UGANDA Microfinance Sector Effectiveness Review

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LIST OF ACRONYMS

AFCAP	Microfinance Capacity Building Programme in Africa
AfDB	African Development Bank
AMFIU	Association of Micro Finance Institutions of Uganda
BOU	Bank of Uganda
CGAP	Consultative Group to Assist the Poor
CERUDEB	Centenary Rural Development Bank
CMF	Centre for Microfinance
DANIDA	Royal Danish Ministry of Foreign Affairs
DFID	Department for International Development (United Kingdom)
EC	European Commission
FSD	financial sector development
FSDU	Financial Sector Deepening Unit (DFID)
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
IFAD	International Fund for Agricultural Development
KfW	Kreditanstalt für Wiederaufbau
MCAP	Microfinance Capacity Building Project
MCC	Microfinance Competence Centre
MDI	microfinance deposit-taking institution
MFF	Micro Finance Forum
MFI	microfinance institution
MoFPED	Ministry of Finance, Planning, and Economic Development (Uganda)
MOP	Microfinance Outreach Plan
MSCL	Microfinance Support Center, Ltd.
MTCS	Medium-Term Competitiveness Strategy (Government of Uganda)
NGO	non-governmental organization
PAP	Poverty Alleviation Project (African Development Bank)
PEAP	Poverty Eradication and Action Plan (Government of Uganda)
PMA	Program for the Modernization of Agriculture (government of Uganda)
PMS	performance monitoring system (AMFIU)
PMT	performance monitoring tool
PRESTO	Private Enterprise Support Training and Organizational Development (USAID)
PSDG	Private Sector Donor Group
QCC	Quarterly Coordination Council
SACCO	savings and credit cooperative
SIDA	Swedish International Development Cooperation Agency
SPEED	Support for Private Enterprise Expansion and Development (USAID)
SUFFICE	Support to Feasible Financial Institutions and Capacity Building Efforts (EC)
UCA	Uganda Cooperative Association
UCAP	Uganda Microfinance Capacity Building Framework
UCSCU	Uganda Credit and Savings Cooperative Union
UICA	Uganda Institute of Chartered Accountants
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

The Uganda Microfinance Sector Effectiveness Review was undertaken in March 2004 at the request of the Private Sector Donor Group (PSDG), a working group of donors in Uganda that has guided many donor collaborative efforts in the country. The review examined the behavior and actions of all microfinance stakeholders in Uganda from 1998 to 2003, identifying factors that both contributed to the sector's success and hindered its effectiveness. Intended to be forward looking, the review also identified specific and actionable recommendations for expanding microfinance in the country.

Microfinance in Uganda grew rapidly between 1998 and 2003 due to a combination of significant donor funding (approximately US$40 million); a shared stakeholder vision for the sector, including active government support for the vision; skilled human resources; and intensive collaboration among the major stakeholders (practitioner organizations, donor agencies, and government bodies). At the end of 2003, approximately 1,500 MFIs were serving more than 935,000 small savers and close to 400,000 borrowers in the country. The Ugandan parliament passed the Micro Deposit-Taking Institution Act in 2003, which created the conditions for MFIs to become regulated, deposit-taking institutions.

Shared stakeholder vision, skilled human resources, and intensive stakeholder collaboration have been the three major drivers of effective microfinance in Uganda. A shared stakeholder vision was developed over time by a close-knit network of leaders in MFIs, government ministries, and donor agencies. This vision allowed the stakeholder network to coalesce, build consensus on microfinance good practice principles, and consistently apply those principles. It also worked to effectively orient newcomers to the Ugandan microfinance community. Other successes of the shared vision include the government's termination of the Entandikwa credit program, and its subsequent decision to refrain from providing financial services directly to citizens.

The high level of technical skill among all stakeholders has made microfinance in Uganda extremely dynamic. The local microfinance community made good use of training, technical assistance, and international resources to build a cadre of knowledgeable microfinance specialists in MFIs, government agencies, local donor offices, and major microfinance projects. The presence of local specialists in turn continues to attract international microfinance experts to the country. The result is a "virtuous circle" of skilled human resources.

A spirit of cooperation among microfinance stakeholders in Uganda led to the creation of several highly active, formal mechanisms for collaboration, including the PSDG (for donors), the Micro Finance Forum (for all stakeholders, including high-level government representatives, where they meet regularly to discuss sectoral issues), its subcommittees (for technical consultations on key issues, such as capacity building, financing MFIs, consumer affairs, regulation, and lobbying, and the industry association AMFIU (Association of Micro Finance Institutions of Uganda). These formal mechanisms have been accompanied by a significant number of informal working groups and exchanges that have played an equally important role in effective collaboration. Other concrete successes include the development and adoption of "Donor Principles for Support to Uganda's Microfinance Sector" in 2001, the passage of the Microfinance Deposit-Taking Institutions Act (MDI) in 2003, and the development of a common donor reporting tool for Ugandan MFIs in 2003.

If microfinance in Uganda is to continue to flourish, a number of challenges must also be resolved. Resolution of these challenges will require conscious stakeholder action in both policy and implementation. Among these challenges are the need for a coherent rural finance strategy that goes beyond microfinance institutions; over-ambitious government expectations of microfinance, particularly with respect to rapid rural outreach; political pressure on the government to intervene in the microfinance market; the need for renewed sector-wide training to develop greater depth of microfinance resources in Uganda; and inadequate protection of poor people's savings in savings and credit cooperatives (SACCOs) and non-governmental organizations (NGOs).

Ugandan microfinance has reached a critical point in its development. Either it will evolve into a dynamic market that is fully integrated into the national financial system, and provides a wide range of financial services to most of the population, or it will remain a successful, but marginal, development niche. To achieve the preferred first option, stakeholders must pro-actively make microfinance part of a larger, financial sector development strategy.

Building a pro-poor financial system in Uganda means building retail institutions, the infrastructure to support these institutions (e.g., audit firms and credit rating agencies), and an enabling environment. These components are, to various degrees, being addressed by Ugandan microfinance stakeholders. Yet, numerous gaps remain. Current efforts are not yet guided by a strategic vision for reorienting the financial system to serve the poor. This reorientation will first require each stakeholder to define its respective role and comparative advantage in the financial system as a whole, not solely within the microfinance sector. The practical recommendations in this review are intended to contribute to the development of a financial system strategy for reaching a far greater number of poor clients throughout Uganda with a diverse range of quality financial services. It is hoped that the review will also provide valuable lessons for microfinance and financial system development in other countries.

I. BACKGROUND

This review was requested by the Ugandan Private Sector Donor Working Group (PSDG) following a CGAP visit to Kampala in April 2002 as part of its aid effectiveness work. Microfinance experts from three donor programs developed terms of reference (TORs) for an analysis of the development of the microfinance sector in Uganda from 1998 to 2003, focusing on the reasons behind successes and failures (or missed opportunities). The final TORs were then discussed with CGAP and the PSDG. The review is not a comprehensive sector study. Rather, it focuses on the behavior and actions of all microfinance stakeholders (donor agencies, government bodies, and practitioner organizations) to identify success factors and constraints to good microfinance practice and effective donor coordination.

Uganda was a good country to study because of the high level of strategic coordination among the government, industry practitioners, and donor agencies. These stakeholders share a common vision for the microfinance industry that was proposed by donors and documented in the Donor Principles for Support to Uganda's Microfinance Sector of 2001. The principles were subsequently adopted by all stakeholders. The timing of the visit was also appropriate, given that Ugandan microfinance is an emerging market poised for increasing professionalization and growth. Market trends over the past five years and new opportunities presented by the Microfinance Deposit-Taking Institutions (MDI) Act of 2003 have combined to open the door to a new potential phase of development.

The review includes practical recommendations for how the Ugandan microfinance sector as a whole can build on its achievements to date to improve its effectiveness. The recommendations are intended to feed into ongoing discussions to help all stakeholders rethink strategies to reach a far greater number of clients throughout the country with a diverse range of quality financial services. PSDG and CGAP also hope that the review will provide valuable lessons for other countries.

The request for the review coincided with the CGAP Aid Effectiveness Initiative. Launched in 2002 with ministers and heads of agencies, the Microfinance Donor Peer Reviews addressed aid effectiveness from a unique perspective. They compelled donor agencies to look at themselves and focus on what they can most directly influence: their own procedures, practices, and systems. Peer Reviews of 17 bilateral and multilateral agencies and three field visits were completed between April 2002 and November 2003.

Box 1. Donor Effectiveness

Donor actions that contribute to the permanent availability of appropriate, client-responsive financial services via sustainable institutions and mechanisms on a massive scale.

The exercise culminated in a meeting in February 2004, "Leveraging Our Comparative Advantage to Improve Aid Effectiveness," that brought together heads of agencies and technical staff to synthesize lessons learned from the Peer Reviews and discuss future steps for collective action. Following the meeting, the 17 agencies issued a Joint Memorandum in which they endorsed five core elements of donor effectiveness in microfinance: (1) strategic clarity; (2) strong staff capacity; (3) accountability for results; (4) relevant knowledge management; and (5) appropriate instruments. They also committed to a four-step work program and gave CGAP and their agencies a clear mandate to conduct country-level reviews.

The Uganda review thus became the precursor to a series of planned Country Level Effectiveness and Accountability Reviews (CLEARs). The review team for Uganda included Ruth Goodwin-Groen, CGAP consultant, Till Bruett, consultant with Alternative Credit Technologies, and Alexia Latortue of CGAP. The full team was in Kampala on February 2327, 2004, with Ms. Goodwin-Groen and Mr. Bruett staying on for an additional three weeks (through March 19). The team interviewed over 75 people representing a broad cross section of stakeholders from senior government officials to commercial bankers to MFI representatives from both the largest microfinance institutions (MFIs) based in Kampala, and a rural MFI eight hours from Kampala. Interviewees also included donor representatives from the full spectrum of donor agencies and donor microfinance projects in Uganda. In addition to holding individual meetings, the team distributed questionnaires, organized a series of focus groups, conducted telephone calls with donor representatives highly involved in Ugandan microfinance who had since left the country, and read existing reports on Ugandan microfinance.

The team introduced the purpose of the review to a group of stakeholders at the beginning of their visit and organized two debriefing meetings at the end to

present their initial analysis and recommendations to the PSDG and a broader group of stakeholders. The two consultants were joined by Brigit Helms and Eric Duflos from CGAP for the debriefing presentations.

The report analyzes the drivers of microfinance sector effectiveness and makes recommendations to improve this effectiveness in Uganda. The analysis and recommendations come from the findings of the review team and feedback from stakeholders during the debriefing presentations. The review team and CGAP staff are available to discuss these recommendations in more detail and to support the various stakeholders as they implement them. To do so, additional visits to Uganda can be envisioned.

Chapter II, "Overview of Microfinance in Uganda," provides a brief history of the phases of development of microfinance from the mid-1990s onward. Chapters III to V address three drivers of effectiveness in the Ugandan microfinance sector: (1) shared stakeholder vision; (2) skilled human resources; and (3) extensive stakeholder collaboration. Together, these drivers were the principal forces that drove achievements in the microfinance sector, although other forces, such as the stable political and economic environment, also played a role. These three chapters examine the drivers first in terms of successes, then in terms of missed opportunities. The missed opportunities provide the foundation for the recommendation that the sector move into a fully developed market phase, with the complete integration of microfinance into Uganda's financial system. Chapter VI addresses the role of donors and the use of subsidies, highlighting the successes and missed opportunities of donor agencies, which have played a special role in helping develop microfinance in Uganda.

Other factors, discussed in less depth, also provided a positive context for microfinance to flourish in the country: the stable political and economic environment in Uganda, including a supportive policy framework; generous support from international donors; and an indigenous entrepreneurial culture. These supportive country conditions facilitated the growth of microfinance, but cannot be said to have propelled its successes. As such, they are not considered to be drivers.

II. OVERVIEW OF MICROFINANCE IN UGANDA

The review was conducted during a crucial period for the Ugandan microfinance sector. Urban markets are becoming saturated with microcredit and, for the first time, MFIs are starting to compete for clients. The MDI Act adopted in 2003 will allow several MFIs to become regulated deposit-taking institutions, enabling them to safely offer clients more services and finance growth with local capital. Commercial banks are increasingly recognizing the potential of the microfinance market and are currently focusing on small savings mobilization. The Microfinance Outreach Plan (MOP) coordination unit under the Ministry of Finance (charged with implementing the MOP and administering donor funds channeled to the microfinance sector), is actively preparing to catalyze sector-wide training efforts. All of these trends are occurring in the shadow of the approaching 2006 presidential elections.

Based on the trends of the past five years, all indications are that the sector is at a crossroad: microfinance in Uganda will either evolve into a dynamic market that is fully integrated into the financial system and provides a wide range of financial services to most of the population, or it will remain a successful, but marginal, development niche.

Microfinance in Uganda: Context and Outreach

Led by the firm hand of President Yoweri Museveni in partnership with an active international donor community, Uganda has enjoyed an unprecedented period of political and economic stability since the mid-1990s. The literacy rate is climbing (now nearly 80 percent), and the HIV infection rate is falling. Financing from donors presently covers more than 50 percent of the national budget, one reason why Uganda is often referred to as a "donor darling."

Uganda has a population of nearly 24 million and 86 percent of its working population is self-employed.[1] Close to 1.5 million people—nearly 90 percent of the non-farming active population—are employed in micro- and small enterprises, representing a significant market for microfinance.[2]

Microfinance in Uganda has been built on the foundation of entrepreneurial clients. MFIs consistently report that their institutional success is due to their hard-working clients. Commercial banks also note that the development of microfinance in Uganda can be attributed to the high rate of entrepreneurship in the country, particularly among women. These perceptions are corroborated by a 2003 international study of entrepreneur-ship that ranked Uganda among the top five "most entrepreneurial countries" of the 41 studied.[3]

Microfinance as part of the larger development agenda. The three major government policy documents that drive the national economic agenda—the Poverty Eradication and Action Plan (PEAP), the Program for the Modernization of Agriculture (PMA), and the Medium-Term Competitiveness Strategy (MTCS)—all deliberately include microfinance. These are living documents, used and updated by all stakeholders in the sector. It is remarkable that they explicitly recognize savings as critical to the development of the sector as a whole. Specifically, the MTCS prioritizes the promotion of savings and the restoration of public confidence in the financial sector, with an emphasis on small deposits. Similarly, the PMA and the MOP both emphasize the need to work with savings-based institutions in rural areas.

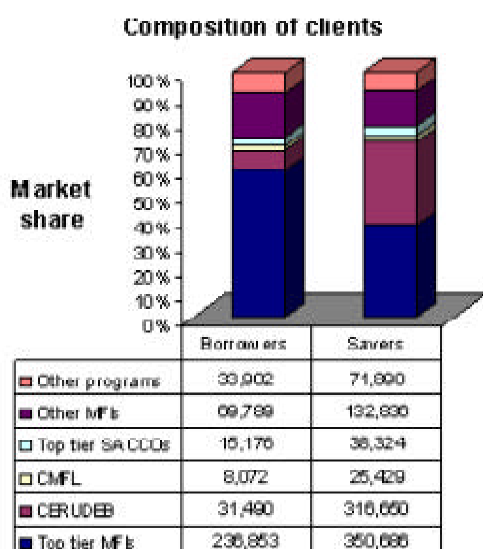
The 2003 revisions to the PEAP also analyzed the challenges in the microfinance industry. These included capacity building, outreach, product mix, agriculture finance, regulation of unregulated and unsupervised microfinance providers (known as "tier 4" institutions), savings mobilization, commercial bank down-scaling, interest rates, credit references, impact assessment, and industry consolidation. The inclusion of such a thorough analysis in the national poverty eradication plan illustrates the seriousness with which microfinance is treated by the government in Uganda.

President Museveni believes that financial services are key to his nation's future and keenly follows MFIs, from the outreach they achieve to the interest rates they charge. His interest, fostered by the sector's success, means that microfinance receives much more government attention in Uganda than in most other countries. The importance that the government of Uganda places on microfinance is facilitating the development of the sector, but it is also posing certain risks, such as political pressure, which in the past has lead to direct intervention of the government at the retail level. In all countries, governments have a constructive but limited role in building financial

[1] MoFPED, "PEAP Revision."
[2] Kappel and others, *The Missing Links*, 51.
[3] Reynolds and others, *Global Entrepreneurship Monitor 2003.*

systems that work for the poor. Microfinance good practice suggests that the optimal role of the government is to develop sound policy frameworks and encourage vibrant and competitive micro-finance among private sector actors, rather than to directly provide financial services.

Figure 1. Estimated Outreach of Reporting MFIs, 2003*



	Borrowers	Savers
Other programs	33,902	71,890
Other MFIs	69,789	132,830
Top tier SACCOs	15,176	38,324
CMFL	8,072	25,429
CERUDEB	31,490	316,660
Top tier MFIs	236,853	350,686

Total number of borrowers: 395,282
Total number of savers: 935,815

Microfinance outreach. Since the mid-1990s, the Ugandan microfinance industry has experienced a continuous upward growth trend. While exact data is not available, it is estimated that at the end of 2002 there were more than 1,300 microfinance organizations operating through 500-plus branches, including a specialized commercial bank (Centenary Rural Development Bank, or CERUDEB), a regulated credit institution (Commercial Microfinance, Ltd., or CMFL), several limited companies, hundreds of NGOs, and over a thousand cooperatives and other community-based organizations.[4] In 2003, several hundred more SACCOs were founded, bringing the total to over 1,500. Together, these institutions serve more than 930,000 savers (see figure 1). The poor savers of commercial banks would greatly increase this number.

Ugandan Microfinance: Phases of Development

Ugandan microfinance has followed a typical pattern of market development. It progressed smoothly from an emerging market to a growth market, and is now poised to reach the developed microfinance stage.[5]

1995–2000: Emerging market. These five years are known as the "business approach" period. Although some donor projects began earlier (e.g., the Poverty Alleviation Project of the African Development Bank, or AfDB), the Private Enterprise Support Training and Organizational Development (PRESTO), launched by the US Agency for International Development (USAID) in 1997, marked the emergence of good practice microfinance in Uganda. PRESTO fostered a commitment among all stakeholders to a private sector, business approach to microfinance. Through its Centre for Microfinance (CMF), PRESTO offered training in micro-lending good practices to all interested organizations. It then offered technical assistance and access to a grants program to help the institutions that implemented good practices, enabling them to grow. These efforts, combined with technical and financial support from other donors, international NGOs, and programs such as the Microfinance Capacity Building Programme in Africa (AFCAP) produced a core group of strong MFIs in the country.

Box 2. Features of Commercial Bank Saving Products

- Tiny minimum initial deposit of UGSH 10,000 (US $5)
- Low or no interest rate
- Often ATM-only accounts, ATMs in convenient locations
- Use of microfinance strategies for attracting clients, such as lotteries for regular savers

In 1997, several donors and MFIs also began to work with a few key government officials on international good practice. This process commenced when leaders from the Bank of Uganda (BOU), the Ministry of Finance, local MFIs, and donor agencies attended a World Bank/World Bank Institute training workshop in South Africa on microfinance. Additional workshops and study tours in Uganda, Kenya, and Bolivia followed. During the conferences and through the

[4] From the "Preliminary Analysis of the National Baseline Survey of Micro Finance Institutions in Uganda."
*Top-tier MFIs include CRS Hofokam, FAULU, FINCA FOCCAS, Feed the Children, MEDNET, Pride, TERUDET, UMU, and UWFT. Top-tier SACCOs include all members of the SACCO apex institutions, Uganda Cooperative Association (UCA), and Uganda Credit and Savings Cooperative Union (UCSCU). Programs are organizations that offer financial services as a secondary business

[5] For a characterization of growth and developed markets, see Grant and Theodore, "Marketing in Microfinance Institutions" (draft).

contacts that continued thereafter, the participants forged a baseline agreement on principles of good practice for the sector and thus became the early champions of good practice microfinance in Uganda. Individuals involved in the process cite the exposure to what was happening elsewhere and the ability to network with a small group of practitioner and government leaders as the key building blocks to sustainable microfinance in Uganda.

Informal contacts among donors, MFIs and representatives of the Ministry of Finance were channeled into a more formal mechanism for collaboration during the process of organizing the national microfinance workshop in 1998, the Micro Finance Forum (MFF). All stakeholders were involved in the founding of the MFF, and in 1998 the Ministry of Finance formally requested that the forum become the main discussion group for microfinance.

The "emerging years" also featured noteworthy failures, including the collapse of the government's Entandikwa credit program and the Cooperative Bank. These failures reinforced the belief that microfinance is best managed as a private sector activity and led to the government of Uganda's commitment to withdraw from direct lending. Key lessons learned included: government credit programs are often politicized; clients do not feel obliged to repay subsidized loans; the government has neither the human nor the financial resources to run a nationwide loan program; and interest rates must be set at market levels by private service providers or costs will not be covered.

In late 1999, the BOU issued a policy statement on microfinance regulation that confirmed the role of the government as an enabler, rather than provider, of microfinance. The BOU supported the view of "microfinance as a line of business," and foresaw the creation of a four-tier financial system that included (1) banks, (2) credit institutions,[6] (3) microfinance deposit-taking institutions, and (4) all other financial service providers, such as non-governmental organizations, savings and credit associations, and community-based organizations.

2000-2003: Growth market. This period is best characterized as the "commercialization period." No single donor program dominated this period, but many contributed to building up a group of sustainable, commercially-oriented MFIs. A vision and donor principles for microfinance was codified in 2001, initially by an active group of donors, then by AMFIU. Ultimately it was integrated into all key sector documents.

The government kept to its decision not to provide funding at the retail level, although it did funnel wholesale funds to a private sector entity on more commercial terms.[7] Donors also provided funding to MFIs on more commercial terms and facilitated MFI borrowing from commercial banks through the use of partial guarantees. By the end of 2003, all of the top-tier Ugandan MFIs had loans or credit lines from banks. The European Community (EC) is an excellent example of this evolution from a donor perspective. In 1998, the EC switched from direct lending to micro-enterpreneurs to lending to MFIs. In the early 2000s, it began providing guarantees to banks to reduce their risk of lending to MFIs.

Specifically, the growth years were marked by:

- ***Increased competition and the active participation of commercial banks.*** MFIs started to compete more for clients than for donor funds. One observer noted, "the days of product-driven MFIs are numbered—the winners will be those banks and MFIs with a strategic marketing focus…and a better understanding of the clients they serve."[8] Commercial banks began taking an active interest in the sector as a profitable business opportunity, mostly focusing on retail savings and wholesale lending to MFIs. The use of technology by innovative banks such as Nile and Orient drove down the cost of serving the "mass savings market." On the lending side, most commercial banks lent to top-tier MFIs rather than develop their own loan products for poor clients, both because the Banking Act does not allow group collateral and because of the time and cost involved in developing new technologies to reach this market segment. Moreover, guarantee facilities available from the EC's Support to Feasible Financial Institutions and Capacity Building Efforts (SUFFICE) project and USAID's Support for Private Enterprise Expansion and Development (SPEED)[9] project reduced the risk of lending to MFIs. While this capital is not cheap (annual

[6] These institutions are similar to finance companies in other countries, but are allowed to intermediate deposits.

[7] Government-financed lending to MFIs is effected through a private company, Microfinance Support Center, Ltd., which was founded by the government, is governed by an independent board, and funded through AfDB loans and grants to the government of Uganda.

[8] Wright and Rippey, *The Competitive Environment in Uganda*, iv.

[9] SPEED managed the USAID Development Credit Authority guarantees. These guarantees were offered to commercial banks to cover their exposure to MFI risk.

interest rates of around 15–20 percent, with a lien on an MFI's receivables), it can be easily accessed and integrates MFIs directly into the financial system. Discussions about other possible strategic alliances between banks and MFIs also began in the early 2000s.

- ***Passage of the Microfinance Deposit-Taking Institutions Act, 2003.*** Long technical consultations (managed by GTZ) and political negotiations resulted in the passage of the MDI Act, opening the way for the strongest MFIs to become true financial intermediaries regulated by the BOU. The 2003 legislation is exemplary because rather than concentrate on legitimizing microcredit or other narrow aspects of microfinance (as is common in other microfinance regulation), it focuses on protecting poor people's savings. This important legislation promises to help MFIs reduce their dependence on donors, grow more rapidly, and offer savings services to their clients. Although only a few MFIs are likely to become microfinance deposit-taking institutions (MDIs) in the next few years, the legislation paves the way for the incorporation of larger MFIs into the formal financial system. The consultative process was also a good illustration of the ability of the government, practitioners, and donors to work together toward a common goal. AMFIU played a pivotal role in this process, leading an initiative to educate politicians and the public, with technical and financial support from GTZ and SPEED.

- ***Amplified focus on savings and rural areas.*** During 2000-03, all stakeholders in the microfinance sector became acutely aware that the successes of delivering microcredit in urban areas were not sufficient for reaching rural areas and intermediating savings effectively. Emboldened by the changes in the financial regulatory framework, several MFIs increased savings mobilization and a few developed savings products. Not to be outdone by the MFIs, commercial banks reduced or eliminated minimum deposit balance requirements to successfully attract small savers in anticipation of the passage of the MDI Act. The number of SACCOs also mushroomed during this period, after the vice president publicly encouraged the creation of new SACCOs. The vice president viewed these organizations as a means by which poor Ugandans in rural areas could generate wealth through self-help. By early 2004, there were an estimated 1,300 SACCOs in the country, up from 250 in 1998. Although these institutions are important providers of financial services in rural areas with few other alternatives, SACCOs in Uganda are seldom held to any standards. None are currently regulated or adequately supervised.

  The growth in SACCOs is partly explained by the lack of services in rural areas. While urban markets are approaching saturation for some products, rural areas (where 75 percent of Uganda's population lives) remain underserved, with about only 20 percent of prospective rural clients receiving financial services.[10] Key government policies have highlighted the role of microfinance in agricultural and rural development. Both the Program for the Modernization of Agriculture and the Medium-Term Competitiveness Strategy more or less delegate their strategies for rural financial system development to MFIs, placing a burden of very high expectations on the sector.

- ***Re-invigorated Association of Microfinance Institutions in Uganda (AMFIU).*** Launched by governor of the Central Bank in 1997**,** when the government decided to get out of microfinance service delivery, AMFIU consolidated its position as the primary collaborative mechanism among MFIs. It was the principal representative of MFIs in collaborative efforts with other stakeholders during this period.

- ***Development of the Microfinance Outreach Plan (MOP).*** Funded by IFAD, DANIDA, and other donors, the MOP seeks to massively increase the outreach of sustainable microfinance in Uganda, especially in rural areas. The initial catalyst for the MOP was a presidential statement in 2001 that the government of Uganda would inject US $5,000 in each of the 5000 parishes in Uganda. This statement provoked an immediate fear within the microfinance community that such a cash disbursement would undermine the sector. Microfinance stakeholders responded quickly, urging the government of Uganda to remember the failed Entandikwa program and to allow the private sector (MFIs) to take responsibility for increasing the outreach of financial services. Other objectives soon were added, including focusing the government's efforts on improving the enabling environment for microfinance and supporting capacity building, as well as increasing rural outreach.

  The MOP clearly achieved the goal of responding to the presidential statement: the government of Uganda decided not to hand out money, but rather urged the microfinance providers to increase their

[10] Wright and Rippey, *The Competitive Environment in Uganda*, 2.

outreach. At the time of the review, the MOP was controversial for a number of reasons, including the role envisioned for financial extension workers and concerns that unsustainable institutions will benefit from significant funding, thus distorting the microfinance market. Components of the plan are now being implemented through existing programs and agencies, such as SUFFICE managing the capacity building unit, and AMFIU setting up a tier 4 performance monitoring system. By using agencies with appropriate technical expertise and political independence, the MOP hopes to avoid undermining the market for sustainable microfinance providers.

- ***Commitment to more transparency and reducing the reporting burden on MFIs.*** Initiated by AMFIU, supported by the government of Uganda, and then taken on by the EC's SUFFICE program, the USAID SPEED project finalized the development of a common donor reporting tool, the performance monitoring tool (PMT), in 2003. Fifteen donors—all of the donors active in microfinance in Uganda—adopted the PMT for reporting by the MFIs that they supported. The PMT reduces the administrative burden on MFIs and allows donors to apply consistent definitions and good microfinance practices in tracking the performance of their MFI partners.
- ***Shift of Microfinance Unit to the Ministry of Finance.*** In October 2003, President Museveni endorsed the move of the microfinance unit from the prime minister's office to the Ministry of Finance, signaling that all financial matters would be under the supervision of the Ministry of Finance. In spite of this positive step, some people continued to express concern about possible government influence beyond its proper regulation and supervision role.

2004 and beyond: Microfinance in Uganda. In 2004, Uganda is at a crossroad: Stakeholders can collaborate to build a developed market or rest on their accomplishments and leave microfinance as a development niche. The sector's well-known success within Uganda, and the extensive documentation of this success, has contributed to high expectations among political leaders. Microfinance stakeholders expressed concern that microfinance has been oversold, while other aspects of financial sector development and poverty intervention are being neglected. Stakeholders noted that many of the microfinance sector's shortcomings are linked to overall financial system weaknesses. To move forward, stakeholders need to look beyond retail MFIs and consider microfinance in the context of the larger financial system.

Beginnings of Financial System Integration. Integrating microfinance into the financial system means looking at all three different levels of financial system development: the micro-level of retail providers, the meso-level of industry infrastructure, and the macro-level of the enabling environment. This approach requires taking a broad look at the players in each of these areas, understanding the constraints they face in expanding poor people's access to financial services and finding ways to overcome these constraints.

MFIs alone cannot solve all of these constraints or serve all markets. The financial systems approach shows that by putting clients in the center, stakeholders can more clearly see what is needed to serve them. At the core of Uganda are poor households: more than 60 percent are engaged in agricultural production and 75 percent live in rural areas.

It is estimated that 38 percent of all Ugandans live below the national poverty line, 94 percent of whom live in rural areas.[11] At the same time, millions of Ugandans are moving to urban areas and entering into the manufacturing and trade sectors each year.[12] MFIs have a unique opportunity to serve both rural and urban markets, and the people transitioning between them, as long as they understand the realities that their clients and potential clients are experiencing.

[11] Kappel et al, *The Missing Links*, p. 23.
[12] Ibid., 38.

Table 1. Description of Ugandan Microfinance Market*

Emerging Market Uganda Activities, 1995-2000	Results
MFIs • International PVOs enter/expand in market • Focus on group lending, basic best practices • CERUDEB expands under IPC management **Donors** • AfDB/PAP grants develop community-based organizations with microenterprise lending • PRESTO/CMF focus on basic practices, business approach, group lending • PRESTO and others provide grants and technical assistance to support strongest MFIs • Multiple donors sponsor policy and regulation conferences and exchanges for government and practitioner representatives • GTZ assists BOU with policy framework **Government** • Entandikwa program fails, with a large amount of non-payments • BOU and MoFPED acquire knowledge of microfinance policy and regulation • BOU closes Coop Bank and privatizes Uganda Commercial Bank **Other** • Certification of AFCAP trainers • Search for permanent home for PRESTO/CMF • Stakeholders start roundtable forum for MF discussions	• Estimated 120,000 clients served** • One bank and five MFIs had more than 10,000 clients • BOU issued policy statement on microfinance regulation proposing four-tier system, commits to MDI regulation • Microfinance Forum (MFF) created to facilitate dialogue between stakeholders • Microfinance incorporated into national poverty alleviation plan (PEAP) • Government of Uganda agrees to shut down Entandikwa credit program

* Adapted from Grant and Theodore, "Marketing in Microfinance Institutions," 12.

** Estimate from Pearson, unpublished report, "Ugandan Donor's Workshop."

Growth Market Uganda Activities: 2000-2003	Results
MFIs • MFIs penetrate Kampala and most secondary cities • Unregulated MFIs begin intermediating deposits • Strengthening of AMFIU • Lobbying of MDI bill **Donors** • USAID/SPEED supports transforming MDIs • EC/SUFFICE supports training, lending to MFIs and bank guarantees • AfDB/RMSP/MSCL supports lending to MFIs **Government** • GTZ/BOU develop MDI regulatory regime • MDI bill drafted • President promises US $5,000 for each parish • Vice president urges SACCO creation • Parliament requests and President orders transfer of all government microcredit schemes to MoFED **Other** • MFF develops subcommittee mechanism • MCC carries on PRESTO training with modest results • Microfinance Outreach Plan (MOP) developed; funded by donors, but managed by government	• Estimated more than 930,000 savers • MFIs borrowing from commercial banks, intermediating deposits from clients • Banks lower minimum deposit size, add ATMs • Practitioners succeed in developing a stronger network organization (AMFIU) • Over 1,000 SACCOS formed • Donor principles for support of microfinance adopted, outline vision for growth market • All MF donors agree to standard performance monitoring tool • Microfinance included as component of PMA and MTCS • MDI Act passed • BOU drafts regulations for MDIs • MOP office created • Government of Uganda concentrates all MF activities (except cooperatives) under MoFPED • MFF "institutionalized" as advisory body to outreach plan office

III. DRIVER NO. 1
SHARED STAKEHOLDER VISION

Stakeholders in the microfinance sector in Uganda successfully developed a shared vision that allowed all players—practitioners (MFIs), donors, and the government of Uganda—to move in the same direction. The core unifying value of the shared vision was a deep-seated conviction that poverty outreach and sustainability are twin pillars that must be achieved together. At its most successful, the shared vision allowed these stakeholders to work collaboratively and take advantage of one another's strengths. It generated broad consensus because it encompassed diverse good practice microfinance interventions, rather than prescribing one preferred implementation method or institutional type. Yet, fundamental differences persist concerning how best to build a retail infrastructure to reach massive numbers of poor people. Also, the role of microfinance within the financial system and the broader development agenda remains unclear for many.

Successes

Effective process for developing good practice principles. Three major factors explain the successful development of the shared vision: (1) multiple collaborative meetings—stakeholders met repeatedly and cooperated on multiple concrete projects, thus building trust and a sense of joint accountability for the sector's development; (2) microfinance champions—technically skilled advocates—represented each of the three major stakeholder groups (MFIs, donors, and the government) and were able to engage in a high level of debate and discussion; and (3) investment of sufficient time—the vision was developed over a period of three years, allowing real understanding and consensus to emerge.

> **Box 3. Stakeholder Clarity in the Eyes of Ugandan MFIs**
>
> An informal survey of 13 MFI representatives by the review team gave stakeholders an average of 80 percent out of 100 percent on clear and consistent vision.

By defining the vision for the sector first, the actors avoided getting bogged down in principles and philosophical debates. Only when consensus was reached on the vision did the actors focus on "how do we get there?" The agreement on good practice principles and objectives for Ugandan microfinance was ultimately codified in the *Donor Principles for Support to Uganda's Microfinance Sector* in 2001. These principles highlighted the donors' common vision for the future of microfinance, including key outreach targets for the year 2005. Through an intensive consultative process, practitioners and the government also came to buy into the vision presented in the principles.

Consistent adherence to good practice principles. Having developed a shared vision and commitment to good practice principles, stakeholders in Uganda then strove to act in accordance with them. The two best examples of stakeholders translating the vision into action are the MDI Act (2003) and donors' funding policies.

Initial debates about a regulatory framework for microfinance took place at the same time that stakeholders were working to define a vision for the sector; the two discussions informed each other. Drafting the MDI bill and ensuring its eventual passage into law in 2003 was a tremendous group effort that brought the entire sector together. The final legislation reflects the core principles of the vision, affirming that microfinance is a financial services business that focuses on "low-income households."

> **Box 4. Examples of Good Practice Principles and Goals**
>
> Stakeholders in the microfinance sector of Uganda agreed on goals, principles, and a code of conduct.
>
> ***Microfinance goals***
>
> - Offer a range of financial services, with new credit and savings products, focused on rural populations.
> - Establish linkages between MFIs and formal financial institutions.
> - Aim for average client growth of 25 % per year (compounded).
> - Increase number of rural clients to 60 % of total clients.
>
> ***Microfinance principles***
>
> - Microfinance is a business, not a welfare activity.
> - Microfinance is a private sector activity inappropriate for direct government intervention.
> - Microfinance encompasses savings as well as credit services.
> - Microfinance is a key poverty alleviation tool.
>
> ***Donor code of conduct***
>
> - Transparency and information sharing are crucial to building an effective microfinance sector.
> - International standards of good practice are desirable to follow.

Despite the fact that they incurred no penalties for non-compliance, most donors consistently tried to apply the 2001 Donor Principles to their funding of microfinance in Uganda—and to hold others to them. Their ability to translate the document into action can be attributed to technically skilled champions who integrated the principles into their respective government and agency policies. The Quarterly Coordination Council of donor and donor projects was organized by the EC's SUFFICE to coordinate applications, review performance appraisals, and coordinate monitoring and evaluations. Working in a context where the local government shared similar principles was also crucial. An encouraging example of the application of sound microfinance principles was provided by the AfDB and the government of Uganda, who collaborated to find a mechanism that would direct an AfDB government loan to private sector microfinance (see box 5).

Box 5. Implementing Private-Sector Funding

The AfDB was able to honor the private sector principle of microfinance, even when its financial instrument was a direct loan to the government, because the Government of Uganda had internalized the same principle. Government policy was to refrain from direct involvement in the implementation of credit projects, so the government of Uganda and AfDB created a private corporation to distribute AfDB funding. Not only did the AfDB initially channel US $2 million through this corporation, it halted funding in 2001 for two years when an AfDB review mission found that the company had not been set up properly. Only after the company was reorganized and a new management team was fully in place did the AfDB renew its funding in February 2004.

Missed Opportunities

Narrow definition of microfinance. The future financial service needs of all low-income clients will not be met if microfinance remains a specialized development intervention. Stakeholders in the Ugandan microfinance sector have been heavily focused on two elements of microfinance: retail-level NGO transformation and the regulatory environment for this new type of non-bank financial institution. The majority of stakeholders do not yet have a clear understanding of what the entire financial system comprises or of how the microfinance market can develop within that system. Few recognize the challenge of developing other types of financial institutions, particularly in rural areas (such as leasing or insurance companies, or informal structures such as SACCOs), or building the infrastructure (audit firms, raters, credit rating agencies, etc.) that can support the growth of a broader financial system. The division between the Agricultural Sector Donor Group, a group of donor representatives that support the agriculture sector, and the PSDG, moreover, fuels the divide between microfinance and rural finance.

As one commercial banker noted, "When it comes to financial system development, everyone seems to be waiting for the others." Stakeholders in microfinance have not sought to fully understand how they fit into the financial system, nor what their respective comparative advantage is in different levels of the system (micro, meso, and macro).

No process for updating the vision. The stakeholder vision for the Ugandan microfinance sector is outdated and narrow. Microfinance in Uganda is moving quickly and has seen many new developments, for example, the introduction of microinsurance products. Yet, there is little stakeholder wide momentum to define a process or mechanism for integrating the new learning and practices into the documented vision. Given the natural turnover of staff in all stakeholder groups, most especially among donors, an outdated vision risks impeding progress. New staff will not be so committed to the vision and the loss of a sense of common purpose underpinned by a current, shared vision may result in splintered and conflicting actions.

Lack of protection of savings in SACCOs and NGOs not sufficiently addressed. Stakeholders acknowledge they have not yet found ways to protect the savings held by tier 4 institutions, which hold the majority of poor people's savings. The 1,300 existing SACCOs had a turnover of approximately UGSH 30 billion (US $15 million) between 2000 and 2003. However, the Commission for Cooperatives has neither the skilled personnel nor the power to identify and close down mismanaged SACCOs, and the BOU does not consider tier 4 institutions its responsibility. The Poverty Reduction Support Credit (PRSC) requires that SACCOs be strengthened in line with international standards, such as the PEARLS monitoring system developed by the World Council of Credit Unions. This is a positive move, but negotiations are going very slowly.

Mistaken assumption that microcredit is a panacea for poverty. Many politicians mistakenly believe that microcredit alone can lift people out of poverty. What is more, they want it to accomplish this feat with low interest rates, often insisting that the 3–5 percent monthly interest that is commonly charged is too high. The concentrated attention given to the sector at the highest level in government policy documents and speeches has placed pressure on microfinance to produce over-ambitious results. It has also stunted public policy debates on what other services poor

people need to complement microfinance and reduce poverty, including a comprehensive plan to address rural poverty.

Box 6. Reaching Rural Areas: Support Market Leaders or Broad-Based MFIs?

Many stakeholders in Uganda believe that supporting a small number of large, efficient, and sustainable MFIs (e.g., microfinance deposit-taking institutions) is the best way to increase outreach and ensure that quality services will be available on a large scale in rural regions. In this view (referred to here as the "market leader" view), a small number of large institutions would expand into rural areas and be financed through local deposits and commercial financing, not subsidized funds. Proponents of this view contend that the most important job of donors is to "pick the winners" well.

Other stakeholders believe that the large institutions will take too long to reach rural areas and that support should be given to the many smaller MFIs already located in rural areas. These stakeholders believe that the small institutions have a true desire to innovate and find ways to reach agricultural and very poor communities and offer the best solution for rural microfinance. They believe that the higher transaction costs of reaching rural clients may make sustainability unattainable and justify using subsidies (the "broad-based" view). The broad-based view, however, simultaneously recognizes the need for consolidation in the sector.

Both views are consistent with aspects of the original shared stakeholder vision. Yet, pressure from the presidency to expand outreach in rural areas has fueled a major divide between these two approaches. Under fire to provide results, proponents of each side have become entrenched in their positions, certain that their way is the only right one. Energy that could be channeled into finding innovative ways of providing more and better financial services in rural areas is instead being spent instead on finger pointing and villianizing the other side. This stance has reduced the focus on the actual challenge at hand: serving rural clients.

Difficult questions avoided. Difficult questions about the future of the microfinance sector were not addressed directly and openly, and have begun to exacerbate divisions among stakeholders and make consensus difficult. These questions include:

1. What is the best strategy for reaching the rural microfinance market?
2. What financial products and services beyond small loans are needed to finance agriculture, a sector that employs over 80 percent of the labor force?[13]
3. What is the appropriate level of engagement with the cooperative sector?
4. How can the MOP be managed appropriately?

[13] Ministry of Agriculture, Animal Industry and Fisheries, PMA, v.

Risk of microfinance becoming a pawn in the 2006 elections. Elections in any country can lead even the most well-informed and well-intentioned politicians to abandon sound principles. Uganda is no exception. Stakeholders in the microfinance sector are fearful that microfinance offers a soft target for potential politicians because it deals with money for the masses—a tempting but potentially lethal combination. Indeed, the political drums of microfinance have already starting beating in anticipation of the upcoming elections. Using microfinance as a means of transferring resources to people before an election can have disastrous consequences for the credit culture of both clients and serious institutions trying to provide quality financial services on a sustainable basis.

Recommendations

1. Develop a process to update the vision of a pro-poor financial system. A new vision of the entire financial system as a system that works for poor people is needed. Such a system would offer poor clients a broad range of financial services (including remittances, insurance, etc.) and implement the infrastructure and oversight needed to make those services sustainable.

- ***Initiate a vision-building process.*** AMFIU should seek donor technical and financial support and take the lead in garnering the support of all stakeholders to define a process to look at the current vision and address existing gaps. In so doing, all stakeholders can build on the energy and processes used in passing the MDI Act.
- ***Engage an expert facilitator for this process.*** Experience shows that a skilled, outsider facilitator can be critical in helping to bring together diverse views and maintaining a focus on desired outcomes. Again, AMFIU could coordinate the recruitment of such a facilitator.
- ***Learn what a pro-poor financial system entails.*** In preparation for updating and expanding the vision, all stakeholders (including MFF, AMFIU, PSDG) should draw on resources in Uganda, as well as experiences elsewhere (e.g., Tanzania) to learn the basics of a pro-poor financial system and to map out what such a system might look like in Uganda.[14] The finance subcommittee of the MFF should take the lead in engaging a wide cross section of government staff on this issue. As the

[14] A good source of information on pro-poor financial systems will be provided by new donor guidelines that are currently being drafted to replace the 1995 "Micro and Small Enterprise Finance: Guiding Principles for Selecting and Supporting Intermediaries."

representative of large and small MFIs, AMFIU should educate practitioners, making a special effort to also reach commercial banks and cooperatives. Finally, the PSDG should organize a forum for donors to discuss the implications of taking a financial systems approach to microfinance and the development of the financial sector as a whole in Uganda.

2. Codify, disseminate, and regularly update the new vision.

- ***Write new principles for supporting microfinance in Uganda.*** The new principles written to replace the 2001 donor principles should address all financial system stakeholders, with specific guidance on the appropriate roles of government, practitioners and donors. For example, concrete guidance for practitioners might include ways to improve efficiency; donor guidelines could focus on how donors should complement and not replace private capital; and guidance for the government could address the importance of cost-recovering interest rates.
- ***Organize workshops/meetings to present the principles.*** Once it is finalized, buy-in to the vision will require a continued consultative process. Special care should be taken to reach smaller MFIs outside Kampala and the SACCOs, as well as parliamentarians. The packaging of the final document is important: it should be kept short and clear.
- ***Orient new staff among all stakeholders to the vision and its implications.*** Once the vision is adopted, AMFIU, the Ministry of Finance, and the PSDG should ensure that new representatives of their respective stakeholders (new MFI directors, new donor staff, and key government staff assigned to microfinance) are apprised of the principles and objectives of the vision.
- ***Establish a rotating "ombudsman" function within the MFF (perhaps within the apex subcommittee).*** To ensure that specific problems and/or new ideas are aired early, stakeholders could benefit from designating a person to hear requests to add topics to the main agenda of collaborative mechanisms. The responsibility for this function should be rotated regularly to ensure maximum neutrality.

3. Prioritize rural finance as a major issue to be tackled jointly.

- *Place rural finance explicitly on the agenda of the apex/PMA subcommittee.* One responsibility of the apex subcommittee of the MFF is advising the Program on the Modernization of Agriculture on rural microfinance. The subcommittee may wish to task a working group with developing a medium-term plan that lays out the responsibilities of all actors in the financial system to reach rural microfinance markets, including exploring how the resources of the MOP can generate the greatest leverage. The plan should include a focus on savings-led strategies. Working group members should have the appropriate technical expertise to work on this issue.
- ***Separate out the specific challenges of agricultural finance from the broader rural finance issues*** and work on finding solutions to these distinct issues. For agricultural finance, invite stakeholders from outside the microfinance sector to take the lead on discussions, building on the recent BOU-commissioned study on agricultural finance to identify solutions to the breadth of existing constraints. Also, the Agricultural Sector Donor Group and the PSDG should organize joint meetings to plan for the implementation of the PMA rural strategy.
- ***Develop criteria for identifying promising rural institutions.*** Identifying the next generation of "top winners" will be important for increasing outreach in the rural areas. While many small institutions are unlikely to ever reach scale and have significant impact, establishing an operational, user-friendly analytical tool to identify those institutions that do serve a niche market well and could grow would be a useful contribution. AMFIU, with donor support, could be charged with this task.
- ***Promote the role of savings as a service and a source of funding for rural MFIs.*** In addition to protecting poor people's savings (see below), the industry should focus on the creating appropriate savings products for rural clients. MFIs could receive assistance for this through the MOP, while donors, AMFIU, and others can support better practices, governance, and oversight for savings mobilization.

4. Protect poor people's savings.

- ***Explore joint oversight of SACCOs by the BOU/MoFPED and the commissioner of***

cooperatives that would meet the definition of significance (such as the number of savers or size of deposit base). Joint oversight responsibilities must include the ultimate power to disband a SACCO or install new management, plus the skilled human resources to identify mismanaged institutions. Joint oversight, together with the requirement for international good practice standards in the microfinance and co-op sectors, should be included in the new co-op law. For example, the law might include a reference to the use of PEARLs or other such systems to increase transparency.

- ***Create a savings subcommittee or working group*** to provide leadership specific to the safety of savings. The existing Tier 4 Regulation Group (formerly the SACCO Regulation Working Group), convened by the MOP, is an ad-hoc working group with too broad an agenda for this urgent specific task. An agenda for the savings subcommittee might include tier 4 regulation in partnership with the MFF's lobby subcommittee; strategic alliances between commercial banks and tier 4 institutions to keep savings safe; a program with the MFF consumer affairs subcommittee to educate potential savers about safe SACCOs (i.e., members of Uganda Credit and Savings Cooperative Union or Uganda Cooperative Association networks that adhere to minimum standards).

5. Position MOP coordinating unit clearly within the microfinance sector.

The role of the MOP in the microfinance sector, and with regard to individual donor projects, merits clarification. Its role as resource center of sorts to the entire industry should be spelled out clearly, including how it will collaborate/complement ongoing donor activities. The MOP should be more transparent about its operating principles, such as how the money for financial extension workers will be spent, minimum qualifications of MFIs eligible for the MCAP matching-grant facility, and the limits to the support of non-sustainable institutions through MCAP. It is recommended that the MOP retain the flexibility to be responsive to market needs and ensure sufficient technical oversight of the projects and institutions it funds by working with qualified donors or support projects, or hiring consultants with sufficient authority and expertise.

6. Map out the respective roles of all stakeholders in developing a pro-poor financial system.

- ***Build on this report to complete a pro-poor financial system template.*** The Ministry of Finance, AMFIU, and PSDG should distribute the financial sector development template included in chapter VI to all stakeholders so that they can identify the services and locations that they are currently providing or funding at all three levels of the financial system. A donor member with the appropriate resources and expertise, such as DFID's Financial Sector Deepening Unit or GTZ, should then compile all the templates and present the findings.
- ***Devise strategy to rectify donor overlaps and gaps.*** A respected member of the microfinance community with the right technical and people skills should be identified to lead a discussion to address areas of overlap and gaps, and to propose solutions. An example of a specific gap is the lack of product development to meet the varied needs of microfinance clients.

7. Be proactive where politics and microfinance intersect.

- ***Accept that microfinance is part of the national debate about poverty reduction.*** All stakeholders should recognize that it is reasonable for the government to be keenly interested in the rapid expansion of microfinance, given its significant potential to contribute to poverty alleviation. The problems come when politicians move out of their oversight role and abandon or neglect other poverty alleviation efforts in the hope that microfinance will "do it all."
- ***Correct assumptions about microfinance being a panacea for poverty.*** AMFIU should launch a public information campaign about what microfinance is and is not, and what it can deliver for Uganda. This task is time-sensitive—those who believe that microfinance is a panacea may become disappointed soon and could withdraw public support from the sector. Key messages might include: (1) microfinance is just one tool for poverty alleviation; (2) microfinance is not appropriate for all people and in all situations—other development interventions may sometimes be more appropriate; (3) microcredit interest rates are based on the high costs of loans for poor people and the financial system; and (4) microfinance is about the long-term, sustainable provision of

financial services that poor people need, including deposit services, insurance, and transfers, not just credit. Consult the *Key Principles of Microfinance* developed by CGAP and endorsed by the G8 for additional messages.

- ***Reach out to politicians to pre-empt the use of microfinance as an election issue.*** AMFIU should educate politicians about the appropriate oversight role for lawmakers in developing a pro-poor financial system and the "polluting" effects of using microfinance as a tool for resource transfers.
- ***Establish procedures for rapid industry reaction to political (and other) challenges***. AMFIU should set up a quick response committee to react quickly to political statements or initiatives that might undermine the microfinance market or misrepresent the sector. A transparent and coordinated approach to responding to such statements should maximize the chances of effectively lobbying the government and reaching acceptable alternative solutions.

IV. DRIVER NO. 2
SHARED HUMAN RESOURCES

Skilled experts work in all stakeholder groups (local MFIs, the government, technical services providers, and donors). Sharing a common vision and a baseline agreement on good practice principles, they work together constructively for the benefit of the microfinance market. The high level of technical skills across all stakeholders also creates a demanding environment in which each stakeholder always wants to do better and is ready to argue fiercely for their beliefs. Ugandan microfinance is a dynamic intellectual community that is attractive to global microfinance specialists and Ugandans. Ensuring the continuity and depth (i.e., reaching middle management) of this community remains a challenge for the future.

Successes

Virtuous circle of local and international specialists. Across all stakeholders, top-quality people with solid technical skills are in place. In the government, technocrats are assigned to follow microfinance and have complemented their financial skills with microfinance training at the Microfinance Training Program in Boulder, Colorado (USA), and other international events. Leadership of MFIs includes well-trained Ugandans and internationals with private sector and banking experience. Highly qualified international technical service providers are also present in the country. And while the availability of local support services in Uganda is still limited, there are a growing number of high-quality local consultants—primarily people with expertise that have left other stakeholder groups. Specialists also seem to trade places frequently in Uganda. It is not uncommon to see government employees move to MFIs, MFI managers taking jobs with donors, and donor staff joining the government.

Excellent training and technical assistance. Industry-wide training provided the sector with a common language and principles, giving microfinance a running start in Uganda. The PRESTO project is credited as one of the most important factors in the development of successful microfinance in Uganda. Its CMF, a one-stop shop for microfinance information and training, came to be regarded at the time as the "gold standard" for training projects. Subsequent training projects have moved from a supply-led to a demand-led approach and focused on specific areas of need or on the achievement of specific goals, such as the EC's SUFFICE capacity building component's partial subsidy of training, which MFIs identify as useful; the AfDB's Microfinance Support Center, Ltd., (formerly the Rural Microfinance Support Project) that provides near market-rate loans to qualified MFIs; AFCAP's consultant certification and training; and USAID's SPEED project, which supports the transformation of large MFIs into MDIs.

Box 7. The SPEED Project of USAID

One part of the SPEED project is to ensure that the top three to five MFIs in Uganda transform into formal sector MDIs. To achieve this goal, SPEED provides substantial training and international technical inputs in the areas of liquidity management, asset and liability management, market research and product development, ownership and governance, internal controls, and information systems, among other topics.

Missed Opportunities

Lack of industry-wide supply of training after the PRESTO project. Stakeholders no longer have an industry-wide supply of training (even though partial funding is available for MFIs to access good local training). There is no strategic development of new training content to keep pace with the increasing complexity and growth of the sector, and there is no mechanism to ensure depth of training among the various stakeholder groups. This vacuum in the availability of good practice training after the PRESTO project ended was due to an unfortunate succession of donor decisions, outlined in box 8. The Microfinance Competence Centre tried to carry on the PRESTO training, with modest results, and a few high-quality courses and consultants were available due to training of trainers workshops offered by AFCAP. But fees for these workshops were too steep for bcal MFIs that were not yet weaned from subsidized training. The training currently available in Uganda tends to be either highly specialized and offered by international consultants (directed to top-tier MFIs) or rather basic and limited (directed to smaller MFIs). Not much is available for the middle management of growing MFIs. The MOP coordinating unit contains a mammoth human resource training component, designed to step into the breach and provide industry-wide perspective and training.[15] However, its courses have yet to get off the ground.

Little specialized training for growth. Virtually no training currently available in Uganda (save that for top-tier MFIs) is specifically designed to help MFIs face the

[15] This includes both the capacity building unit, which is commissioning materials and seeking to certify trainers, and the Microfinance Capacity Building Program (MCAP), which is currently in international tender and will provide matching grants for training and technical assistance.

multiple challenges of growth, such as portfolio and accounting systems for a large branch network, internal controls, or maintaining a high-quality portfolio while expanding and cutting costs. Most consultants and local service providers have managerial and institutional development capacity, but lack the specific technical skills to help MFIs move into the financial mainstream. As two independent groups of MFIs admitted, many MFIs are handling growth by trial and error. There appears to be no local service provider capable of assisting middle-tier MFIs with issues of financial system development or transformation. This fact is unsurprising, given that there has been no significant sector-wide investment in technical service providers since 2001.

Box 8. No Effective Successor to PRESTO

PRESTO was a project designed for an emerging industry - the Centre for Microfinance (CMF), for example, was never intended to be permanent. Although the apex subcommittee of the Microfinance Forum proposed an independent CMF II, USAID thought it would be more efficient to merge the CMF with the GTZ plan for a Microfinance Competence Center (MCC) in the Ugandan Institute of Bankers. The merger would bring training and policy work together in the MCC, which would have the mandate to update and expand training and technical services provided to MFIs and to offer additional training of trainers, as well as courses for the Ugandan government officials and donor staff. It was assumed that this combination of services would attract other donors. In accordance with this assumption, the CMF turned over its materials, equipment, and database to the MCC with little transition or actual donor support.

When USAID was preparing its next project, the design team understood that other donors would fund the MCC and there was no need for USAID funds. USAID thus chose to focus on the niche of transforming MFIs to regulated financial institutions (the SPEED project). The EC's SUFFICE capacity building component was a demand-led project that primarily provided subsidies to MFIs seeking to attend MCC trainings. GTZ provided support for a business plan and the development of two new courses, and DANIDA gave support for staff salaries. GTZ ended support when MCC's new products and governance were found lacking.

Unfortunately, no donor became truly committed to the MCC, therefore none was committed to technical oversight. Although DANIDA stepped in to sustain the MCC, they did not commit the technical resources or oversight needed to oversee the development of a true Microfinance Competence Centre. Patchwork funding is insufficient to build such a center from scratch. Today, the MCC offers only 10 subsidized courses, most of which are adapted from PRESTO trainings, and few technical services.

Skin-deep human resources across all stakeholders. The dynamic public face of microfinance in Uganda is, for the most part, only "skin deep." Middle management is not well developed and all stakeholders are overly dependent on a few high-profile and often over-stretched individuals. For the long-term sustainability of microfinance in Uganda, this problem is most acute with regard to local capacity. Most leaders are not preparing others to take over once they move on (although Women and Microfinance Uganda has an explicit mentoring goal). If a few well-placed people were to leave, the ongoing development of microfinance would be seriously affected.

Recommendations

1. Continue investing in capacity building across all stakeholder groups.

- ***Invest in training people regularly, especially local staff.*** The investment in sending people to training programs, exchange visits, etc., has clearly paid off in Uganda. As microfinance evolves and financial institutions grow and offer more complex services and products, constant professional development is necessary across all stakeholder groups. For example, SACCOs require training on record keeping and financial management; BOU supervisory staff need to better understand how to implement the MDI Act, and donor staff need a better grasp of financial sector development issues, beyond retail-level work.
- ***Highlight importance of "succession planning."*** All stakeholders groups should actively champion the need to develop capacity beyond top management. They should also prepare a succession/transition plan for key positions. For example, AMFIU should stress the importance of early succession planning with it membership. Donors should build in overlap time when key local office or project staff leave the country so that they may orient and pass on institutional memory to the newcomers.
- ***Keep up support for an associate bachelor's degree program.*** GTZ has supported the development of an associate bachelor's degree program in microfinance and community development with an Africa-wide focus, that combines distance learning modules with a series of 1–2 day workshops held during the residential periods. Based on initial positive reviews, this program is worthwhile. However, to provide hard skills to practitioners, the curriculum could be more technical and analytical, rather than broad and theoretical.
- ***Support the development of AMFIU.*** As a broadly representative association, AMFIU has the potential to be a major contributor to development of the sector. AMFIU is still fairly young and requires support from its members and donors in order to expand its own capacity to take on this role. In doing so, donors and members must

recognize that their support should not compromise AMFIU's independence as a voice for the industry as a whole.

2. **Maximize the capacity building efforts of the outreach plan.**
   - ***Put in place MOP staff with technical expertise and political independence.*** Donors funding the MOP and the responsible government officials should ensure that the MOP's capacity building efforts are managed by staff with appropriate skills and independence to design, implement and prioritize capacity building efforts effectively. MOP staff should proactively collaborate with other capacity building programs in the sector to leverage opportunities and minimize redundancy.
   - ***Create and regularly update the inventory of training and technical services.*** As an information center, the capacity building unit under the outreach plan coordination unit should maintain a list for the whole industry of all locally and internationally available training and technical services of relevance to microfinance. Optimally, this database should also include a standard assessment of these training resources.
   - ***Identify long-term "home" for training courses.*** The outreach plan's curriculum development subcommittee should search for long-term partners to help design course materials and provide permanent homes for the courses that are being developed. Possible options include universities, business schools, or training centers.

3. **Reorient financial extension workers to provide financial management training for community-based organizations.**
   - ***Offer basic financial management training.*** Many grassroots community-based organizations, including SACCOs, urgently need basic financial management training. The MOP currently calls for the deployment of financial extension workers to create linkages between clients and MFIs. Many stakeholders are concerned that this approach may not be judicious. A possible, more effective use of financial extension workers would be for them to provide consumer education training that emphasizes the rights and responsibilities of MFI clients, as is currently envisioned by the consumer education subcommittee of the apex subcommittee of the MFF.

4. **Focus practitioner training on efficiency, governance, and accountability.**
   - ***Emphasize efficiency, good governance, and accountability.*** All donors should work closely with the MFI partners they fund to improve work processes and systems for increased efficiency and sustainability, governance for better safety of funds, and accountability for maximizing the return on capital. Focusing on these core areas will help MFIs position themselves in an increasingly competitive environment, prepare for MDI licensing, and operate with reduced donor subsidies.
   - ***Promote AMFIU's role in supporting MFIs in core areas***. AMFIU has a great opportunity to provide leadership and added-value services by offering performance benchmarking to its members, building on the performance monitoring tool and the forthcoming performance monitoring system (a financial data collection and benchmarking tool). AMFIU could also provide briefing notes on what constitutes good governance for a range of institutional types. Finally, AMFIU could broker information that MFIs may need to increase their efficiency, such as announcing the newly created CGAP product costing tool for practitioners.[16]

[16] For more information on the product costing tool, see www.cgap.org/productcosting.

V. DRIVER NO. 3
INTENSIVE STAKEHOLDER COLLABORATION

Stakeholder collaboration is rightly considered a success story in Uganda and has been a major driver of effectiveness in the industry. Collaboration in Uganda goes beyond donor organizations and includes all stakeholders groups. Interviews with stakeholders confirm that collaboration in the past five years has been extraordinary and they give it high marks for its effectiveness and the positive participation of MoFPED and BOU.

At the same time, it appears that the close sense of partnership among stakeholders is beginning to fray. Each of the stakeholders expressed exasperation that the others are not being transparent. Such frustrations are a natural part of any relationship and can be healthy if they result in a deeper dialogue. They are also the effect of the expansion of the microfinance sector from a cohesive small group of stakeholders to a much broader set of players who are outgrowing the existing methods and mechanisms of collaboration. If these frustrations are not addressed, however, they can undermine partnerships, trust and, ultimately, the possibility for effective collaboration.

Much has been written on donor collaboration in Uganda and elsewhere. The purpose of this section is to look at collaboration among and between all stakeholder groups (including practitioners and government), not just among donors. The section also highlights specific collaborative mechanisms and attempts to identify the key factors that contributed to their effectiveness. A description of three specific mechanisms that have been important for stakeholders (the MFF, AMFIU, and PDSG) is included, as is a brief case study comparing two collaborative efforts.

Factors Contributing to Good Collaboration

Individual conversations and focus group discussions confirmed David Wright's conclusion that collaboration is critically dependent on the individuals involved.[17] Two additional factors emerged as being equally important, namely, the nature of a given issue and the structure or the process of the collaborative mechanism. For each of these three contributing factors, several key aspects of the Ugandan experience are critical.

[17] For more information on David Wright's framework for analyzing donor coordination, see Wright, *In-Country Donor Coordination*.

The People Factor (Who Is Involved?)

- ***Qualified personnel.*** The participation of highly qualified people from all stakeholder groups made meetings and collaborative initiatives dynamic and results-oriented. Individuals engaging in collaborative efforts can only be effective if they are qualified, have some technical background, and have made some effort to be informed on the issues at hand. AMFIU's leadership, for example, is extremely well-versed in both microfinance and larger financial sector issues.
- ***Sufficient committed personnel.*** Stakeholders must make collaboration part of staff members' job descriptions. In Uganda, several donors (including the EC) explicitly incorporated collaboration into the terms of reference of their staff and/or project staff. Stakeholders without sufficient staff often are unwilling or unable to regularly attend key meetings. The level of staff commitment is equally important. This is particularly true of stakeholders who are not only focused on microfinance, but manage a larger portfolio of development projects.
- ***Local representation.*** Collaboration works best in country. Lack of sufficient local representation hinders the numerous informal and personal interactions that contribute to effective collaboration. Not surprisingly, several of the donors most active in collaborative efforts are highly decentralized. For example, DFID, EC, USAID, and GTZ all have separate, independently managed projects dedicated (in part) to microfinance.
- ***Presence of decision makers.*** Collaboration is best when the participants are decision makers or can significantly influence the decisions of their organizations. If decision-making authority is limited or in the hands of a distant office, extra effort must then be made to inform and involve the true decision maker. The fact that the Ugandan government was represented at a senior level in forums like the MFF certainly gave that body more standing and influence.
- ***Practitioner involvement.*** A common denominator of a number of successful collaborative efforts was the active participation of MFIs themselves, both directly and through AMFIU. While donors or donor project staff can

effectively act as agents of the organizations they support, direct MFI involvement seems to lead to a broader acceptance of the final outcome.

- ***Role of champions.*** Specific individuals are identified early on as champions of certain issues and play a key role in moving the issue forward. Stakeholders mentioned the need to get the champion's support for an issue at the beginning, usually through informal contacts.

Box 9. GTZ/Sida Collaboration

When Sweden opened its embassy to Uganda in 2001, it sought to make effective use of its limited aid resources. Sida developed its strategy for support of the Ugandan private sector in line with the priorities laid out by the government of Uganda in its Medium-Term Competitiveness Strategy. Working with the BOU was a natural choice, given its key role in the MTCS "priority actions" to strengthen the financial sector and increase access. However, only 20% of Sida's private sector budget and staff time was available for a financial sector project (approximately US $3.2 million over three years). Through the PSDG, Sida identified GTZ as the primary donor agency working with the BOU and saw the possibility to increase its impact by collaborating with the existing GTZ Financial Systems Development project.

The BOU also preferred that Sida work through the existing GTZ support structure, rather than create a new project office. Through complicated negotiations, Sida contracted GTZ as its implementing agency. Rather than pool funds, Sida chose to fund certain activities of the project, which were budgeted and accounted for separately from GTZ activities, but managed by GTZ technical staff in the BOU. The separation is virtually invisible to stakeholders not directly involved in program management.

All three partners are satisfied with this successful collaboration. Lessons learned include:

- Maintaining distinct funding sources for project activities has increased the cost of monitoring and reporting. A basket approach to funding might be preferable so that there is a single project budget financed by multiple sources.
- Partners must understand their role from the beginning: silent partner, equal partner or lead partner.
- Partners should negotiate with the decision-making parties to any agreement so it is clear when each partner's approval or consultation is required.
- The funding cycles of the partners need to be addressed so that the project is prepared for the possibility that one partner's funding may not be renewed.

The Substance Factor (What Is the Issue?)

- ***Clear goal.*** Issues get more attention if they have a clearly defined outcome, desired by all involved. In such circumstances, even those stakeholders with limited staff make it a priority to get involved (as opposed to the case of meetings and events that more generally address collaboration and exchange). The way that all stakeholders galvanized the drafting and passage of the MDI Act is a striking example.
- ***Shared interest.*** Not surprisingly, collaboration is easiest when the benefits or outcomes are widely shared. With respect to the joint donor reporting tool (the performance monitoring tool) that was adopted by all donors to receive regular reports from their MFI partners, all stakeholders stood to benefit from a reduced administrative burden, consistent reporting, and increased transparency.
- ***Good understanding of concepts and priorities.*** Developing a shared interest in an issue results from stakeholders' understanding of the concepts and priorities. Collaboration usually begins with education of stakeholders on this issue, often by the champion(s).
- ***Pro-active approach.*** In the Ugandan context, stakeholder collaboration appears more successful when initiated by interested stakeholders who seek to move forward a specific idea or vision. Collaborative efforts that are perceived as defensive, i.e., to stop an action, are more likely to fragment collaboration and lead to discord. An example is the MOP, originally designed to counter a presidential statement rather than to implement a shared vision. Champions play a role in setting either a proactive or reactive tone to the conversation.

The Process Factor (How Do We Work It Out?)

- ***Some structure.*** Informal contacts are vital to the development of ideas and maintaining the momentum of collaborative efforts, but some minimal structure for collaboration is necessary to get things done. MFIs individually could not have engaged with the other stakeholders as efficiently and effectively as they did via the representation of AMFIU.
- ***Open mechanism.*** If representatives of all stakeholder groups are present, it is more likely the collaboration will result in a sense of ownership. "Donor-only" or "government-only" discussions are appropriate for a number of issues, but often result in misunderstanding or miscommunication by other stakeholders who may be affected by the decisions of such discussions.
- ***Government access.*** Uganda is remarkable for the level of government accessibility to MFIs and donor agencies and vice versa. If a mechanism

provides access to government, it helps to solidify the government's commitment to the industry.

- ***Recognized authority.*** If the mechanism has some recognized political, financial, intellectual or moral authority, it is more likely to succeed. This is also true of the leader or champion of the collaborative mechanism. The Ministry of Finance's chairmanship of the MFF certainly gave the forum an official standing.
- ***Transparency*.** Collaboration mechanisms must have some clearly understood rules of operation and decision making Even if the rule is "no rules," it is important for stakeholders to define how a group will make decisions, monitor progress, and hold each other accountable for results.

Three Collaborative Mechanisms

This report focuses on three examples of collaboration: one that is chaired by the government (MFF), another that is run by the MFIs (AMFIU), and a third that is exclusively for donors (PSDG and Quarterly Coordination Council).

Microfinance Forum (MFF). The MFF has become the most important collaborative mechanism in Uganda. The body resulted from informal contacts among some of the donors, larger MFIs, and the Ministry of Finance. It holds fairly regular meetings and acts as an information clearinghouse and, to some degree, a gatekeeper.[18] It has grown and developed several committees (working groups) to deal with specific issues, including finance, capacity building, lobbying, and most recently consumer affairs. With the exception of the lobbying committee, these groups meet fairly regularly to develop proposals and policies for the sector.

Association of Microfinance Institutions in Uganda (AMFIU). Since 2001, AMFIU has grown to be a respected national MFI network and an important contributor to stakeholder collaboration. Stakeholders attribute much of AMFIU's recent successes to the credibility, talent, and personalities of its chairperson and director.

Private Sector Donor Group (PSDG) and the Quarterly Coordination Council (QCC). Donor collaboration takes place at two levels. The PSDG is a working sub-group of the Ugandan Donors Group, staffed by donor representatives responsible for private sector development, including microfinance. The group generally meets monthly to discuss both policy and strategic issues, as well as to exchange information and discuss collaborative efforts. At the project level, the QCC brings together donor and project staff who are directly involved in the implementation of microfinance projects to discuss issues at the MFI level.

Case Study of Two Collaborative Efforts: MDI Act versus MOP

Two instances of collaboration are striking for their importance and the high level of interest that they generated among all stakeholders: (1) the development and passage of the MDI Act in 2003, and (2) the development of the Microfinance Outreach Plan, which is still in the early stages of implementation. It is interesting to note that across all three factors that contribute to effective collaboration (people, substance, and process), the collaboration for the MDI Act exhibited more positive aspects than did the MOP.[19] Stakeholders were eager to claim their part of the success of the passage of the MDI Act, whereas the MOP has often been surrounded by controversy and discord.

Box 10. AMFIU: A Snapshot

The vision of AMFIU is to be a strong and sustainable national network of all microfinance institutions in Uganda. The mission of AMFIU is to enhance the sustainable delivery of financial services by all microfinance institutions in Uganda. The objectives of AMFIU are:

1. To enhance collective action by MFIs and other stakeholders for a conducive policy and regulatory environment for microfinance in Uganda.
2. To develop and strengthen systems for information collection, analysis, and dissemination through databases, print, and electronic media.
3. To strengthen the capacity of MFIs to deliver appropriate and sustainable microfinance services to the economically active poor through coordination and organization of lateral learning workshops, thematic debates, exchange visits, and linkages with other organizations.
4. To develop and operationalize a performance monitoring system for MFIs that will set standards and increase professionalism in the industry.
5. To strengthen AMFIU's secretariat in providing the required and mandated services to its members and the microfinance industry at large

[18] Meeting frequency has been more varied recently, particularly since the passage of the MDI Act.

[19] Representatives of all three stakeholder groups were invited to a focus group where they discussed both of these collaborative efforts and were asked to compare and contrast the two.

Table 2. A Comparison of Two Collaborative Efforts

	MDI Act	MOP
People Who?	• Practitioner initiated (the big MFIs) • GTZ, USAID/PRESTO, other donor agencies staffed by technical experts, World Bank as additional champion • MoFPED and BOU • AMFIU • Stakeholders made significant time and staff available to work on issue	• Donor developed (officially developed by MFF's apex subcommittee, but EU/SUFFICE and AfDB/RMSP lead the effort) • Key donors, IFAD and UNDP, without local technical representation • AMFIU participated, but did not lead • Ministry of Finance acted as facilitator for MFF to meet with government of Uganda • Perception of little time to react
Substance What?	• Clearly defined goal of new legislation and regulation • Shared interest to increase sound provision of financial services • Did not require significant funds	• Broad goal of outreach • Multiple issues addressed, combined into one plan • MFIs initially unclear on benefits • Some donors mistrustful of government of Uganda implementation • Involved significant public and donor funds
Process How?	• Proactive effort • Much education of all stakeholders on policy and regulation of MFIs • BOU had authority to draft • Practitioners lobbied the government directly and through AMFIU for passage • MFF provided forum for discussion and feedback • Access and involvement of government • Donors funded all efforts	• Reactive: effort largely arose in response to president's speech • Very small group of apex subcommittee members drafted it all • MFF had no formal standing, although the Ministry of Finance lent its support • Individual MFIs consulted, but decision makers not part of drafting • Primary focus on winning internal government buy-in from president, prime minister, other ministers • Unclear process for addressing concerns and comments

Collaborative Mechanisms: Successes

This section highlights the successes of the three collaborative mechanisms in table 3. The three mechanisms have provided effective channels to promote microfinance good practices, define priorities for new micro-finance legislation, clarify the role of government in microfinance, and make available information and training on a range of issues affecting microfinance in Uganda.

Table 3. Successes of Three Key Collaborative Mechanisms: MFF, AMFIU, PSDG/QCC

	Main Characteristics	Successes
MFF	• ***Access***: Provides MFIs and donor projects with direct access to the Ministry of Finance and other stakeholders • ***Authority***: Through its chairperson, a senior minister of finance, decisions of the MFF often become the decisions of the minister, even though the MFF has no formal mandate to make decisions • ***Members***: Open to all who wish to attend, but does not require attendance • ***Expertise***: Chairpersons and active members of most subcommittees are high caliber and often recognized experts (and champions) in the field, both local and expatriate • ***Frequency:*** Meetings are held fairly regularly • ***Information***: Provides most stakeholders with official information and orients newcomers to the sector. Preserves the continuity of initiatives, many of which have outlasted their original champions • ***Flexibility***: Mechanism is not rigidly defined and allows for new issues to be addressed as they arise	• Serves as key forum for all stake-holders to address • Provides a one-stop shop of "who is doing what," so all can be informed of what is happening and avoid duplication of efforts • Acts as guardian of "good practices" for the industry, e.g., the MFF held long discussions with IFAD about a planned rural finance project; these funds ultimately were redirected to support the MOP • Creates subcommittees to deal with specific issues in more depth • Played key role in advising the Ministry of Finance and BOU on the policy statement for microfinance and the MDI Act—all stakeholders coordinated their technical inputs, consultation and lobbying efforts via the MFF
AMFIU	• ***Access***: Represents practitioners to parliament, the president, and the Ministry of Finance • ***Authority***: Recognized as voice of all practitioners • ***Activities***: Activities are clearly linked to an articulated mission and objectives • ***Members***: Nearly 100 members, which include the largest MFIs, small MFIs, a bank, and SACCOs. Members pay dues and are therefore vocal in requiring results • ***Oversight:*** Board is active and committed to overseeing AMFIU, plans for its future • ***Expertise***: Professional, well-respected manager • ***Flexibility***: Stable funding, including coverage of operational expenses by a single donor,* not forced to pay overhead by taking on projects, so it can choose projects freely	• Lobbies effectively on key microfinance issues, chairs the lobbying committee of the MFF • Trains MFIs on performance monitoring • Assists the MOP coordinating unit in developing district microfinance committees • Works with Ugandan government to propose the best regulatory solution for tier 4 institutions • Takes a pragmatic approach and opts out of certain activities for which it is not well-suited, e.g., management of a credit bureau and direct provision of training services
PSDG/ QCC	• ***Access***: Direct access to government counterparts, particularly Ministry of Finance • ***Authority***: Donors provide over 50 % of the Ugandan government's budgetary resources • ***Presence of Decision Makers:*** Representatives often have the power to make or guide decisions on policy and funding • ***Instruments:*** Diverse and appropriate • ***Scope:*** Covers private sector development topics • ***Membership***: Donors only , closed to others	• Promotes good practice in project design and implementation • Brokers deals between donors to basket fund or jointly fund projects (e.g., GTZ and Sida collaboration) • Discusses respective strengths of donors and implications of how to support projects • Monitors donor-funded institutions to prevent double funding and ensure compliance with donor agreements

HIVOS has provided AMFIU with approximately US $150,000 for a three-year period covering the duration of its current business plan; GTZ has also provided €500,000; and SPEED, SUFFICE, and other donors have provided funding for specific initiatives and projects.

Collaborative Mechanisms: Missed Opportunities

This section highlights the missed opportunities of the three collaborative mechanisms in table 4 below. Notwithstanding the successes achieved via the mechanisms, they have fallen short in several areas, most particularly with regard to transparency and accountability. Also, incentives for participating in the collaborative mechanisms could be made clearer and information flows improved.

Table 4.
Missed Opportunities of Three Key Collaborative Mechanisms: MFF, AMFIU, PSDG/QCC

	Missed Opportunities
MFF	• Insufficient clarity on the mandate and role of subcommittees in technical advice and decision making • No process for officially approving decisions leads to perception among a minority of stakeholders that the MFF is used for "rubber stamp" approval, as well as confusion about what decisions have been "consulted" • Few checks and balances on subcommittee chairpersons—they have significant control over the process and outcome of the work assigned to them • Unfunded mandates are not uncommon, e.g., Uganda Capacity Building Programme, was designed by the MFF but was unfunded until it was incorporated into the MOP strategy
AMFIU	• Not much success in promoting standardization • Incomplete development and implementation of the performance monitoring system , a data collection tool and database for MFI financial data • Unresolved conflict of interest between promoting member interests and monitoring member activities
PSDG	• Lack of microfinance expertise of participants; they occasionally do not have a good understanding of issues at hand or the projects funded by their agencies • Sporadic contact with other stakeholder groups, especially practitioners, due to closed membership • Insufficient transparency (whether perceived or real) about decisions taken; poor or no communication to others • Serious reservations about the MOP were not necessarily formulated with a full understanding of the motivations of the Ministry of Finance.
QCC	• Potential of QCC is underutilized due to poor attendance of key donors and project managers • Perception by leading donors of others' unwillingness to share information openly

Recommendations

The following recommendations build on the remarkable collaborative successes in Uganda to date.

1. Place accountability squarely on the collaborative agenda.

- ***Consider an annual peer review process.*** There is a great deal of "buzz" about the successes of microfinance in Uganda. Clearly, the sector has benefited from significant amounts of public money. To ensure both that funds are maximized and the growth of the past five years is magnified, the MFF could provide a forum for each government and donor agency to present its contribution to the development of microfinance in Uganda, as well as it future plans. Stakeholders might also consider using an annual peer review process to evaluate their strengths and weaknesses.

2. Clarify the role of the MFF.

- ***Decide on primary function and mandate of the subcommittees***. The MFF must clarify the role of the subcommittees in providing technical advice and decision-making for the industry. If the subcommittees have a decision making role, guidelines as to how decisions are made and how recommendations are presented to the Ministry of Finance are needed.
- ***Establish a regular meeting schedule and a process for putting items on the agenda***. To ensure that the MFF can serve as a useful collaborative mechanism for all stakeholders on all issues, a transparent process for determining meeting schedules and agendas should be developed. Otherwise, the MFF is vulnerable to being bypassed when contentious issues arise, such as the MOP.
- ***Nominate an ombudsman.*** The MFF should nominate an ombudsman with the power to address the concerns of members who feel that either the consultative or decision-making process is not consensual or transparent.
- ***Ensure appropriate funding.*** Prior to mandating any activity to be undertaken by a member of the MFF, the forum should determine and confirm the availability of appropriate funding. Mandating activities that are never implemented, such as the Uganda Microfinance Capacity Building Framework, undermines the credibility of the MFF and disperses the efforts of individual members.

3. **Incorporate collaboration into all leading stakeholder job descriptions.**

- ***Integrate collaboration as a task in all stakeholder job descriptions.*** Collaboration should be included in the job descriptions of all stakeholders, especially donor staff, selected government representatives, and practitioner representatives such as AMFIU. Although no fixed norm can be pre-determined for all, 10 percent of an individual's time would seem appropriate as an average. In the case of donors, leading agencies with the most technical capacity would probably require more time. Annual performance evaluations should also take into account the staff contribution to enhancing collaboration. Because both informal and formal networking are so important in Ugandan microfinance, it cannot be left to chance that stakeholder representatives will have the time and incentive to collaborate.

4. **Find creative ways to engage absentee donors in the key collaborative mechanisms.**

- ***Designate local representatives.*** Centralized donor agencies without a local presence or sufficient staff should designate a representative to participate in collaborative mechanisms on their behalf.
- ***Meet regularly with representatives of key collaborative mechanisms.*** When staff from donors with no or little field presence travel to Uganda, they should make a special effort to meet with a wide cross section of relevant stakeholders, including representatives of the main stakeholder collaborative mechanisms.
- ***Plan for channels of communication.*** The MFF ombudsman should promptly bring concerns and/or complaints about absentee donors to an agreed person in headquarters. With the authority of the Ministry of Finance, the ombudsman should address issues raised at the MFF about the quality of their programs. Such a system may also be considered for donors with representation in the country.

VI. THE DONOR ROLE AND THE USE OF SUBSIDIES

The sheer amount of international development assistance invested in the sector cannot be ignored in a discussion of the success factors of Ugandan microfinance. Knowledge of other countries indicates, however, that money alone is not enough. Uganda is a fortunate case where large amounts of money came with dedicated people with the right technical skills, a clear vision, and the foresight to work together to achieve greater impact.

Yet to meet the promise of a fully developed microfinance market that is integrated into the financial system, donors (and, indeed, all stakeholders) cannot rest on their laurels. Especially at a time when grant funding is less available and the commercial sector is taking a keen interest in microfinance, donors must carefully define their role and priorities in Ugandan microfinance.

Successes

Donor money plays a big role in Ugandan microfinance. The top donors (DFID, USAID, EU, and GTZ/KfW) to Uganda in the past four years are also the top microfinance donors, making them deeply invested in the success of microfinance as a part of the country's overall development. More than US $40 million in international assistance has been invested in the sector from 1999–2003, including nearly US $20 million in direct support to MFIs, which has been one of the reasons behind the fast growth of the sector.

Technical oversight accompanied donor money. From 1999–2003, most of the money flowing into the sector was passed through well-designed donor projects staffed by specialists, both local and international. As a result, Uganda has a strong set of top-tier MFIs with the potential to become regulated institutions. When large donors without on-site technical managers wanted to enter the market, specialists, other stakeholders worked diligently to build in adequate technical oversight of their funds. When DFID's Financial Sector Deepening Unit and MOP saw SPEED had a comparative advantage in managing the transformation of MFIs to MDIs, they decided to ask SPEED to manage their transformation funding.

Donor champions (the "connectors") were particularly effective behind the scenes. Donor champions with credibility across all stakeholder groups (often representing strategic donors) have been particularly effective in promoting good practice informally. These champions can be best described as "connectors." Few and far between, they are persons who possess both excellent technical skills and the right blend of persuasion and negotiation skills. They move easily from one stakeholder group to another and develop superb personal connections with government officials, MFIs, and other donors to discuss problems and good practice solutions. These connectors have taken on responsibilities well beyond their own duties. They act as chairpersons of MFF subcommittees, leaders of ad-hoc working groups, and sponsors of numerous unofficial educational and networking events.

Donors kept practitioners at the forefront. Although several Ugandan stakeholders confirmed that "behind most things in microfinance, you will find a donor," donors have sought to be responsive to the expressed needs of MFIs and to keep practitioners at the forefront of all major initiatives. MFIs in Uganda have had a fairly powerful voice. In the 1990s, many of the major MFIs benefited from the presence of onsite international specialists, who facilitated interaction with donor representatives. Today, almost no MFIs have onsite expatriate managers, but their level of interaction with donors remains high. In part, this is due to AMFIU. Whereas the MFIs created AMFIU, donor financial and political support made AMFIU a strong spokesperson for MFIs. Donors have worked closely with AMFIU and supported it to become a vocal participant in key activities, such as the MDI Act and the more recent tier 4 discussions.

Missed Opportunities

Inadequate application of performance-based mechanisms for donor subsidies. Overall, there is a consensus that donors in Uganda have done well, perhaps better, than in many other countries. But there is also a sense that donors could have achieved more with the investments that were made. Several close observers of donors in Uganda noted that many were not focused on ensuring the maximum impact of their funds. Specifically, some donors put money into MFIs that will never be sustainable and are not contributing to either outreach or innovation. Other donors gave grants to MFIs, instead of helping them get access to commercial financing. As donors continue to be attracted to Uganda, it is now necessary to ask how donor funding—like the recently approved US $25 million loan from IFAD to the government—can move

beyond a "do no harm" approach to complementing domestic capital flows.

Insufficiently broad vision of financial system development. As noted in chapter III, all stakeholders have a narrow vision of microfinance. With regard to donor support, this narrow vision translated into programmes and projects that did not pay enough attention to developing the industry infrastructure ("meso level"), which is vital to a flourishing microfinance sector. Also, while donors invested a lot at the policy level, little has been done to protect the savings held in SACCOs or to help strengthen their systems for accountability.

Lack of engagement with the outreach plan. The microfinance outreach plan has been the source of much frustration and disappointment to much of the donor community. Many donors felt sidelined during the development of the MOP and felt that the precedent of close collaboration and good practice microfinance, which has been central to Ugandan microfinance, had been abandoned. Rather than seek to understand the government of Uganda's position and come to a workable (even if second best) solution, many donors remained entrenched in their positions. As a result, their ability to negotiate effectively with the designers of the outreach plan was greatly reduced.

Non-existent agricultural finance strategy. The strong focus on MFIs has obscured the much larger challenge of developing a financial service market appropriate for agriculture. Since the Program for the Modernization of Agriculture delegated responsibility for rural finance to the apex subcommittee of the MFF, there has been too much emphasis on the potential of MDIs to serve this market. The mushrooming number of cooperatives reflects the political imperative to work with farmers, but also the failure to address the significant needs of rural communities. Even now, the focus on finding a solution to tier 4 regulation is taking attention away from finding a solution to the development of appropriate services and delivery mechanisms—something regulation will not solve.

Recommendations to Improve Donor Effectiveness

1. **Focus on comparative advantage and improve transparency of decision-making on funding to maximize the return of investment (social and financial).**
   - ***Work only in the areas where the donor has a comparative advantage in skills, history or financing.*** Not every donor should or can intervene at every level of the financial system. Donors should assess their individual strengths, perhaps using the five core elements of donor effectiveness that emerged from the 17 microfinance donor peer reviews, to understand where they can add value.[20] For example, a donor with limited technical capacity and grant funding is ill-suited to provide institution-building support. Donors should align their operations to their respective comparative advantage.
   - ***Be transparent about funding decisions*** Given the interrelated nature of the industry, stakeholders should have input on a donor's funding decision if it can lead to significant market distortion. Donors should be able to justify their support of one MFI to its competitors.
   - ***Use performance-based funding and benchmark MFI partners against regional best practices.***
   - ***Pair big money with strong expertise.*** The newest money flowing into the sector will be from IFAD and AfDB. IFAD has no local presence in Uganda, and AfDB has a single representative at present: neither has strong technical backstopping capacity. There is already concern among donors and MFIs that the mechanisms that manage these funds (MOP and Microfinance Support Centre, Ltd.) are not fully appropriate or do not have sufficient technical oversight. Donors with strong technical skills should use their expertise to increase the potential positive impact of these mechanisms. Just as the World Bank has been selected to oversee IFAD funds, other donors could provide technical experts for specific projects or windows.

2. **Invest in developing local capacity.**
   - ***Prioritize building the capacity of Ugandans.*** Ugandan microfinance has benefited greatly from the access to top-notch microfinance specialists, both long-term advisors and short-term consultants, including those who have provided training and technical assistance. Yet, donor staff rotate frequently, and the cost of flying in experts to deliver one-off technical assistance is high. The very sustainability of microfinance in Uganda depends on the availability of Ugandans with the skills and experience to work in different stakeholder groups. While such people exist, they are in extremely high demand, and many more are

[20] Helms and Latortue, "Elements of Donor Effectiveness in Microfinance: Policy Implications."

needed to meet the needs of the dynamic and evolving microfinance sector.

3. Engage positively with the outreach plan, while recognizing its risks.

- ***Collaborate to frame the role of the microfinance outreach plan in the microfinance sector***. The risks of the MOP are many, including unclear accountability for results, the stifling of innovation through a standardized training curriculum, and the possibility of inappropriate government involvement. The financial extension workers in the MOP exemplify these risks: they have ambiguous job descriptions and are accountable to several different agencies responsible for recruitment, training, housing, remuneration, and supervision. To mitigate these risks, donors—especially those with technical skills—should move beyond the debates linked to the MOP's genesis and development, and focus on defining clear boundaries that can frame its contribution to the sector. Given the numerous collaborative mechanisms in Uganda, if donors choose to constructively engage with the MOP, particularly through the MFF subcommittees, the time is still ripe to integrate it in a defined and positive manner into the overall microfinance sector.

  As noted in the first recommendation above, donors can increase their effectiveness in building a pro-poor financial system in Uganda by focusing on their respective comparative advantage. Using the analysis in this report and earlier work done by CGAP, table 5 shows steps that donors can follow to identify their comparative advantage and then take the most effective action. Please note that this table is not comprehensive; it is simply one tool that donors can use to increase their effectiveness in building a pro-poor financial system.

Some examples of how table 5 might be used in the future include using the characteristics of donors active in Uganda to identify their respective comparative advantages, as shown in the following examples:

- The microfinance outreach plan coordinating unit is, in one sense, a large donor with long-term vision and political clout. It has a comparative advantage in making SACCOs safe places for poor people to save. It has already organized a working group to respond to Parliament's mandate for tier 4 regulation and has the opportunity to go much further.

- The Financial Sector Deepening Unit of DFID has private sector credibility and specialist staff, long-term vision, and a range of instruments. It has a competitive advantage in building the infrastructure of the financial sector, especially in leading the discussion about what it means to develop a pro-poor financial system.

- The Stromme Foundation has high tolerance for risk, combined with grant instruments and a focus on poverty. If they teamed with a donor with private sector credibility and specialist staff, they would have a real competitive advantage in supporting the development of better financial products for the rural poor.

Table 5. Donor Action for Building a Pro-poor Financial System in Uganda

	1. Key gaps in developing a pro-poor financial system in Uganda	2. Who should fill these gaps?	3. Characteristics of donors best placed to support this gap	4. Recommended action for donors (including the MOP)
Financial intermediaries (micro)	▪ Insufficient institutional capacity to reach large numbers of poor people, particularly in rural areas ▪ Limited products for rural poor ▪ Lack of insurance products ▪ Under-representation of commercial banks in collaborative efforts ▪ Limited use of data-stream/wireless technology in rural areas ▪ Unsound and unsafe SACCOs	▪ MFIs, MDIs, and banks ▪ Insurance companies ▪ MFIs with donor funding for research and development ▪ AMFIU ▪ Commissioner for co-ops	▪ Private sector credibility and specialist staff in Kampala ▪ Tolerance for some failure (pushing new frontiers is risky) ▪ Appropriate instruments including substantial grants for research and development, capacity building; and equity for MFIs	▪ Implement performance-based financing with real consequences ▪ Require MFIs to reach sustainability and graduate to commercial funds ▪ Build technical capacity of SACCOs ▪ Train all SACCOS in the new standard accounting/reporting system developed by WOCCU ▪ Invest in research and development for information systems, new products and wireless technology
Financial infrastructure (meso)	▪ Lack of vision for infrastructure needed for sector development ▪ Inadequate MFI information systems for fast growth ▪ Few auditors specialized in microfinance ▪ Minimal training facilities to build local capacity ▪ No credit reference service (CRS)	▪ AMFIU ▪ MFIs/AMFIU with donor support for research and development ▪ Donors with MOP	▪ Patient, long-term vision ▪ Private sector credibility and specialist staff in Kampala ▪ Grant instruments that allow for five-year horizon for results	▪ Lead debate on building the financial system (including leasing) ▪ Collaborate to fund research and development on MIS ▪ Build on initial CGAP/UICA auditor training in microfinance standards ▪ Build market for local training services, stimulate private provision of these services (e.g., universities) ▪ Once CRS established, train tier 4 institutions to report
Policy (macro)	▪ Inadequate regulation and supervision of SACCOS ▪ No agreement on role of financial services in poverty alleviation ▪ Uncertain role of MFF in decision making	▪ Commissioner for co-ops, BOU, UCA, UCSCU ▪ AMFIU ▪ MoFPED and MOP	▪ Decision makers and specialist staff in Kampala ▪ Large donors with long-term vision and political clout ▪ Grant instruments to fund small, focused technical assistance (e.g., workshops)	▪ Lead dialogue on financial system expansion ▪ Fund training of co-ops, apex bodies, and BOU on SACCO regulation

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Annex 2: Ugandan MFI and Donor Survey Results

Effectiveness of Microfinance Stakeholders in Uganda *
(in percentages, with 100% the highest rating)

Key elements of effectiveness	Stakeholder: MFIs	Government	Projects	Donors	Average for all stakeholders
Strategic clarity	85%	77%	77%	82%	**80%**
Staff capacity	65%	57%	75%	69%	**67%**
Appropriate instruments	85%	69%	72%	71%	**74%**
Relevant knowledge generation	85%	67%	77%	71%	**75%**
Accountability	74%	62%	73%	77%	**72%**
Cross-cutting collaboration	90%	81%	78%	76%	**81%**
Average effectiveness rating	**81%**	**69%**	**75%**	**75%**	**75%**

* As rated by Ugandan MFIs in 2003; compilation of responses from 13 individual Ugandan MFIs.

Survey Results: Estimated Donor Support to Microfinance, 1999- 2003 *

Type of support	Description	Support (in US $ millions) 2003	2002	2001	2000	1999	Total support (US $ millions)
Total support for Uganda microfinance	From the number above, the amount dedicated to the microfinance sector, both through standalone projects or components. The number should be the amount disbursed and include support from any part of the donor agency (e.g., regional office or headquarters).	17.20	5.02	7.86	1.94	9.01	**41.03**
Direct grants and investments in MFIs	Total amount of grants or non-reimbursable investments that were given to MFIs, either by the donor or through a donor-funded project (e.g. SPEED, SUFFICE, etc).	5.24	3.09	0.66	1.29	8.52	**18.80**
Direct loans and guarantees for loans to MFIs	Total amount of loans made to MFIs by the donor or donor-funded project.	7.25	-	3.87	-	-	**11.13**

*Compilation of individual responses received in 2003 from the following donor agencies:
DANIDA, DFID, World Bank, GTZ, Sida, NORAD, EU, UNDP, AfDB,and USAID

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