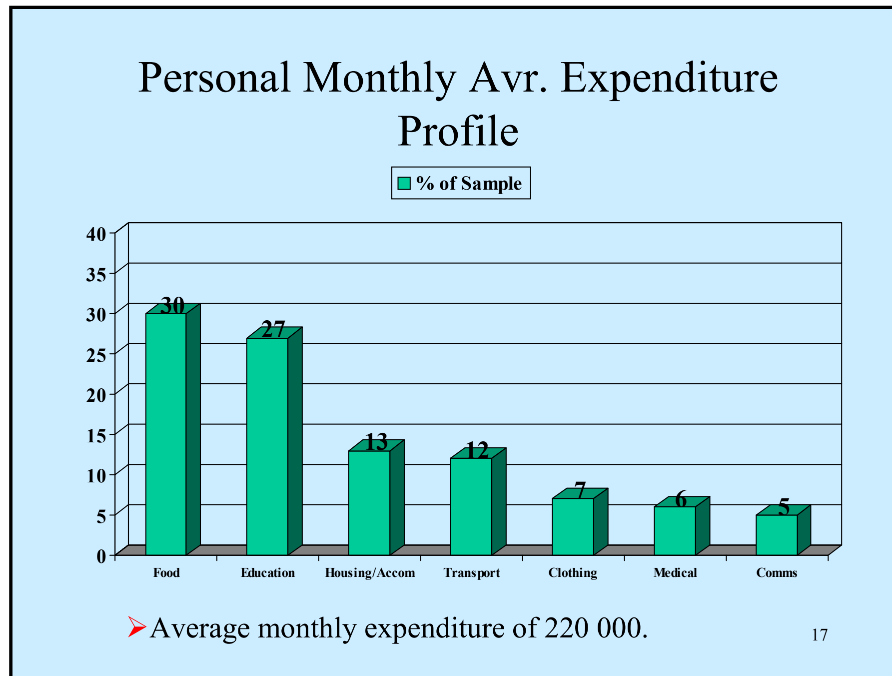
3. The Findings from the Studies
3.1 The Market
The semi-random sampling strategy used in the quantitative study was designed to assess Ugandan MFIs' target market and therefore interviews were held in sites in areas of high pedestrian traffic in Mbale, Jinja, Mukono, Kampala, Masaka and Mbarara. The intention was to target the economically active portion of the adult population and therefore the assumption was made that such persons are typically mobile. As Rob Hudson notes in his report "An In-Depth Quantitative Assessment of the Ugandan Micro-Finance Environment", "this assumption proved to be accurate" (Hudson, 2003).

From a demographic perspective, 55% of the research sample is self-employed. Given that 5% of the sample have no form of employment one can "estimate" that around 56% of the economically active adults are self-employed. The high ratio of self to formally employed persons has and will continue to play an important role in financial product design and roll out, particularly regarding loans.

The average monthly personal income reported in the quantitative study was Ush.209,410 ($110), with the average monthly household income reported as Ush.275,691 ($145). This is broadly corroborated by

the average monthly expenditure of Ush.220,000 ($116) reported by respondents. This monthly expenditure is broken down as follows:

Figure 4. Personal Monthly Average Expenditure (Hudson, 2003)

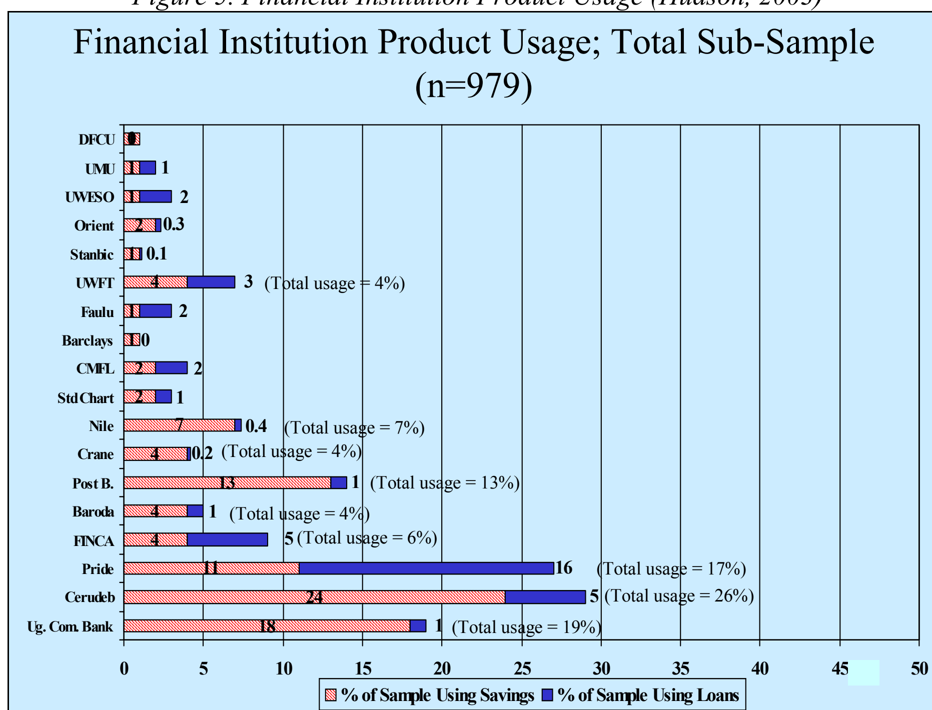


The 27% of monthly household expenditure, or Ush. 59,400 ($31), dedicated to education could be of particular interest to MFIs interested in developing new products. The importance of, and struggle to meet, education expenses has been a recurring theme of all *MicroSave* studies in East Africa over the last five years (see, for example, Wright et al., 1999 or Rutherford, 1999).

55% of the (primarily urban) sample had used a “bank, MFI, SACCOs or any other type of financial institution” during the previous 12 months. The distribution of institutions they had used is, of course, to some extent driven by the banks, MFIs etc. operating in the areas where the interviews were conducted. Nonetheless, the pattern of usage in these particularly competitive areas is instructive.

Masiko (2003) estimates that in 2002 NGO-MFIs and SACCOs had 700,000 loans outstanding, but cautions that, “this figure may not reflect the number of people actually served, as clients access loans from more than one institution” (Masiko, 2003).

Figure 5. Financial Institution Product Usage (Hudson, 2003)



45% (n=827) of the sample had not used a bank/MFI account in the past year. 26% of this "un-banked" sub sample had used a financial institution previously (but more than 1 year before time of interview). Of these, respondents had used the following institutions (in descending order of previous usage): Uganda Commercial Bank, Greenland Bank, Cooperative Bank, Post Bank, Centenary Bank and Pride. The key reasons for respondents stopping usage of financial institutions were:

- Financial problems / lack of funds / business failure etc.
- Branch / institution closed[6]
- Respondent changed location
- High bank fees / chargesGroup failure
- Achieved target / obtained goal sought in usage of the financial institution

Thus, only about a third of the total research sample, comprising predominantly economically active individuals, have never used a financial institution. But 84% of the sample that has never used a financial institution (n=610) felt that they did not have an adequate understanding and knowledge of banking products and wanted to know more. And 71% of this sample have considered or wanted to use a financial institution. The key reasons given by these respondents for not following through with their desire to use a financial institution were:

- Insufficient money – income / no money / no business
- Lack of understanding regarding banks / not familiar with banks / need more info / intimidated by application process – procedures
- Uncertain as to ability to repay loan / fear consequences of defaulting

Of the current non-users (i.e. if we include those who have previously used a financial institution's services but more than a year ago as well as those who have never done so) 81% would like to use financial institutions in the future.

Thus the market potential for MFIs remains large – communication remains a key challenge. The market for MFIs in the areas visited is approaching the likely one-quarter to one-third degree of penetration which is the maximum that has been attained by microfinance programmes in the most competitive countries. MFIs can no longer survive by expansion alone, but must set priorities of client retention through offering better and more varied products.

[6] Greenland Bank and the Cooperative Bank have been closed, although most branch locations of the latter have been re-opened by other financial institutions.

3.2 New Entrants to the Market

The longitudinal study highlights the new entrants into the microfinance market place. These include Crane and Nile Banks (which are focusing particularly on savings services with ATMs), Orient Bank (which is offering group-based loans), and Stanbic (which is focusing particularly on savings, ATMs and salary-based lending). These new entrants have reasonably high awareness levels amongst their potential clientele (see Figure 6.) but in April/May, 2003 when the quantitative study was conducted, UCB in particular still suffered from an image problem, despite the fact has been bought by Stanbic Bank, which is progressively re-branding all the old UCB branches. As a result of this re-branding exercise, UCB's image is already beginning to change into that of a modern efficient and affordable bank. Stanbic/UCB's opening balances are less than all the MFIs and they have set up many ATMs. In several locations round Uganda, the bank set up tents where they provided training to clients on how to use ATMs. The effectiveness of Stanbic's efforts to re-brand and re-position UCB was shown in the work conducted by *MicroSave* to update the competition analysis matrices in July 2003. These matrices showed that Stanbic/UCB is beginning to enjoy an image of a modern, fast and customer-responsive bank.

There are also suggestions that new entrant private sector consumer lenders such as Access Financial Services are likely to grow in market share. These institutions are likely to reshape much of the microfinance landscape significantly as we shall see below.

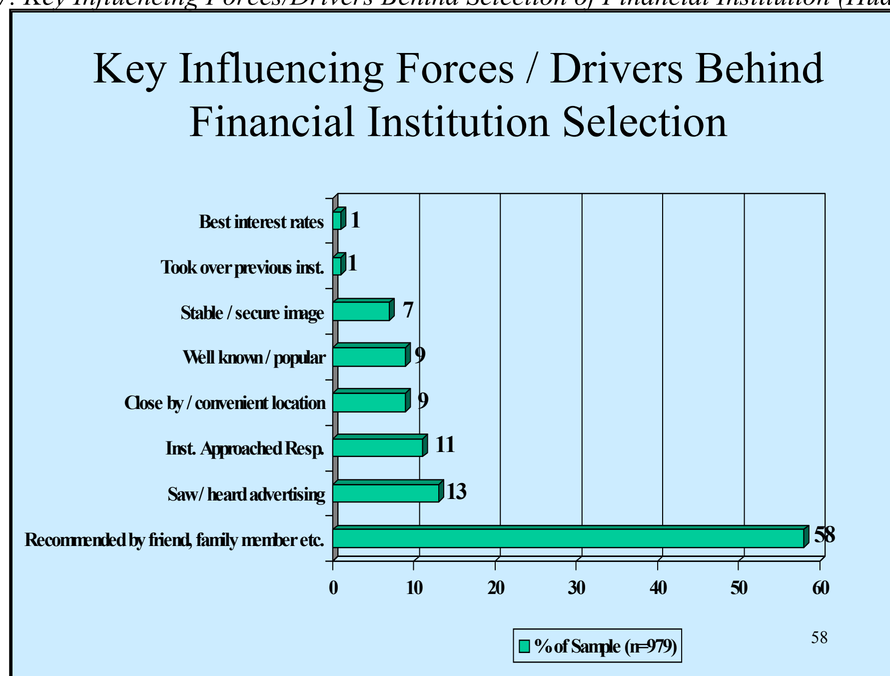
Figure 6. Financial Institution Awareness Assessment (Hudson, 2003)

	% of Sample				
Financial Institutions	**Spontaneous Awareness (unprompted)**		**Aided Awareness**	**Total Awareness**	**Gives Slow Service (Top 10)**
	First Mention	**Other Mention**			
Uganda Commercial Bank	27	57	14	98	31
Centenary Rural Development Bank	22	48	23	93	12
Baroda Bank	4	37	40	81	1
Post Bank Uganda	3	25	50	78	10
Standard Chartered Bank	2	30	42	74	
Nile Bank	3	27	41	71	
Crane Bank	3	24	41	68	1
PRIDE Uganda	9	31	24	64	4
Barclays	2	18	41	61	
Uganda Women's Finance Trust	2	18	39	59	1
FINCA	5	20	32	57	1
UWESO	1	9	46	56	1
Orient	1	10	33	44	
Stanbic	1	12	31	44	
Commercial MicroFinance Ltd	2	8	26	36	
DFCU (Development Finance Co. of Uganda)	1	7	25	33	
Uganda MicroFinance Union (UMU)	1	7	22	32	
Faulu	2	8	21	31	
Housing Finance Co.	1	4	22	27	
Ugafode	0.4	5	18	23	
FOCCAS	1	6	16	23	1
MedNet	0.4	4	14	18	

3.3 Clients' Sources of Information About Services

As noted above, communication remains a significant challenge. In a competitive environment MFIs will need to pay increasingly close attention to how clients get information about their services. The quantitative research suggested that word of mouth from family and friends was the dominating factor. 58% of respondents cited this as the key factor that influenced their decision to select a specific financial institution (see Figure 7). This was corroborated by the qualitative analysis, which found that the need to form groups to access loans often drives much of this as friends and neighbours seek to recruit new members into their groups. The good news is that this type of promotion is as cheap as it is effective. The bad news is that it can also be effective in spreading incorrect or negative messages about the institution and its products. Creative MFIs might want to look at how they can optimise positive and accurate word of mouth marketing conducted by their clients – this is likely to be a more effective strategy than traditional approaches through media-based advertising.

Figure 7. Key Influencing Forces/Drivers Behind Selection of Financial Institution (Hudson, 2003)



3.4 Clients' Reasons for Choosing Financial Service Providers

Once clients have had recommendations, their reasons for choosing financial service providers give clear indications of what they are looking for. In both the quantitative and qualitative studies staff attitudes, interest rates, loan terms (including grace period) and collateral requirements figured prominently. It is perhaps the importance of staff attitudes/customer care that might surprise MFIs – and it is of course this aspect that will have a disproportionate influence on word of mouth marketing.

Figure 8. Reasons for Choosing Financial Service Providers-Loans (Mukwana and Sebageni, 2003)

Position	Reason 1	Reason 2	Reason 3
1=	Staff Attitude/Customer Care	Interest Charged on Loans	
3=	Flexibility of Terms (e.g. loan term, repayment schedules etc.)	Collateral Requirements	
5	Grace Period		
6	Speed of Service		
7	Business Type (e.g. history, size etc.)		
8	Own Experience		
9	Perceived Institutional Capacity to Deliver (size of first loan, loan increments etc.)	Methods Used in Handling Defaulters	
11	Prior Arrangements with Institutions (e.g. salary or school fees)		

Position	Reason 1	Reason 2	Reason 3
12	Confidentiality		
13	Institutional Transparency	Clear Communication	Multiplicity of Bank Charges
16	Proximity		
17	Customer Literacy Level		
18	Personal Knowledge of a Bank Staff Member		

Figure 9. Reasons for Choosing Financial Service Providers-Savings (Mukwana and Sebageni, 2003)

Position	Reason
1	Physical Appearances (i.e. of premises, guards, weapons etc.)
2	Ease of Access to Savings (liquidity of savings)
3	Perceptions of Institutional Stability
4	Ownership
5	Interest Paid on Savings
6	Working Hours

3.5 Movements Between Financial Service Providers

Moving between financial service providers is not undertaken lightly – it involves significant effort and inconvenience. Savers need to close their account(s), retrieve the money deposited (net of any closure charges), take it to another bank in which they have to open an account and then inform the relevant business associates and friends of the change in bank account details. Borrowers are likely to lose access to the larger loan size to which their credit record entitles them, and may have to find group members to trust.

Despite these inconveniences, the quantitative study indicates that 14% of those using savings accounts had changed financial service provider in the past two years. The key drivers of these changes, or the "churn", in savings accounts being:

- Bank closed / doubt over bank's future / liquidity rumours / image problems (n=24)
- Congestion in branches / slow service (n=17)
- Customer changes location / new institution more accessible / better location (n=16)
- High charges / fees (n=8)
- Rude staff / impolite staff / lack of customer orientation (n=7)
- Influence of employer / new employer (n=5)

Approximately 16% of the 'loan users' had changed financial institution where loan account is held in the past two years. The key drivers of this churn being:

- Interest rates (n=12)
- Group loans – unfavourable (n=9)
- Changed location / other institution more accessible (n=4)
- Unrealistic payment policy / stringent loan conditions (n=3)

These seem relatively low levels of churn amongst "loan users" given the historically high levels (25-60%) of client exit or drop-out from Ugandan NGO-MFIs (Wright, 1999a). While this number included those clients "resting" between loan cycles, the churn data above seems to suggest that either levels of drop-out are reducing as MFIs tailor and improve their services for their clients in response to competition or that many clients simply do not borrow from an MFI again after they have dropped out – remember 26% of the "un-banked" sub sample had previously used a financial service institution. The true picture probably comprises some components of all these explanations.

The qualitative studies enrich this analysis by noting that the four main reasons for moving between institutions are as follows:

"1. Awareness of new information from another institution

People who are already clients of an institution sometimes join another institution just to 'try it out' when they receive new, attractive information about the latter. In doing this, they will not necessarily leave the current provider immediately. They will usually keep both memberships as they familiarize themselves

with the new institution's terms, conditions and offerings. They will normally receive this information from peers, especially those who may have been with them in the former institution then left for the latter. The peers normally do this as they are trying to grow their own solidarity groups.

2. Customer disloyalty due to poor customer care
Where customers are not treated well by the institution, the temptation to move to another provider is extremely high. The customers will normally jump out of their current institution at the first opportunity they get.

3. Emergencies and the unwillingness of friends to lend money
Access to loans from friends and relatives is decreasing in urban Uganda, as people believe loans will not be repaid, and this will adversely affect their friendships. This general unwillingness of friends to lend money unfortunately extends even to emergency situations. An emergency can force a person to seek credit from any source even if they are already burdened with debt.

4. Physical relocation of the person or the institution
Some institutions can cater for the movement of a client to a new location by transferring them to the nearest branch (e.g. Faulu Uganda) but this is not common" (Mukwana and Sebageni, 2003).

3.6 Multiple Use of Financial Service Providers

3.6.1 Multiple Use of Financial Service Providers - Loans

Section 3.5 above explains some of the multiple usage of financial institutions amongst Ugandan MFI clients – they are transitioning between two MFIs. But many are also "patching" loans together to achieve the size of loan that they believe their business requires. Others are driven to borrowing from several MFIs in the face of emergencies, to assist with consumption smoothing, to refinance existing loans or to maintain the level of capital in their businesses as they repay the initial loan from the first MFI. And some feel that using several institutions provides greater opportunities to access loans when they are needed – thus reducing the household's exposure to risk.

This sensitive area of multiple borrowing was, perhaps unsurprisingly, one of the two areas where there was a significant dissonance between the quantitative and qualitative findings. The qualitative research suggested that the level of multiple usage of financial institutions was much higher than was reported to the quantitative survey enumerators. The quantitative study focused on borrowing from the formal and semi-formal sectors and reports only around 15% of those using financial institutions for borrowing were using more than one institution. But only 12% currently had more than one loan outstanding, and of this 12% around a quarter have taken out one loan to pay off another.

Masiko (2003) found that 23% of respondents with loans cited the need to service other loans and another 4% cited settling personal debts as the main reasons for borrowing. Clearly, "other loans" may well include a significant amount of informal sector debt (not just from moneylenders, suppliers etc. but also from friends and relatives). And in many of these cases it may have been a rational economic decision to pay off one more expensive loan with a less expensive one. Or (as noted above) they may be transitioning between different MFIs.

In contrast to the low proportion of multiple borrowers reported in the quantitative survey, the qualitative report notes, "Multiple institution users were present in all groups assembled and in most groups they outnumbered users of only one institution" (Mukwana and Segabeni, 2003). In part this reflects the sampling strategy for the focus groups, which were purposely selected from areas where many MFIs were operating. But it is fair to suggest that effective rapport-building, moderation and group dynamics are likely to elicit more forthright and honest responses to sensitive issues such as multiple usage and over indebtedness than quantitative survey instruments.

The qualitative study showed that people use several MFIs simultaneously for a variety of reasons, which are ranked in order of importance in Figure 10.

Figure 10. Motivation for using multiple loans (Mukwana and Sebageni, 2003)

Position	Reason
1	To make up the required capital (by "patching" loans together)
2	To finance another loan (repaying the loan or obtaining required upfront savings)
3	To finance critical demands and emergencies
4	Consumption smoothing
5	To take business opportunities
6	To avoid fluctuation in business stock
7	To finance different businesses or projects (without co-mingling loans)
8	Greed, or the intention to defraud

Patching loans together is a time-consuming and difficult business, as participants in the focus groups highlight. "In many cases, microfinance institutions do not give the clients enough money. Respondents said it is common for one to ask for a loan of a specified amount and be given much less than one applied for. When this happens, such a loan will just become a burden because it is not sufficient for the intended purpose … The client will however still usually accept the reduced loan…. Having done this, the client will then usually get another loan to raise the shortfall and to be able to meet his target purpose" (Mukwana and Sebageni, 2003). This also suggests that part of the low reporting of multiple loan use in the quantitative study might be driven by its focus on multiple usage of institutional credit as opposed to both formal, semi-formal and informal sector loan use. This is also reflected in the reasons given by respondents to the survey for their use of multiple institutions (see Figure 11).

Figure 11. Motivation for multiple financial institution usage on loans (Hudson, 2003)

Verbatim Coded Responses (n=49)	Frequency of Response	%
To access more funds / can't get enough needed from one institution	44	89.8%
Better services	6	12.2%
Changed banking institution / to try a new institution / ease of application with institution	4	8.2%

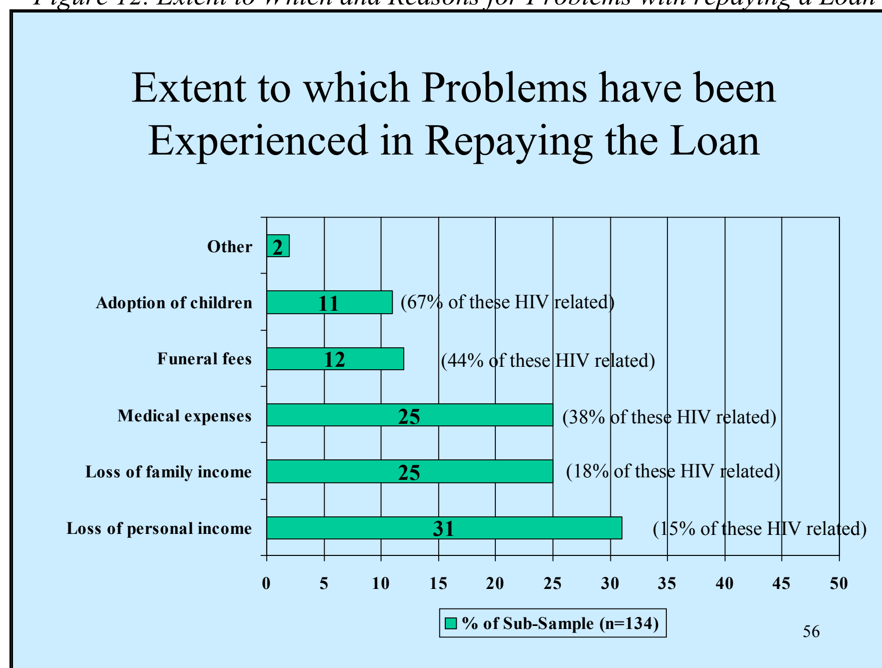
Masiko notes that "the key driving factor for respondents to take an additional or more loans is that *loans are too small*", and goes on to postulate that the loan sizes do in fact typically correlate with the stated working capital requirements of clients. Masiko theorises that borrowers have financial needs over and above their need for business capital (in particular school fees) and finance these through debt. This finding corroborates earlier work by *MicroSave* (Wright et al., 1999) and the AIMS studies that repeatedly found significant (averaging up to 40%) proportions of "working capital" loans being diverted to finance "consumption" activities.

From the above it is clear that, as in Bangladesh (Chaudhury and Matin, 2002), it is important for MFIs to distinguish between opportunity- and distress-driven multiple borrowing. If MFIs are able to develop effective assessment systems to make this distinction, the former presents the prospect of more business both for the MFI and the borrower. Conversely the distress-driven multiple borrowing represents a danger both to the MFI and its clients. But again, in the context of borrowing to finance emergencies (which are often driven by the need to finance school fees and health related expenditures) MFIs also have an opportunity. Creative MFIs might look at savings products to assist clients to build-up reserves to manage these emergencies; or indeed at short-term emergency loans to assist clients respond to them as they arise. Without these, clients will often sell off the stock or run down the business that the MFI has financed through its larger loan, in order to meet the emergency. And, of course, work continues at Microcare and elsewhere (McCord and Osinde, 2003) on developing cost-effective health insurance. Similarly, there remains a significant, largely untapped market for top-up loans midway through a typical working capital loan cycle to maintain stock levels in businesses as the initial loan is repaid (Mukwana and Sebageni, 2003; Beijuka et al., 2003).

Nonetheless, both the quantitative and qualitative studies note that there are many clients struggling to repay their loans. Hudson, (2003) notes that 39% of the sub-sample that currently have an active loan indicated that they have experienced problems in repaying the loan (see Figure 12). Indeed, in some of the focus groups much of the discussion was round over indebtedness and how participants could or

could not manage it. Managing over indebtedness involved a variety of mechanisms from running more than one business, borrowing from others (employer or business supplier for example), selling personal assets, reducing personal expenditure and (if worst comes to worst) running away (Mukwana and Sebageni, 2003). The adverse effect of the HIV/AIDS pandemic on borrowers and their families is also clear in Figure 12 (Hudson, 2003).

Figure 12. Extent to Which and Reasons for Problems with repaying a Loan



3.6.2 Multiple Use of Financial Service Providers - Savings

The use of several financial institutions in order to save is less sensitive and more common (in around 28% of cases) – not least of all due to the prevalence of compulsory savings requirements as a prerequisite for obtaining a loan. Clients are generally unwilling to put more into a compulsory savings account (or indeed a voluntary savings account with the same institution) than the minimum required to access the loan. This is because they fear of losing the money under the group guarantee system – so they will often have a current or savings account with another financial institution instead. With the growing number of ATMs available to lower-income clients, many are opening accounts to use this accessible and flexible service.

Figure 13. Motivation for multiple financial institution usage on savings (Hudson, 2003)

Verbatim Coded Responses (n=168)	Frequency of Response	%
Wanted other services / access to ATM services	93	55.4%
To acquire a loan / forced to open savings to acquire a loan	70	41.7%
To save	27	16.1%
Anticipated closure of bank / spread savings / don't like to keep all eggs in 1 basket	26	15.5%
Flexible services	11	6.5%
Need to open a new - additional account for salary deposits	9	5.4%
Less congestion / affords a choice if one bank has congestion - is busy, is closed etc	6	3.6%
For accessibility to savings in different area - geographical locations	4	2.4%
For my privacy	3	1.8%
Changed bank	2	1.2%

3.7 Client Service

As noted above in section 3.4 above, client service and the speed of service are key determinants of client satisfaction and choice of financial service provider. This was a recurring theme in all the studies and a

key reason for clients moving between service providers (Beijuka et al., 2003). As Kaffu and Mutesasira note, "It is very clear that customer care and speed of service are becoming the most important considerations for clients choosing between MFIs. As a matter of priority, MFIs should make investments in improving customer care. This can be achieved by examining and re-engineering processes to improve the speed and quality of customer service, through implementing customer-focused staff incentive schemes and, of course, traditional training for staff. MFIs should therefore also consider investing in establishing customer service desks in their branches – to provide advisory services and to keep tellers focused on completing transactions as quickly as possible" (Kaffu and Mutesasira, 2003).

The qualitative and longitudinal studies reveal that the key drivers of "poor customer service" are:

- Talking impolitely/lack of respect
- Slow service/long queues
- Unmanned counters
- No access to manager
- No customer service desk
- Poor communication/no opportunity for feedback
- Poor transparency vis-à-vis charges/fees
- Rapid changes in policy

On the loan side, speed and quality of service is also driven by MFIs' policies on loan disbursement. "Speed of service is one of the biggest complaints from most clients interviewed. As has often been documented, throughout the world, moneylenders continue to attract clients in spite of their high interest rates simply because of the fast service they offer. Centenary Bank has already demonstrated how this can be done through its "Automatic Loan" which offers clients with a good track record fast loan processing. Periodic mapping of internal processes with a view of improving efficiency will be a strong differentiating factor for MFI and the improvements in the speed of service will increase client retention" (Kaffu and Mutsasira, 2003). An additional challenge faces group-based lenders, since clients are less and less willing to wait for all members to repay in order to access their next loan (Mukwana and Sebageni, 2003). The pressures that lead to groups "unzipping" outlined by Wright (2000) and Matin (1997) are beginning to surface – and the competition in the Ugandan market means that clients do have alternatives.

Competition is also driving down the amount of time MFIs spend on training before clients are given loans. "Two years ago, 8 weeks of pre-credit training was the norm for new clients. Today clients can get loans in as few as 3 days - especially if they have a clear credit history from a respectable competitor" (Kaffu and Mutesasira, 2003). This also has its downsides since one of the prevalent complaints from clients was that they received inadequate training in the MFIs' terms/conditions (thus causing confusion and misunderstandings). Furthermore, as groups are reformed, it is often the existing group members who train the new ones. This is also likely to have negative consequences for intra-group dynamics over time.

The latest competition analysis matrix exercise (completed in July 2003) indicated that banks and MFIs are now beginning to address their historical problems with client service. "In almost all the institutions, customer service has improved tremendously. The staff are friendly, welcoming and more informed, the facilities are clean and inspire confidence. The speed/process of transactions has improved and the average loan disbursement time for MFIs is 2-3 days and a week for banks if all requirements are in place" (Kaffu, 2003). This suggests that the opportunities to differentiate an institution/products on this important basis may be diminishing.

3.8 Loan Products

3.8.1 Group v. Individual Loans

The pressures on group lending were highlighted in the quantitative study which found that while group lending practices still dominate the market (accounting for 63% of respondents' loans), the clients' preference is, in 81% of cases, for an individual loan. Indeed, the longitudinal study (Beijuka et al., 2003) seems to suggest that clients are moving to individual-based lending over time. Individual loans are usually preferred because of the risk of members defaulting/being forced to rely on other persons and because clients prefer individual responsibility. The 19% who prefer group loans like them on the basis that they are easy to manage and they can rely on the support of fellow group members who can "bail them out". Previous work by *MicroSave* (Wright et al., 1999) suggested that the minority who like group-based systems are often the new entrants to MFIs, and certainly the experience in Bangladesh is that the effectiveness of group-based systems decays over time (Wright, 2000).

Small wonder, therefore that, whereas in 2001 only Centenary Bank and Uganda Women's Finance Trust offered individual loans, by the beginning of 2003, almost all of the major MFIs in Uganda have started individual lending. This move is in part to stem the loss of their high value clients to other financial institutions offering individual loans and also (in some cases) to begin to tap into the salary-lending market niche (see section 3.8.3 below). One MFI is even beginning to phase out its group-based lending programme as unpopular and expensive.

Another important aspect of the preference of clients for individual loans over group-based loans is the repayment schedule. 70% of the sub sample that was currently borrowing were on a weekly repayment schedule, but 77% would prefer a monthly repayment schedule. Similarly, individual loans are typically associated with longer repayment terms, a feature preferred by 81% of respondents. Clients prefer longer repayment periods (particularly for larger loans) because they result in less pressure on the business, are easier to repay and are more manageable since they provide time to generate profit. This issues is linked to the persistent demand for a grace period (Mukwana and Sebageni, 2003; Beijuka et al., 2003) – which a monthly repayment schedule *de facto* provides. Some MFIs (particularly Faulu and UMU) have started to extend the grace period they offer to their clients and are reaping the benefits.

3.8.2 Collateral

Individual loans are, however, typically collateralised, and clients have very clear views on and issues with current collateralisation practices in Uganda. There was a common perception that MFIs took collateralised household assets far in excess of the value of the loan they were securing. "They complained that current collateral requirements were exploitative and unfair. An institution can take advantage of this perceived unfairness by securing an established percentage of the value (e.g. 150%). Respondents suggested that this percentage, which they mentioned specifically … was fair. This would still work out better than the current situation where respondents reported that some institutions secure assets worth in some cases more than ten times (1000%) the value of the loan" (Mukwana and Sebageni, 2003). Focus group participants also complained that the collateralisation process was at times demeaning and inadequately confidential – so that all their neighbours (and possibly family members) knew that they were borrowing. In particular, they cited being forced to have their photographs taken standing next to the collateralised asset.

3.8.3 Salary-based Lending

Many of the mainstream banks, non-bank financial institutions (including Housing Finance Company of Uganda), and indeed the MFIs are now offering loans to lower-income salary earners. This largely removes the need for collateral as it is payroll-based and, with the right agreements with employers in place, is a relatively low-risk lending opportunity. As a result, the competition in this market niche is strong and growing.

Figure 14. Salary Loan Size Analysis (Kaffu and Mutesasira, 2003)

Name of Institution	Term In Months	Interest	Basis	Size (Min to Max) Ush
Allied Bank Limited	12 to 24 months	25% per year	Declining	Ush.500,000 to Ush.10 million
Bank of Baroda	10 months	24% per year	Declining	5 times net pay up to Ush.5 million
Barclays bank	12 to 48 months	32% per year	Declining	Ush.1 million to Ush.10 million
Centenary Bank	6 to 36 months	19% per year	Declining	Ush.500,000 up to 12 times net pay
Crane Bank	24 months	25% per year	Flat	Ush.1 million to Ush.10 million
DFCU Bank	24 months	21% prime rate + up to 10% per year	Declining	6 times net pay up to Ush.15 million
Orient Bank	24 months	21.5% prime rate	Flat	4 times up to Ush.10 million
Stanbic Bank	6 to 24 months	25 per year	Declining	3 times net pay up to Ush.12 million
Standard Chartered Bank	24 months	Competitive rates	Declining	4 times net pay up to Ush.10 million
Housing Finance Company of Uganda	24 months	21% per year	Declining	6 times net pay up to Ush.10million
Access Financial Services	3,6,9,12 months	24% per year	Declining	Ush.80,000 to Ush.2 million
Commercial MicroFinance Ltd	6, 12 up to 18 months	2.5% per month	Flat	Ush.300,000 to Ush.5 million
Faulu	6 to 12 months	2% per month	Flat	Ush.800,000 to Ush.10 million
FINCA	3 to 12 months	3% per month	Flat/Declining	Ush.500,000 to Ush.10 million
Med Net	6 to 12 months	4% per month	Flat	Ush.2 million to Ush.10 million

Name of Institution	Term In Months	Interest	Basis	Size (Min to Max) Ush
Myriad Financial Services	6 months	9.75% per month	Flat	4 times net pay up to Ush.2 million
PRIDE Uganda	12 to 18 months	25% per year	Flat	Ush.1.5m to Ush.12.6 million
UMU	6 to 12 months	4% per month	Declining	Ush.1 million to Ush.5 million
UWFT	4 to 9 months	2.5% per month	Flat	Ush.500,000 to Ush.5 million
FSA Kampala	3 to 6 months	9% per month	Declining	Ush.40,000 to Ush.2 million

The rapid growth in this sector is likely to have important substitution effects on the MFIs traditional business since many of their traditional borrowers seem to find it cheaper and more convenient to borrow through an employed relative than to take groups-based or heavily collateralised individual loans.

"*If someone needs working capital, they can ask a civil servant to apply for salary loan on their behalf. The salary loan has better terms. It does not come with weekly repayments and meetings. It tends to be bigger from the outset. This makes a big difference to most business people*".
– A client of CMF Ltd with Mukono District Administration. (Kaffu and Mutesasira, 2003)

3.8.4 Interest Rates/Fees

In this work and past *MicroSave* studies, clients have repeatedly cited interest rates as one of the top determinants of their choice of the financial service provider from which they borrow. But the quantitative study reveals that only 11% of the sub sample of those currently borrowing had "shopped around" multiple institutions prior to taking their loan. Furthermore, as Hudson (2003) notes, "Less than 10% of those respondents that had loans at the time of interview have changed supplier in the past 2 years based on price (although price is the most common driver of churn)". Clients feel that the prices they are paying for loans are high, but are unable or unwilling to search for better deals.

The qualitative studies help us understand that clients are more likely to be unable than unwilling to "shop around". It is transparency or communication of pricing (or rather the lack of it) that prevents clients from differentiating between suppliers on this basis. As Mukwana and Sebageni (2003) stress, "It must be noted however that although clients said that they took price into account, when they were pressed for detail, they did not seem to know the actual details of the interest they paid on their loans. So even though they said interest was important to them, they did not really know the differences in interest charged by different providers on their loans. It is probably realistic to conclude that although clients say interest rates influence their choice of providers of credit services, the reality is that this is not the case – simply because of the lack of clear documentation and communication of effective interest rates by MFIs". The obfuscation of prices/fees means that the competitive environment is not working for the clients on price in the same way as it is in other aspects of the product (group- v. individual-based lending, reduced compulsory savings requirements, grace periods, lengthening loan terms etc.). This presents an important challenge to the microfinance industry, and an opportunity for the MFIs to differentiate themselves on the basis of transparent and fair pricing

3.9 Savings Products

3.9.1 Minimum Balances

With the entry of formal sector commercial banks into the lower-income market place, they have significantly reduced their minimum balances (see Figure 15). In particular, having taken over Uganda Commercial Bank, Stanbic Bank appears set to capitalise on UCB's old branch network by using it to attract large numbers of savers and serve them using ATMs. As part of this effort, Stanbic/UCB has started an extensive re-positioning and re-branding campaign that is already paying dividends – UCB is beginning to lose some of its old negative associations and to be seen as a modern, fast bank. The implications of this, if Stanbic/UCB manage to roll-out the new product and systems throughout the branch network, are likely to transform the market. With the financial strength and systems of Stanbic Bank and the UCB network, it is possible that Stanbic/UCB will both deepen and broaden access to savings services to a level where they will provide a very strong challenge to most other players in the market. This is likely to provide particular problems for those NGO-MFIs seeking to transform into Microfinance Deposit-taking Institutions under the new microfinance legislation. Unless they find niche markets (defined in geographic, product or demographic terms) these institutions are likely to struggle

against a bank that already had a reputation for stability and is now gaining a reputation for customer service too.

Figure 15 Minimum Balances of Selected Banks

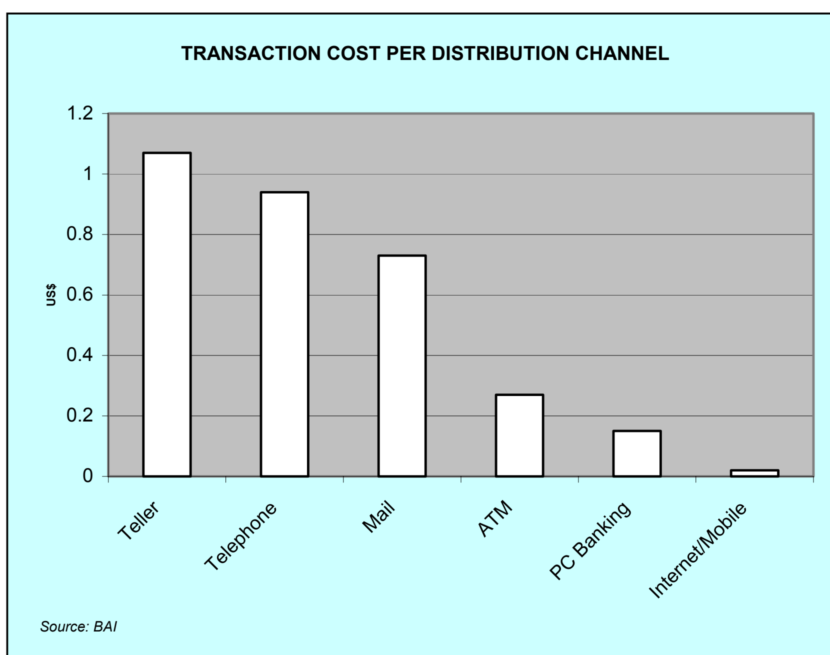
Name of Bank	Old Minimum Balances (Ush.)	Current Minimum Balances (Ush.)	% Change
Stanbic Bank	500,000	20,000	-96%
Crane Bank	200,000	100,000	-50%
Cairo Bank	300,000	30,000	-90%
Allied Bank	100,000	50,000	-50%
Post Bank	20,000	50,000	+250%

The recent falls in T-bill rates have also encouraged these banks to get into salary-based lending, and the lower minimum balances may well allow them to start lending against savings history. The latter may be relatively easy as a result of the Ugandan legislation that provides for very stiff penalties for "bouncing" cheques. These commercial banks could potentially simply require borrowers to writing post-dated cheques for each instalment of the loan, thus providing a very strong incentive to repay. Orient Bank, DFCU Bank and HFCU have also introduced saving accounts with chequebooks. As Kaffu and Mutesasira (2003) note, "This is a trend likely to be followed by other banks. In addition, this will increase access to financial services especially with banks, hire purchase companies, MFI and moneylenders who tend to prefer post dated cheques as part of collateral". If Stanbic/UCB follow this trend, and successful roll-out a savings/post-dated cheque-based lending product, the implications for the microfinance industry in Uganda could be momentous.

3.9.2 ATMs

The perennial challenge facing MFIs seeking to provide savings services to low-income people is the cost of managing these low-value high-transaction accounts. As can be seen from Figure 16, this is now changing with the advent of relatively low-cost technology Ketley and Duminey, (2003).

Figure 16. Transaction Cost Per Distribution Channel

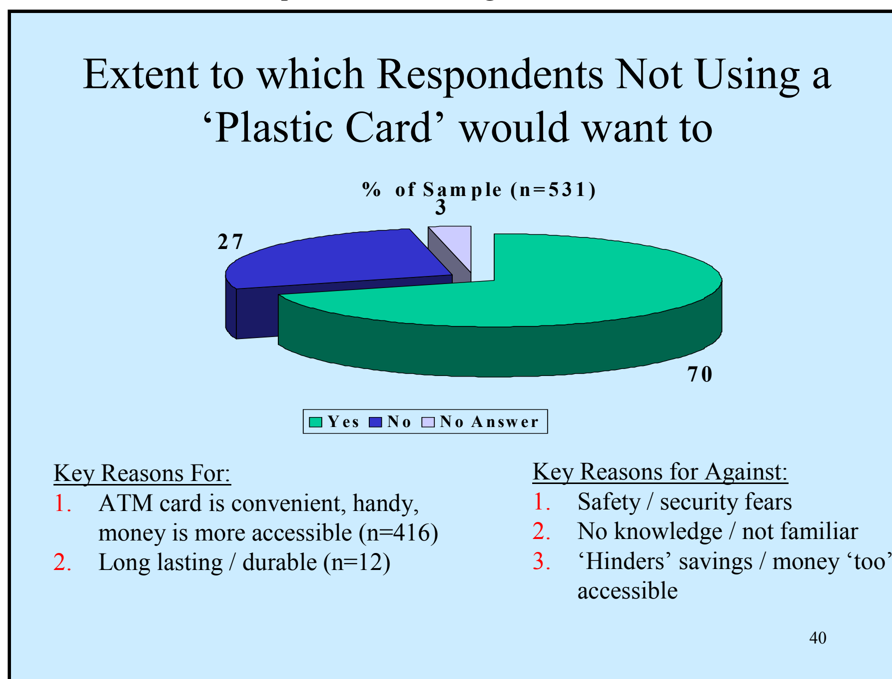


The quantitative survey showed that 15% of the savings account sample already use a plastic card to facilitate transactions. Kaffu and Mutesasira (2003) note that, "Two years ago, there were 4 ATMs in Kampala – and Standard Charted Bank owned most of them. As of early 2003, Crane Bank had the most ATMs, a total of 16 in Kampala and its suburbs. Nile Bank and Barclays Bank have 8 ATMs each, while

Standard Chartered Bank and Orient Bank have 6 each. Other banks include Baroda with one ATM and Allied Bank with 2 ATMs". Four months later, in July 2003, Crane Bank had 28 ATMs; and Nile Bank and Stanbic Bank had 14 ATMs each, with Stanbic, in particular, aggressively pursuing the lower income savings market. Other banks are already moving towards this and there are initial efforts underway to look at the potential of using the mobile phones that are so prevalent in Uganda to further cut costs.

Nor is "techno-phobia" likely to be a barrier to the adoption of these time- and cost-saving distribution channels. The 'non-plastic card' users were subsequently asked whether they would be happy to use this product if requested to do so by their financial institution. As illustrated in Figure 17, the vast majority of 'non-plastic card' users are receptive to the application of the product. What is also evident through the respondent reasoning in favour of plastic cards is the strong perceptual affinity between plastic cards and ATM usage.

Figure 17. Extent to Which Respondents not Using a Plastic Card would Want to and Why



4. Conclusion

Significant changes are underway in the Ugandan microfinance marketplace – and they are happening at such a pace that it is very difficult to keep tack of them. MFIs should seek to update competition matrix analyses (see the *MicroSave* "Competitive Environment in Uganda" CD or *MicroSave* website for an example of one of these) for their chief competitors on a quarterly basis.

The Ugandan market differs substantially from those in Bangladesh and Bolivia in that hitherto up-market, commercial banks are entering and providing financial services to low-income clients. Furthermore the MFIs in Uganda seem to have been more creative and market-led in their response to the growing competition than in Bangladesh, where the group-based, one year-long working capital loan remains the product of choice for almost all MFIs. As in Bolivia, most Ugandan MFIs are moving towards offering a variety of loan and savings products, and many are offering their clients individual loans. In Bangladesh, the larger MFIs are also slowly beginning to offer larger, individual-based "enterprise loans" as well. And in contrast to Bangladesh and Bolivia, there is (at present at least) limited evidence of chronic over-indebtedness in Uganda.

In Uganda, commercial banks and, more recently, consumer lenders are entering the market place increasing the pressure on traditional NGO-MFIs even in their usual markets. They are doing this by offering alternatives to usual MFI products, either directly (in terms of savings services and, in the case

of Orient, group-based loans) or indirectly (through salary-based loans which are beginning to be used as a substitute for group or household asset-collateralised loans). The comparative and competitive advantages of banks (particularly in areas like salary-based lending) are likely to force NGO-MFIs into other markets. In particular, it Stanbic/UCB rolls out its low minimum balance savings account through its extensive network, it will change the face of the financial services landscape in Uganda. Furthermore, with the heavy penalties for bouncing cheques in Uganda, creative banks may well be ale to lend against these savings accounts. But with 45% of people un-banked, and 84% of these keen to learn more about, and 71% of these keen to access financial services, significant opportunities remain for creative MFIs.

The effect of competition in Uganda has been to the benefit of clients in terms of:

- The greater availability of individual loans and salary-based loans for lower-income clients;
- A greater diversity of loans above and beyond the standard working capital loan;
- Loans with longer repayment terms;
- Extended grace periods;
- Reduced compulsory savings balances;
- Reduced minimum balances;
- More ATMs; and
- Improving customer service.

However, competition is yet to benefit clients in terms of the cost of borrowing, and while they report taking price into account, few (if any) clients can get and process the information on the real under-lying costs of borrowing from the different players in the market. Until significantly more transparency is introduced either by the MFIs themselves or by a third party, clients will struggle to make rational decisions based on the cost of borrowing. But as the competition heats up pricing is likely to become an important way of product differentiation. Johnson (2003) notes that in a highly competitive market in Kenya, there were three stages of the development of competition – first access/availability of services, followed by customer service and then finally price.

The small business lending market continues to be under-served and is an area worthy of serious exploration by MFIs in Uganda. This calls for:

- Product redesign including repayment structure and longer term of loans; and
- Individual lending methods and skills, which MFIs will need to develop in a deliberate and systematic manner.

Multiple use of financial institutions is increasingly common and MFIs need to understand the underlying reasons for this on a case by case basis. In many cases this phenomenon is driven by opportunity rather than distress, and even in the case of multiple borrowing in response to distress, there may be important opportunities for MFIs to respond positively to their clients' needs. Fears of massive over indebtedness seem to be premature, but there are some households with this problem – certainly 39% of respondents noted that they had struggled or were struggling to repay their current loan.

In the main, however, the competition in the Ugandan market place remains a positive force that is challenging MFIs to improve their products and services and to seek out and serve market niches. This is likely to enrich, broaden and deepen the outreach of the MFIs over time. It appears to have galvanised the microfinance industry into a more client-responsive approach – to the benefit of the MFIs and their clients.

As Kaffu and Mutesasira, (2003) note, "The days of product-driven MFIs are numbered as more and more banks and MFIs are responding to the demands of their clients and moving towards a market-led approach. The winners in the Ugandan competitive market place will be those financial service providers with a strategic marketing focus … and the clients they serve".

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Appendix 1: Study Design

The research programme built on *MicroSave-Africa*'s extensive demand-side analysis of the Ugandan market over the last four years (see for example Mutesasira, 1999, Rutherford, 1999, Wright et al. 1999 and Sander et al., 2001) comprised four complementary components:

- A Longitudinal study updating *MicroSave-Africa*'s Competition Analysis Matrices and conducting a time series analysis
- A Qualitative study of clients' behaviour and perceptions in the competitive market
- A Quantitative study of clients' profiles, needs and use of financial services
- Analysis of supply-side data on financial service providers and related qualitative analysis of clients' perceptions of these.

Longitudinal Study

For two years *MicroSave-Africa* has conducted periodic competition analyses reviewing the financial landscape in Uganda. This study conducted one more comprehensive round of competition analysis for savings products, and short- and long-term loans. The competition analysis matrices were then validated with MFI clients to assess how their perceptions of the products on offer vary from the actual products being offered. This process allowed the development of a comprehensive "Financial Landscape Analysis". This work was further supplemented by a "Time Series Analysis" of carefully selected clients' use of financial services over a twelve year period. The Longitudinal study was focused primarily on Kampala.

Qualitative Study

The qualitative study sought to:

- Understand how clients decide among different financial service providers.
- Understand why clients have moved among financial service providers.
- Understand how clients are using the many options available to them (including accessing financial services from several sources simultaneously), and,
- Assess the implications for the MFIs operating in these markets and donors funding them.

The study looked at both savings and credit and was used to inform the design of the quantitative research and the analysis of the results.

The qualitative study cover Jinja, Mukono, Masaka, Mbale and Kampala. These are the markets where new entrants are aggressively marketing as well as markets where traditional MFIs are in competition with SACCOs and FSAs on the one hand, and commercial banks experimenting with microfinance on the other. Investigation of these complexities provided a deeper understanding of the rationale for consumer behaviour in these markets.

The team interviewed clients and non-clients of different financial institutions, including Financial Community-Based Organisations. It used a range of techniques including:

a) Focus Group Discussions
b) Individual In-Depth Interviews
c) Participatory Appraisal Techniques drawn from the *MicroSave-Africa* "Market Research for MicroFinance" toolkit

Quantitative Study

The objective of the quantitative study was to develop accurate and up to date market intelligence to support the strategic marketing activities of Ugandan MFIs and the investment decisions of donors. Tasks under this component included:

Market Analysis:

- Assess existing and potential market size through extrapolation from research findings with population / census estimates, using international experience to estimate the degree of saturation that the Ugandan microfinance industry can reasonably be expected to attain.
- Identify and prioritise reasons for clients buying financial services.
- Assess product usage trends and patterns.

- Establish baseline data on degrees of cross indebtedness (people having loans from more than one financial institution) and over-indebtedness (roughly indicated for the purposes of this study either as people reporting difficulty paying back loans, or people using one loan to pay back another).
- Identify and prioritise key motives behind supplier selection:
  - Do persons 'shop around' and if so upon what factors do they make their decisions?
  - How important are referrals and word of mouth promotion?
  - What role does convenience of location play in the process?
  - How price sensitive are buyers of financial products & services?
- Document indications of changes in loan use over time with successive loans, particularly shifts in loan use out of investment into consumption, or vice versa.
- Produce a demographic profile of the market and associated segments.

Competitor Analysis:

- Profile market awareness and usage levels of the different suppliers of financial services.
- Identify key factors in the selection of financial institutions.
- Assess how different financial institutions are perceived.

The survey was conducted in collaboration with TMS Financial and Wilsken and was based on 1,800 one-on-one interviews conducted nationally in 10 sites, spread among Mbale, Jinja, Mokono, Kampala, Masaka and Mbarara. Sites included areas of high competition, such as the Owino Market section of Kampala; areas where MFIs are in competition with SACCOs and FSAs (Masaka, Jinja); densely populated neighbourhoods, and at least two peri-urban areas.

Analysis of supply-side data

Supply-side data was collected from MFIs and commercial banks operating in two key areas (Maska and Mbale) where the other studies were also working. This allowed the research team to assess the overall status of the market and the relative magnitude of the financial flows, numbers of customers within these areas.

The Research Team

Leonard Mutesasira coordinated much of the research programme. Ernest Kaffu and Peter Mukwana spear-headed the longitudinal study. Grace Sebageni and Peter Mukwana conducted most of the qualitative work. For the quantitative study Ernest Kaffu worked closely with TMS Financial, a South African market research firm specialising in financial markets to draw on their expertise in survey research and Wilsken for data collection, capture and cleaning. Graham A.N. Wright was responsible for the overall research design and took the lead on pulling together the synthesis paper. In this he was ably assisted by Paul Rippey of FSDU and Susan Johnson of ImpAct.