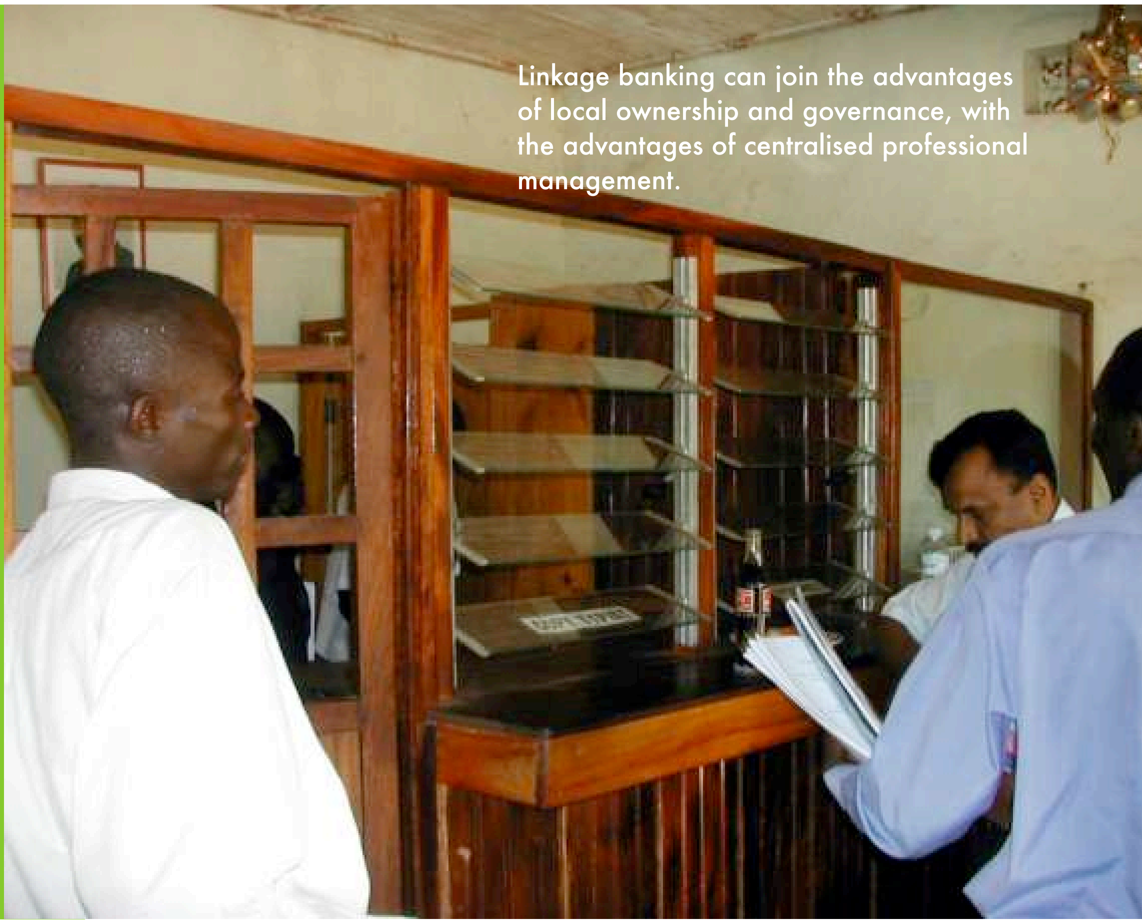
Linkage Banking



Linkage Banking can be Profitable for Banks and their Partners

Linkage banking is a business partnership between a regulated financial institution (bank, credit institution, or microfinance deposit-taking institution) and one or many independent, non-regulated institution(s), such as Savings and Credit Cooperatives (SACCOs) or credit-only MFIs. Unlike the case of mergers and acquisitions, linked institutions remain distinct, independent firms. The linkage may include other partners, such as an NGO or a service company as well. The relationship between the parties should be formal, mutually beneficial, long-term, creative and evolving. Simple refinancing arrangements, where the regulated institution provides loan capital to the non-regulated institution, may be the first step in establishing a linkage banking arrangement, but is not in and of itself typically thought of as *linkage banking*.

Not surprisingly, linkage banking is creative and there is no unique model to respect. Linkage banking relationships develop over time, with an increasing level of inter-relationship between the parties. The figure on the right places some of the common components of linkage banking on a continuum. However, not everyone will follow this same progression, nor will every relationship reach the point of equity stakes (with the regulated institution holding shares in the non-regulated one, or vice versa).

Start Small – and Enrich the Linkages, as Confidence Grows

- Equity Stake
- Agency Relationship
- Co-Branding
- Back Office Cooperation
- Capacity Building
- Financial Services

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Linkage Banking Support

The following donors and apex organisations support Linkage Banking arrangements in Uganda:

DFID's Financial Sector Deepening Project (FSDU) - FSDU's Consolidation Challenge Fund cofunds (on an 80%-20% basis) studies by institutions considering linkages, and offers informational "Consolidation Road Shows" to groups of MFIs. Contact: CCF@FSDU.or.ug

Microfinance Outreach Plan's Matching Grant for Capacity Building (MCAP) will support linkage of upper and lower tier financial institutions to increase the number of microfinance clients served by the institutions in rural areas. Contact: outreachplan@utlonline.co.ug

Rural SPEED - USAID's Rural Savings Promotion & Enhancement of Enterprise Development Project (Rural SPEED) facilitates linkage banking by increasing rural non-regulated financial institutions' viability as linkage banking partners through capacity building and strategic grants (on a cost share basis). Assistance focuses on financial management, governance and strengthening information systems. Contact: linkages@speeduganda.org

SNV's Linkage Banking programme brings together microfinance organisations (MFOs), commercial banks, Central Banks, donors, fund managers, and insurance companies. SNV helps small MFOs to improve and expand on their delivery systems, and to link up with other financial institutions with the technology and mission to serve complementary markets. Contact: snvuganda@snvworld.org

Uganda Cooperative Alliance (UCA) encourages SACCOs to enter into linkage banking arrangements with other financial institutions to improve their capacity to provide services to their members. Contact: General Secretary, ucainfocen@uca.co.ug

Uganda Cooperative Savings & Credit Union Ltd (UCSCU) - In order to provide better quality services for the members of its affiliated core SACCOs, UCSCU encourages them to develop linkage banking arrangements. Contact: uscsu@africaonline.co.ug

Common components of Linkage Banking include:

Financial Services: Often the first step in establishing a linkage banking partnership involves use of the financial services of the bank by the MFI or its clients. Frequently, the two parties negotiate more favorable terms for the MFI, in exchange for the amount of business that the bank will gain. Both partners can use this arrangement to establish mutual trust and confidence. For example, a bank may offer <u>loan capital</u> to a partner MFI, and at the same time manage any excess funds that the MFI may have. Often in Uganda, the clients of an MFI are encouraged to open <u>savings accounts</u> at branches of the bank, and use their passbooks as evidence when borrowing from the MFI. This is an easy early step in building linkages. Finally, by using the MFI's network, the bank can increase the service points for its <u>money transfer</u> business. Typically a non-regulated institution cannot be a primary agent for an international remittance service (e.g. Western Union, MoneyGram), but it can be appointed a sub-agent of a bank.

Capacity building: The regulated institution can offer capacity building to its partners in the form of training, apprenticeships, and employee exchanges. These can be in such areas as accounting, internal controls and audit, treasury management, customer service, and human resource management. The MFI benefits from low- or no-cost training, while the bank is building the institutional capacity of its partner, hence lowering its risk. Services that the bank offers will be low cost to the bank, but of high value to the partners.

Back Office Coordination: As the relationship becomes more advanced, the bank may take on some of the MFI's back-office tasks, such as IT or accounting, on a fee basis. This saves the MFI from making expensive investments in these areas, while allowing it to benefit from the bank's expertise and scale. The bank can leverage its existing capabilities to gain an additional source of fee income.

Co-branding of savings and electronic banking products: Once sufficient trust has been built, the bank may allow the MFI to offer some of its products on a co-branded basis. The MFI benefits from a wider product offering (critical in times of increasing competition), while the bank gets a wider distribution network without adding "bricks and mortar". Also, the bank's brand can penetrate into areas where future customers live.

Agency relationship: Depending on regulatory constraints, the MFI may act as an agent of the bank, offering its services on an agency basis. This is one step beyond co-branding, as customers may not even realise the difference between an MFI-managed product and a bank-managed product.

Equity stake: To ensure continuity and a degree of control, the bank may wish to take an equity stake in the MFI. This can give the bank a seat at the table for all major decisions, and ensure that the goals of the partners continue to be in harmony. Alternatively, but less likely, the MFI might take part ownership in the bank, to ensure that it remains the bank's preferred partner.

While there are many benefits to a successful linkage banking partnership, the partners need to have confidence in each other. The bank is taking on reputation risk, particularly if the MFI is offering products on its behalf. Likewise, the MFI is taking on the risk that the bank will find a different partner, leaving it without valuable services on which it has come to depend. Also, the bank could eventually enter into direct competition with the MFI after using the partnership to learn its business. Therefore, it is essential that the partners trust each other, support each other's social missions and business objectives, and continuously negotiate new ways to make the relationship valuable to both parties.