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Microfinance in Uganda

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Table of Contents

Abbreviations

ADB	African Development Bank
ADC	Austrian Development Cooperation
AMFIU	Association of Micro Enterprise Finance Institutions of Uganda
BoU	bank of Uganda
CBO	Community Based Organization
CERUDEB	commercial bank providing microfinance services
CMA	Postbank and Capital Markets Authority as main partners
CMF-PRESTO	Rural Microfinance Support Program (formerly PAP)
CML	a privately owned microfinance institution
DREPS	District Resource Endowment Profile Survey
ERP	Economic Recovery Programme
EU	European Union
FSA	Financial Service Associations
FSD	Financial System Development Project
GoU	Government of Uganda
GTZ	Gessellschaft für Technische Zusammenarbeit
IMF	International Monetary Fund

IPC	International Project Consult
MCC	Microfinance Competence Center
MDIs	Microfinance Deposit-taking Institutions
MFIs	microfinance industry in Africa. Some
MFPED	Ministry of Finance, Planning and Economic Development
MSEs	micro and small enterprises .
NGO	non-governmental organisation
PAP	Poverty Alleviation Project
PDSP	Private Sector Development Program
PEAP	Poverty Eradication Action Plan
PMA	Plan for Modernization of Agriculture .
PSD/CB	Private Sector Development/Capacity Building
PSDP	Private Sector Development Program
PSDSG	Private Sector Donor Sub-Group
RFSC	Rural Financial Services Component
RMSP	Rural Microfinance Support Project
ROSCAs	Rotating Savings and Credit Associations
SACCOs	Savings and Credit Associations
SPEED	Support to Private Enterprise Expansion and Development

SUFFICE	Support for Feasible Financial Institutions and Capacity Building Efforts Programme
UCA	Uganda Cooperative Alliance
UCSCU	Uganda Cooperative Savings and Credit Union .
UIB	Uganda Institute of Bankers
UMU	Uganda Microfinance Union
UNDP	United Nations Development Program
USE	Uganda Security Exchange ,
UWFT	Uganda's Women Finance Trust
WOCCU	World Council of Credit Unions

Part I:
Microfinance in Uganda
Sector Overview

1 Introduction

1.1 Background to the Study

This overview presents part of the findings of the evaluation of microfinance as an instrument of the Austrian Development Cooperation (ADC) in Uganda. The evaluation has been conducted by Lechner and Reiter Institute of Social Research, Vienna, and commissioned by the Austrian Ministry of Foreign Affairs, Department for Development Cooperation. The evaluation team consisted of the Walter Reiter (team leader), Andy Carlton, Hannes Manndorff and Andrew Obara. Elisabeth Rhyne acted as additional advisor and was involved in the preparation of the evaluation and the analysis of the findings.

The evaluation of microfinance as an instrument of the Austrian Development Cooperation has comprised three stages: The first stage consisted of the assessment of Austria's microfinance interventions in Zimbabwe and was carried out in 1999. During the second stage, ADC's microfinance strategies and their application in Mozambique and Namibia were evaluated in early 2000. The assessment of microfinance as an instrument of the Austrian Development Cooperation in Uganda represents the final stage of the evaluation cycle.

While in the first two stages the evaluations have focused on the analysis of the institutions supported by Austria and the assessment of ADC's policies and structures, the focus of the final stage has shifted to the analysis of the environmental conditions of microfinance in Uganda and how these conditions impact on the performance of the microfinance industry and the institutions supported by Austria. This overview is part of the output of the evaluation and is open to a wider public than the assessment of ADC's microfinance policies and strategies in Uganda.

1.2 Microfinance and its context

Interest in microfinance has soared in the recent decade and the instrument is now seen as one of the most promising tools to tackle poverty in the developing world. The fascination with microfinance derives from the fact that the provision of financial services can contribute to poverty reduction and pass the test of sustainability at the same time. For donors, microfinance is especially attractive as it can be delivered in an institutional and financially sustainable manner that permits them to withdraw after making relatively modest investments. However, microfinance has sometimes disappointed its supporters. Only few of the hundreds of microfinance programs inaugurated in the last decade have proven their sustainability. A growing body of evidence indicates that the instrument does not meet the high expectations initially placed on it in terms of client impact. Few microenterprises experience sustained growth, while a majority grow only a little or maintain their operations at a constant level. It is also unusual for credit to trigger a continuous increase in technical sophistication, output or employment. It is much more common for each of these variables to reach a plateau after one or two loans and remain in a steady state. As far as empowerment is concerned, microfinance services have shown little potential to thoroughly change existing inequalities in power relations or the role of women in society. (*Buckley* 1997; *Goetz* and *Gupta* 1996; *Hulme* and *Mosley* 1996; *Zaman* 1998).

However, empirical evidence shows that microfinance interventions have indeed the capacity to reduce poverty, contribute to food security, and change social relations for the better. Positive impacts have been detected at the enterprise as well as household level. Newer research indicates that participation in microfinance programs contributes to reduced vulnerability to economic risks. Microfinance services help the poor to diversifying their income sources, building up physical, human and social assets, focus on good money management, rebuild the household's base of income and assets after economic shocks have occurred and to smooth consumption (*Cohen* 1997; *Cohen* 1999; *Hulme* 1998, *Ito* 1998; *Sebstad* and *Chen* 1996). The impact assessment studies carried out in Uganda confirm positive affects of microfinance services on poverty reduction, as will be outlined in Chapter 4.2.

The success of a microfinance program – defined in terms of outreach, financial sustainability and/or socio-economic impact – depends on an interaction between the characteristics of the program itself (both its design and the way it is managed) and the context in which the program is implemented. The program environment can influence the success and impact of microfinance interventions in two distinct ways. First, socio-economic conditions may affect both the ability of clients to benefit from their loans and their capacity to repay. Second, the environment directly influences the operation of the program itself, for example by restricting the possible range of program activities or the terms on which services can be offered (*Snodgrass* 1997).

Uganda is generally seen as the country with the most vibrant and successful microfinance industry in Africa. Some MFIs have experienced strong growth and are now reaching a considerable number of clients, with three serving between 25.000 and 45.000 clients. A number of microfinance providers are close to financial sustainability or have already surpassed it. A series of impact studies conducted in Uganda in the past years have demonstrated that the provision of microfinance services contributes to reduced client vulnerability to economic risks, results in strengthening linkages of clients and their households to the agricultural sector, and enables clients to acquire valued skills.

Moreover, all observers agree that the success of microfinance in Uganda is closely linked to a number of enabling contextual factors specific to the country. The overview will therefore put emphasis on the description and analysis of the environment in which microfinance has developed over the past years. Thus, the objective of this paper is to contribute to the understanding of practitioners, policy makers and donors why microfinance has worked in Uganda and to draw some general conclusions in terms of external factors conducive and/or adverse to microfinance success.

2 Microfinance Context in Uganda

2.1 Overall Context

Uganda is a country with a remarkable development. Having emerged only ten years ago from a savage civil war with the economy in ruins and its international reputation destroyed by 25 years of dictatorship, it is now held up as one of the few African success stories of the last decade. On the economic front Uganda can boast some very impressive statistics. Over the past decade, the size of Uganda's economy has more than doubled with average growth rates of about 6% per annum. According to a recent survey, Uganda ranked second in

Sub-Saharan Africa in terms of GDP growth since 1990.During the same period, inflation was brought down from the dizzy heights of 240% pa in 1986/87 and has been less than 10 percent in the last five years. These achievements can largely be attributed the government's commitment to macroeconomic stability and the liberalization of the economy including the financial system (*MFPED* 2000; *Wright* et al 1999a).

However, a closer look at the situation of poverty in Uganda reveals a much less encouraging picture. Recent surveys conclude that between 1992 and today, Uganda has made little headway in the fight against poverty. Although different methodologies to gauge the extent of poverty in Uganda have been used, all analysts agree that at least 50% of the population lives below the poverty line. With an estimated US$ 290 GNP per capita Uganda still ranks amongst the twenty poorest countries in the world. While infant and maternity mortality remain very high, the fertility rate (6,7 children per woman) is one of the highest in the world. Economic liberalization has created a health care system that places the poor at a stark disadvantage. Life expectancy has fallen from 48 years in 1980 to 43 years in 1995, largely due to the impact of the AIDS epidemic. The disease takes a particularly heavy toll on the economy as it tends to rob society of its most productive members in their 30s and 40s (*MFPED* 2000; *Wright* et al 1999a).

Poverty is particularly prevalent in rural areas. With a share of nearly 50% of GDP, agriculture continues to dominate the Ugandan economy. Despite considerable productivity and output improvements for certain cash crops following the government's liberalization efforts, the rural economy is still largely dominated by low productivity subsistence production. While cash crop producers have benefited from liberalization, the large smallholder sector with average holdings of 1,6 hectares has seen very little real growth over the last decade due to lack of access to agricultural inputs and financial services, declining soil fertility, poor infrastructure, information and communications and the inability to access output markets. The poorest 20% of the population, who have no or very little involvement in the production of cash crops, may actually be worse off (*Wright* et al 1999a).

2.2 The Private Sector

The Government of Uganda wants the private sector to become the "engine of growth" of the Ugandan economy and a central pillar for increasing incomes, creating employment and consequently poverty reduction on a sustainable basis. The structural adjustment policies pursued in the 1990s triggered public sector retrenchments and severe cuts in government expenditure, which has resulted in the massive lay-off of government and parastatals employees. Modernization and restructuring of the private sector, including the banking industry, further contributed to huge job losses in the formal sector.

The under- and unemployed are increasingly forced to engage in a variety of economic activities to generate sufficient income. With men as the traditional income providers finding it ever more difficult to support their families, an increasing number of urban and peri-urban women enter the labor market to engage in various sectors ranging predominantly from petty trading to service provision and in some cases even manufacturing activities on a significant scale. The vast majority of these activities take place in the informal sector, which is estimated to account for about 80% of Kampala's current employment (*Wright* et al 1999a).

As a result of the prevalence of self-employment, the Ugandan private sector is dominated by micro and small enterprises (MSEs). According to several studies, around 80% of all firms fall under the MSE category and only about 10% can be classified as large firms with sales over US$ 500.000. Micro and small enterprises employ the greatest number of people. The micro enterprise sector is estimated to provide 90% of the total non-farm employment. However, the private sector is still constrained by various factors, including: inadequate provision of vital utilities, insufficient access to appropriate financial services, an inadequate commercial justice system, a high level of corruption, an insufficient tax administration, poor regulation and a weak institutional framework. As a result, private sector investment remains low, currently estimated at 13% of GDP, a good deal below the Sub-Saharan average of 20% of GDP (*MFPED* 2000; *Wong* 1999).

2.3 The Financial Sector

Prior to the launching of the Financial Sector Reform Program in 1993, Uganda's formal financial system was considered to be one of the least developed in sub-Saharan Africa. It was small in terms of value and volumes transacted and had only a very limited number of financial products for business entrepreneurs. The reform program included improving the effectiveness of monetary policy, the revision of financial legislation, strengthening the central bank and restructuring some insolvent banks. The financial system reform has shown some positive results. A number of private sector financial institutions promoted by both Ugandan and foreign investors have been licensed. This has increased competition and encouraged efficiency. Interest rates as well as the foreign exchange market have been liberalized, which has resulted in increased private and foreign capital inflows into the economy (*Bategeka* 1999; *MFPED* 1998).

However, the **formal financial system** has continued to be extremely fragile and underwent a serious crisis between 1997 and 1999. Five banks including the popular Cooperative Bank unexpectedly closed because of internal financial problems, partly due to inadequate prudential supervision, which led to gross violation of banks regulations. They fell short of capital requirements stemming from problems of poor loan documentation, inadequate provisioning, insufficient risk assessment capacity, internal fraud and other management weaknesses. Moreover, the partial privatization of the Uganda Commercial Bank, which resulted in the closing of many rural branches, left large areas of the country without any formal financial services (*MFPED* 2000).

Banks registered in the past years have failed to contribute significantly to the expansion and deepening of the financial market. They have hardly introduced any additional services and products. Many services such as adequate deposit facilities, checking transaction accounts, letters of credit and equity investment are provided to individuals or firms only to an insufficient extent. As in many other parts of the developing world, commercial banks have been very reluctant to open their doors to poor clients as these are usually not able to meet the requirements asked for by banks in terms of collateral, minimum balances, etc. In response to the Bank of Uganda's increased capital adequacy requirements and in pursuit of prudent operations and efficiency banks have become more conservative in their lending practices. However, this may have been taken to an extreme as most formal banks have resorted to investing in Treasury Bills as opposed lending to the private sector (*MFPED* 1998; *Mutesasira* et al; 1999; *Wong* 1999).

Although interest rates have fallen from as high as 40% in 1992 to around 20% in 2000 as a result of low inflation and structural reforms in the financial sector, real rates still remain prohibitively high for many businesses. The major single factor for continuing high real interest rates has been the high intermediation costs, which have been driven up by inefficiencies in the banking sector and a large proportion of non-performing assets in the banks' portfolios (*MFPED* 2000). The overall repayment rate of the commercial banks continues to be extremely weak and may be as low as 55% according to a banking insider. As far as the geographic distribution of commercial banks is concerned, it can be ascertained that the central and southwestern regions are very well served with banking facilities while the rest of the country remains under-banked.

The closure of a number of banks may suggests that the bank of Uganda (BoU) lacks the capacity to fulfill its role of supervising and regulating the financial sector. In particular, BoU seems to have an insufficient number of experienced and qualified staff and has also not been able to resist political pressure (*Wong* 1999). The BoU itself argues that the closure of banks shows that the central bank is in fact working effectively, as these banks only had to close down because the BoU as supervisory body forced them to do so. A new Financial Institutions Act will soon be presented to Parliament, aimed at strengthening prudential regulation and supervision. The proposed Act also provides for the regulation and supervision of deposit taking microfinance institutions. However, in light of the above-described circumstances, many actors of the Ugandan microfinance industry doubt that the Bank of Uganda has the capacity of to take on the additional responsibility of supervising deposit-taking MFIs.

As a result of continued economic and financial instability, financial deepening has been very low and improved only slightly over the past decade. Measured as the proportion of broad money to GDP, it increased from about 9% in 1990 to 11% in 1996. This compares negatively with countries at a similar level of development like Tanzania and Kenya, where the ratio of broad money to GDP was 35% and 40% respectively in 1990 and 1996. Uganda's savings rate of currently about 11% is one of the lowest in Sub-Saharan Africa and also constitutes a serious impediment to further economic growth (*Obwona* and *Ddumba-Ssentamu* 1999; *Bategeka* 1999).

Currently, the formal financial sector includes the Central Bank (Bank of Uganda), 18 commercial banks, 6 credit institutions, 3 development banks, 20 insurance companies, one leasing company, a savings and credit union with over 2000 participating savings and credit associations, a post office savings bank, and a national social security fund. As will be discussed in Chapter 6, most of these institutions do not provide services to micro and small enterprises and poor households (*Katimbo-Mugwanya* 1999; *Opiokello* 2000).

The closure of banks and bank branches as well as the drive for prudent operations and efficiency of the banking industry has cut off the fast growing micro and small enterprise sector and the low income population generally from access to financial services. This gave **microfinance institutions** the chance to fill the gap and expand rapidly from the mid-1990s onwards. Microfinance came to be viewed as the most obvious vehicle for delivering financial services to the urban and peri-urban low-income earners as well as to the rural population. The following chapters will describe the making and development of what is now generally regarded as the most advanced microfinance industry in Africa.

As already outlined above, the poor and very poor have extremely limited access to formal sector institutions. While the microfinance sector is growing rapidly, it provides financial services to only a minority of around 150.000 clients. Most poor people rely on the **informal sector** to manage their money. A recent study (*MFPED/UNDP* 2000) revealed that of all people borrowing money 79% obtained credit from informal sources in comparison to 21% borrowing from commercial banks. More or less everyone saves some cash at home or with a close family member or friend, though the poorest may experience periods when they can’t do so. Among group-based devices Rotating Savings and Credit Associations (ROSCAs) are especially popular in Uganda. Even within FINCA Village Banks members have established their repayment ROSCAs. Despite an obvious need for safe opportunities to save small amounts of cash, there are only few deposit collectors operating and those that there are, lack the degree of standardization and professionalism found among them in West Africa. The poor and not-so-poor have almost no access to moneylenders of any sort, a fact that contributes to the widespread popularity of the MFIs (*Bagazonzya* and *Mbabazi* 2000; *Rutherford* 1999). Informal and formal financial service providers as well as semi-formal arrangements like Savings and Credit Cooperatives will be examined in more detail in Chapter 7.

3 History and Current Status of the Microfinance Industry

Compared to other well-advanced microfinance countries like Bolivia or Bangladesh, the microfinance industry in Uganda is fairly new. Informal financial arrangements like ROSCAs have existed in many forms in Uganda for several decades. From the mid-1980s on credit schemes started emerging as side components of social welfare programs. Like in all other parts of the developing world, these components usually followed a project-oriented approach, disbursed credit at subsidized interest rates, had very poor repayment rates and were therefore typically rather short-lived.

The first true microfinance institutions like FINCA and Uganda's Women Finance Trust (UWFT) appeared in the early 1990s. However, they did not start to expand in terms of significant client outreach and receive recognition until the mid 1990s. With increased interest from donors and NGOs discovering that they can make a lasting impact on poverty alleviation by offering sustainable financial services, the microfinance industry began to take shape. In January 1996, USAID sponsored a microfinance seminar that was considered to be an eye opener for many practitioners, who were exposed to best practice methodologies and the importance of sustainability for first time in earnest. At the same time, the government started to view the private sector as the most important contributor to economic growth and identified improving the access to financial services as one of the key strategies. Microfinance became an issue for the Ministry of Finance and Economic Planning (MFPED) as well as the BoU, as both made themselves acquainted with national and international experiences and practices in this field.

In early 1997, PRESTO/Center for Microfinance started to provide trainings and technical assistance to MFIs in key areas like loan tracking, interest rate setting, business planning, product development, and ownership and governance. Over the past years other projects and institutions also began to provide valuable capacity building to the microfinance industry. From 1997 onwards a strong collaborative effort emerged among donors, government, the central bank, practitioners and capacity building providers. What started in 1998 as a consultative working group has now developed into a full Microfinance Forum which meets monthly to discuss topics, exchange information and share ideas on key issues affecting the sector. In 1997, the Association of Micro Enterprise Finance Institutions of Uganda (AMFIU) was set up to serve as a practitioner platform to share experiences and technologies and act as a lobby and advocacy body for Ugandan MFIs.

In mid 1999 many key players of the Ugandan microfinance scene, especially among donors, left the country. After a brief period of less intense coordination, a microfinance workshop facilitated by AFCAP brought the donor community together again in April 2000. A joint vision for the development of the microfinance industry for the next five years was mutually agreed on as well as strategies needed to achieve this vision. Donors defined very ambitious outreach expansion plans and agreed on a coherent strategy for a demand driven capacity building initiative. Other workshops and seminars also including practitioners, government and the Bank of Uganda followed and further strengthened the microfinance community. At the moment, a number of initiatives like common donor guidelines, universal reporting standards, a rating system, guarantee funds, a capacity building initiative for MFIs graduating to formal status, etc. are discussed with broad participation from most stakeholders.

As outlined earlier, the closure of banks and bank branches as well as the adoption of more stringent lending policies among commercial banks left almost all micro and small entrepreneurs and poor households without access to financial services. The microfinance industry, which over the past years came under pressure to fill this gap and become self-sustaining, has to some respect succeeded in doing so. A significant number of MFIs have taken important steps towards professionalisation and transformation into well-organized, well-managed and commercially viable institutions that provide financial services to an increasing number of clients with proven poverty reducing impact.

The environmental conditions in which the Ugandan microfinance industry has thrived over the past years can generally be described as favorable, including macroeconomic stability, strong and competent MFIs, practitioners and donors committed to best practices, MFIs with international alliances, a by and large supportive government and a constructive cooperation among stakeholders. The industry was also able to overcome the results of former instability and bad practices. The long-lasting civil strive has probably destroyed part of Uganda's social capital, the history of poorly managed credit schemes has damaged the credit culture in some parts of the country, and the closure of a great many banks has eroded the trust of clients into financial institutions. However, none of the bigger MFIs faced serious delinquency problems once they had embraced professionalism. This can probably be ascribed to the fact that these MFIs have applied their methodologies in a very disciplined way and put a lot of emphasis on building an effective repayment culture among their clients.

Currently, there is one commercial bank providing microfinance services (CERUDEB), one recently established privately owned credit institution (CML), about 15 larger MFIs and around 80 CBOs and NGOs providing savings and credit services on a smaller scale. The top five institutions (CERUDEB, FINCA, PRIDE, UMU, UWFT) have already surpassed or are close to full financial sustainability. New providers continue to enter the market and join a relatively mature and professional industry. Competition in Kampala and the surrounding region is becoming strong and some providers fear that some urban areas in these parts of the country may already be close to saturation for the types of products offered. One of the most pressing challenges for a large number of MFIs in Uganda are high drop out rates, indicating that clients make use of increased competition and shop around, but probably also suggesting that clients are not satisfied with the products offered. In fact, a closer look at the methodologies reveals that the services and products offered by the majority of microfinance providers are very similar to each other and are not adjusted to the specific needs of different client groups. The following chapters will discuss microfinance clients, the role of the government, the new legislation, stakeholder coordination mechanisms and initiatives, microfinance providers and capacity building initiatives in more detail.

Tabelle 1: Table 1: Microfinance Providers in Uganda

MFI	Year of establish-ment	Methodology	No. of clients	Sustainability
CERUDEB	Trans-formed into a commer-cial bank in 1993	Individual lending	14,000 bor-rowers 45.000 savers[1]	Full financial sus-tainability
FINCA	1992	Village banking	23.500	Full financial sus-tainability
PRIDE	1995	Adjusted village banking	24.500	Close to opera-tional sustainability
UMU	1997	Solidarity group lend-ing and individual lending	10.000	Close to opera-tional sustainability
CMF LTD.	1999	Group and individual lending	13,000	Close to financial sustainability
UWFT	1985	Group lending and individual lending	35.000	Operational sus-tainability
FOCCAS	1995	Village banking with education	7,500	Approx. 50% op-erational sustain-ability
FAULU	1995	Group and individual	8,000	Just below 50% operational sus-tainability
UWESO	1996	Group	8,000	Below 50% opera-tional sustainability

4 Clients and Impact of Microfinance Services

4.1 Clients of Microfinance Institutions

Microfinance Providers in Uganda reach low-income households in both rural and urban areas, but not the poorest of the poor. The average client is female, married, between 30 and 39 years and sufficiently literate with an average household of 7 people, many of whom are dependents. Commerce is the main activity of clients, followed by agriculture, services and

[1] Only CERUDEB, as a commercial bank, is entitled to mobilize savings, apart from savings and credit cooperatives.

manufacturing. Clients of MFIs tend to cluster around the poverty line. Most users of MFI services appear to be non-poor, but not wealthy: they tend to come largely from households that can usually meet their daily needs, have access to primary education and basic health services, and have accumulated some assets. They tend to spend a high proportion of their earnings on basic needs such as food and education of children. This group of clients are in the "comfort zone", they enjoy a relatively stable income source and sufficient livelihood diversification, allowing them to service regular repayments even when faced with small crises. However, they remain vulnerable to shocks, and access to microfinance has proven to play an important role in managing this vulnerability (*AIMS* 1998; *COWI* 2000; *MFPED* 2000c; *Mutesasira* et al 1999; *Wright* et al 1999a).

Those significantly below the poverty line do not seem to join Ugandan MFIs. This occurs for several reasons, including (*CGAP* 2000; *Wright* et al 1999b):

- exclusion by the MFIs themselves due to their focus on microentrepreneurs with sufficient repayment capacity;
- exclusion by groups unwilling to take responsibility for the poor in case of delinquency;
- self-exclusion due to a fear of credit;
- product exclusion where the "one-size-fits-all" working capital loan on offer does not meet their needs; and
- emphasis on credit delivery and little attention to the needs of the poorest for safe and accessible savings services

However, critics of microfinance based on "not reaching the poorest" tend to overlook the dynamic nature of poverty. Not-so-poor households hit by severe crisis (fire in houses and businesses, theft of business assets and chronic illness including HIV/AIDS, etc.) may be transformed into "poorest" households with alarming rapidity. This is why microfinance's role in assisting in development and maintenance of robust household economic portfolios is so important for everyone who does not have access to formal financial services (*Wright* et al 1999a).

Presently, about 150.000 clients are served by MFIs in Uganda. Compared to an estimated 7.5 million economically active Ugandans living below the poverty line, this is still a relatively low outreach. Although many MFIs claim to serve predominantly the rural population, the participants of the two microfinance workshops in April and June 2000 estimated that

80% of the MFI clientele was urban and 20% rural. In these workshops, the microfinance community agreed on the vision to expand the rural coverage to 40% of the total MFI clientele within the next five years. Given that the microfinance industry is expected to grow by 50% per year in the same period, this estimate seems to be very optimistic. Although the population density in rural Uganda is much higher than in most other parts of Africa, rural outreach expansion still faces the challenges of insufficient infrastructure, low education levels, increased intermediation costs, greater risks due to higher exposure to agricultural production, etc. As will be argued in Chapter 7, Community Based Organization (CBOs) and Savings and Credit Associations (SACCOs) operating in rural areas seem to be an appropriate vehicle to reach more rural savers and borrowers. However, most these institutions have displayed a formidable lack of systems, governance, ownership and management. Therefore, they will have to receive substantial amounts of capacity building until they will be able to serve large quantities of rural clients in an effective and sustainable way.

4.2 Client Impact of Microfinance Services

Over the past years, a number of attempts have been made to assess the impact microfinance providers are having on the livelihoods of the poor in Uganda (*AIMS* 2000*; Barnes*, *Morris* and *Gaile* 1998; *Gaile*, *Duursma* and *Eturu* 1999; *Mutesasira* et al 1999; *Wright* et al 1999a; *Wright* et al 1999b). MFIs that participated in these evaluations included FINCA, PRIDE, FOCCAS, UWFT and CERUDEB. Although the studies place emphasis on different aspects, they all reveal positive impacts from participation in MFI programs:

Participation in microfinance programs contributes to reduced vulnerability to economic risks.

The poor are very vulnerable to risks (such as illness or death of a household member, medical expenses, funeral costs, crop failure, the loss or theft of a key asset, or a dramatic change in prices), and microfinance services in Uganda have proven to help the poor to protect against these risks. Individuals and households pursue strategies to protect against risks ahead of time. As MFIs provide loans for working capital and to purchase productive assets, clients are able make their enterprises more competitive and increase profits (although in most cases only to a limited extent), diversify their income sources and broaden their asset base. Participation in microfinance programs also appears to enable clients to build the households' human assets, for example by investing into children's education or household members' health. Even when loans are used for business, the household's own capital is thus freed for other investments, particularly in school fees and health care.

Group-based lending schemes provide clients with an opportunity to build their social assets by reinforcing reciprocal relationships and social networks. Membership of microfinance groups links individuals, households and enterprises into a vital web of business and personal relationships that enables members to better cope with the challenges of life. However, in some cases membership to groups can also become a social liability, especially where there is a consistent pattern of non-payment and mounting peer pressure. Access to financial services also allows the poor to cope with shocks or economic stress events once these take place. Clients use MFI loans to re-stock their businesses and to smooth consumption. As most MFIs offer only inadequate savings services, only few clients were able to use these as source of liquidity in times of emergencies.

Participation in microfinance programs results in strengthening linkages of clients and their households to the agricultural sector.

MFI clients are actively involved in the agricultural and natural resource based marketing chain. Loans to microentrepreneurs strengthen their position in the agricultural sector. Microfinance program participation results in clients expanding the amount of land they cultivate and diversifying the crops they grow for sale and domestic consumption. Clients of MFIs are more likely than non-clients to increase their remittances to rural dwellers.

Participation in microfinance programs enables clients to acquire valued skills

In self-assessments, clients tend to mention acquisition of business related knowledge and savings skills among the most important positive results of participation in their microfinance program. Many clients also testified that they had learnt leadership and public speaking skills from participation in MFI groups. Numerous clients gave proof of this by joining wider institutions and standing for election in local councils. Participation in a credit with education program results in clients trying new health and nutrition practices and informing others about these practices.

The lending strategies of MFIs appear to be more of a deterrent to continued participation than factors within the clients households and enterprise

Reasons clients give for departing a MFI program tend to relate more to the lending methodology than problems with loan repayment. Most drop-outs complain about inadequate loan amounts and terms, mandatory weekly meetings and having to pay for group members who default.

Participation in MFIs does not help the poor to meet their savings needs

Most MFIs only offer loan-linked, compulsory, locked-in savings system and no poor-friendly savings products. Also for legal reasons, Ugandan MFIs are not providing facilities that allow the poor to save in a way that would help them to meet their current needs and opportunities and to save for the future. As a consequence, the poor are often forced to use high-risk (and often high-loss) informal savings mechanisms.

4.3 Gender and Empowerment

The vast majority of clients of Ugandan MFIs are women: loans to female clients constitute around 75% of the loan portfolio and 80% of the savings portfolio (*MFPED* 2000c). Some microfinance providers like FINCA, FOCCAS or UWFT only target female clients. Most MFIs focus on women for two reasons. First, lending to women is thought to benefit the whole family and strengthen the role of women in society. The second reason is that women, like in most other parts of the world, have proven to be better repayers. In some cases, women groups of female-only MFIs accept men if they replace their deceased wives. CERUDEB, a commercial microfinance provider with slightly larger average loans than most other MFIs, pursues an equal access policy and asks for collateral. This sometimes excludes women. However, it is not uncommon that a loan is in the husband's name but the woman is running the business. In most microfinance institutions, especially in those only targeting women, at least half of the workforce is female. While MFIs increasingly recruit female credit officers and women constitute approximately half of senior management (varying form organization to organization), board members are still mainly men.

Although most MFIs in Uganda specifically target women, only few have altered their methodology in significant ways for this reason. Most microfinance providers feel that women's empowerment is an important aspect of financial service provision, but that they are first of all obliged to seek efficiency and sustainability in order to guarantee a durable access to financial services to the greatest possible number of poor clients.

As the impact studies conducted in Uganda (*AIMS* 2000*; Barnes*, *Morris* and *Gaile* 1998; *Gaile*, *Duursma* and *Eturu* 1999; *Mutesasira* et al 1999; *Wright* et al 1999a; *Wright* et al 1999b) mainly evaluated MFIs with exclusive or at least large female clientele, the impact results presented above mainly concern women. Two studies (*Barnes*, *Morris* and *Gaile* 1998; *Wright* et al 1999a) looked at gender issues in more detail and generally confirm the gender-related findings of the other research initiatives. MFI participation helps women to protect themselves and their households against risks by rendering their enterprises more competitive, diversifying their income sources, broadening their asset base, re-stocking their business and smoothing consumption. The impact study conducted for CERUDEB (*Barnes*, *Morris* and *Gaile* 1998) found that women clients have significantly greater positive economic impacts relative to female non-clients than do male clients over comparable non-clients. Female CERUDEB clients also expressed greater satisfaction with the credit and savings services provided by the bank than did their male counterparts.

Box 1: Ugandan microfinance clients

Client A

Maria Mutola[2] is a member of a FINCA village bank in south-eastern Uganda. She is on her ninth loan cycle, and has had few problems with repayment or any other aspect of being a

[2] Name changed by authors.

borrower. Her business is wholesaling dried small fish, known as *mukeje*. Twice a month she travels for one and a half days to the island of Chisugu, in the middle of Lake Victoria, 30 miles from the shore. There she buys the *mukeje* from the local fishermen. Her average purchase is 500kg, at about USD 2,5 per kg. She hires a boat to bring the fish back, then transports it to Kampala where she sells it to various customers, mainly to a large industrial feed company. If demand is high, she charges USD 3, making a profit on her work of USD 25. If demand is low, she drops her price to USD 2,7, but is still able to make a comparatively good living out of her business, according to her own words.

Client B

One of the FOCCAS clients had borrowed USD 60. However, the entire stock of her tiny food retailing business had been worth that much. When asked what she had used the loan for, she answered that she put USD 45 into school fees, bought a sow (female pig) for USD 10, and used only USD 5 on stock for her business. The sow was a sort of insurance policy in case she could not afford the loan repayments. She would fatten the sow and sell it when the loan became due. However, the sow turned out to be pregnant, and had a litter of 10 piglets. So she diversified her activities and also went into the piggery business.

The above-mentioned studies also revealed that participation in microfinance programs allows Ugandan women to acquire business and non-business related knowledge, learn from each other, strengthen their business and personal relationships and learn leadership and public speaking skills. Many women that had performed management roles in microfinance groups have been elected into local councils. Belonging to MFI groups also provides women with status and prestige in the community, makes them less dependent on their spouses for money, increases their influence and bargaining power within the household and improves their self-confidence. Some researchers (*Goetz* and *Gupta* 1996; *Mayoux* 1997) have suggested that microfinance programs make women even more vulnerable to gender-based conflict since they sometimes pass their loans to their husbands. This practice of giving loans to the husband to use seems to be less common in Uganda, and when done, it is usually economically rational (*Wright* et al 1999a).

As described above, parts of the Ugandan microfinance industry are moving towards sustainability and commercialization at an impressive speed. Most donors and a considerable number of practitioners are committed towards turning the provision of microfinance services profitable and independent from donor money. While hardly debated in the Ugandan microfinance industry, this trend might lead to less attention to empowerment issues. For example, some MFIs are considering or are already experimenting with individual loan products, which have less potential to strengthen women networks and female solidarity than group loans. Also, some female-only MFIs are planning to open their doors to men, mainly because where some urban markets might be close to saturation men are seen as an untapped client group. Although these developments might have some negative impact on women's empowerment, it could be argued that an expanding and sustainable microfinance industry has probably more overall positive gender effects than a smaller industry that concentrates primarily on empowerment. Moreover, even if an increasing number of MFIs also promote individual lending, in a growing industry group lending will expand, too.

5 Government Policies, Programs and Regulatory Framework

5.1 Government Policies

It is widely accepted that the establishment of an enabling environment by Government of Uganda (GoU) has played an important role for the development of a healthy national microfinance industry. Like in other countries where microfinance emerged robustly, macroeconomic stability and serious financial sector reforms set the stage. In addition, with microfinance becoming a constituent part of the financial sector and emerging as an instrument of poverty reduction, the GoU has over the past years developed a special interest and expertise in it.

After the end of nearly two decades of civil strive, an Economic Recovery Programme (ERP) was launched in 1987 with support from the International Monetary Fund (IMF) and the World Bank. Since that time, the GoU has pursued structural adjustment policies and succeeded in stabilizing the macroeconomy and fostering growth. As mentioned earlier, inflation has been reduced to single digit levels since 1990 and average growth rates have been around 6% per annum. Since 1993, when the Financial Sector Reform Programme was launched, the GoU has promoted a more market-oriented financial sector approach, deregulated interest rates and liberalized the exchange rate in 1994. Moreover, the privatization of state controlled banks was initiated, although not very successfully (*MFPED* 1999a; *Opiokello* 1999).

The economic strategies of the Government of Uganda for poverty alleviation are laid down in the Poverty Eradication Action Plan (PEAP) and the Plan for Modernization of Agriculture (PMA). Both policy documents identify efforts to increase the ability of the poor to raise their incomes – either by increasing their productivity or by entering new productive activities – as important strategies to improve the quality of life of the poor. Moreover, both policy documents identify microfinance as an important instrument to alleviate poverty. The GoU also acknowledges that the role of the government in microfinance is limited to the provision of the appropriate legal and policy environment and capacity building (*MFPED* 1999a; *MFPED* 1999c).

Within the GoU, the Private Sector Development/Capacity Building (PSD/CB) policy unit in the Ministry of Finance, Planning and Economic Development (MFPED) handles microfinance issues. As one of its activities, the policy unit is in the process of establishing a comprehensive microfinance database that should promote coordination, monitoring and evaluation in the industry. Representing the GoU, the head of the PSD/CB policy unit hosts and chairs the Microfinance Forum, the most important coordination mechanism in the industry. Moreover, the PSD/CB policy unit has been involved in the process of developing a regulatory framework, which will be discussed below. In general, the Ministry of Finance, Planning and Economic Development has been supportive of the microfinance industry, accessible to the needs and ideas of its stakeholders, and has tried to engage in a constructive dialogue on relevant issues. The government's commitment to microfinance has probably been linked to the crisis of the traditional financial sector and with microfinance at least partly filling the gap left by the closure of formal banks. However, other Ministries have been less accessible to good microfinance practice and continue to support grant based programs.

Although the microfinance industry is committed to educate the public and government about its practices, there has recently been some disquiet over the interest rates and recovery methodologies used by some MFIs. Newspapers have published articles about exploitative microfinance providers and parliamentarians have repeatedly accused MFIs of usury. While these incidents may partly be due to ignorance regarding microfinance best practices, individual MPs also seem to engage deliberately in MFI-bashing campaigns, expecting to gain some popularity out of it.

5.2 Government Microfinance Programs

The GoU was involved directly and indirectly in microfinance service delivery to clients through a number of projects and programs, such as NURP and SWARP, the Cotton Subsector Development Programme with a line of credit in the BoU, and the Rural Farmers Scheme. However, all of these programs have been characterized by high delinquency rates and low levels of self-sufficiency (*MFPED* 1998).

In response, the GoU has promoted a new generation of Government funded programs that channel funds to clients through existing NGOs and CBOs. The two most important programs are PAP (Poverty Alleviation Project) and Entandikwa. Although these programs were better designed than the older generation of credit schemes, they have run into similar problems. For example, most clients have conceived of Entandikwa as politically motivated, because loans have often been approved through local councils. This perception has encouraged loan recipients to default. Other problems with Entandikwa include unsustainably low interest rates, insufficient institutional capacity and lack of staff for monitoring and supervision. Currently, Entandikwa is in the process of being converted into a line of credit for MFIs (*MFPED* 2000a).

As PAP has performed only slightly better than Entandikwa, the credit scheme has been phased out and transformed into the Rural Microfinance Support Project (RMSP). The project will operate as an apex organization, providing capacity building as well as lines of credit to existing MFIs. These two functions will be separated and MFIs will only receive resources to on-lend after they have proven their capacity to do so. RMSP will mainly focus on small-scale CBOs, but will keep its line of credit open to larger MFIs. While RMSP seems to have some potential to become a successful initiative, there remains little doubt that the GoU has so far failed as microfinance provider. The GoU has contributed to the erosion of credit culture where its programs have acted on politically motivated grounds and disbursed credit without insisting on repayment.

5.3 Regulatory Framework

The regulation and supervision of microfinance activities has been one of the most debated topics in the Ugandan microfinance industry over the past years. The Financial Institution Statue (1993) in its current form does not cover the provision of microfinance services directly, leaving most microfinance operators in a regulation-free state. Only CERUDEB, a commercial bank microfinance provider, is currently under supervision of the Bank of Uganda. Efforts to develop a regulatory framework for microfinance in Uganda began with an Austrian-financed project in 1996 aimed at educating the central bank about microfinance and setting up a rating system for MFIs. While discussions about a rating system have only now been taken up again, ensuing events resulted in the development of legislation for the regulation and supervision of microfinance activities. The legislation is still in draft form, but has already been agreed on by Cabinet and will soon be presented to the parliament.

The development of a regulatory framework has been a relatively consultative effort, with a number of practitioners and donors eager to support the initiative from the beginning. Over the past years, the German agency GTZ has provided technical assistance in the area of regulation and supervision to the central bank. The principles of the framework have been discussed in various meetings and all stakeholders had ample opportunity to comment. However, most practitioners feel that the process has become less consultative over the past year. At least in part, this may be due to the authorities' understandable qualms about negotiating regulations with those who are to be regulated. Policy papers, like the BoU policy document on Microfinance Regulation of last year, remained silent on some key issues, triggering fears among providers that the regulation may contain provisions that could be harmful to them.

The proposed microfinance regulation views microfinance as a line of business, which can be done by organization licensed as a microfinance provider. The Bill will cater for the specific requirements of Microfinance Deposit-taking Institutions (MDIs) and will most probably follow the approach of risk-based supervision, i.e. concentrate on institutional aspects such as quality of corporate governance and management, business policies and procedures, effectiveness of internal controls, and the adequacy of the MIS. Quantitative analysis, i.e. financial ratios, will still play a role but will be understood as complementary within the framework of risk-based supervision. The proposed regulatory framework will only provide for those MFIs with a track record and those which reach at least financial self-sufficiency, meet stringent governance, portfolio quality and capital adequacy requirements. Microfinance providers that do not mobilize and intermediate deposits will not be affected by the Bill.

As already mentioned above, there is concern in the Ugandan microfinance community that the regulation may be too strict in some areas and damage the industry. For example, if prudential licensing requirements for community-based MFIs provide for a minimum number of members that is very low, this could put out of business many organizations that offer savings services in places where no one else is likely to provide them. Another concern is that the minimum capital requirements might be too high for some emerging MFIs, which could endanger their survival. Savings-oriented initiatives, like MicroSave Africa, argue that it should be left primarily to the savers where and how to save, as no system of supervision will secure savings deposits. Alternatives suggested for supervising MFIs that accept deposits include a savings guarantee foundation to which MFIs subscribe, a rating agency that grades and certifies MFIs, a market-driven savings deposit insurance scheme, etc. (*Mutesasira* 1999). On the whole, the regulators face the difficult task of finding a balance between protecting deposits and securing the health of the financial system on the one hand, and providing a framework that does not restrict the expansion and development of the Ugandan microfinance industry.

As already discussed in Chapter 2.3, there is considerable doubt about the capacity of the Bank of Uganda to take on the additional responsibility of supervising deposit-taking MFIs. The striking number of recent bank failures suggests that the BoU does not have what it takes to fulfill its role of supervising and regulating the financial sector. Whether the Government of Uganda will succeed in strengthening and expanding the central bank's supervisory capacities remains to be seen.

6 Stakeholder Coordination Mechanisms

Compared to most other African countries, Uganda stands out for a relatively strong and effective coordination among stakeholders of the microfinance industry. While the consolidation of practitioner, government and donor interests has not been without frictions, the general willingness to listen to each other, learn from each other and coordinate and cooperate is widely acknowledged as one of the key reasons for Uganda's success in microfinance.

As described in Chapter 3, the microfinance industry began to take shape in the mid 1990s. Before that, very little coordination took place and most projects providing financial services displayed a remarkable lack of appreciation for good practices. With increased interest from donors, exposure to international experiences, growing government commitment to private sector development and practitioners linking to international microfinance organizations like FINCA International and PRIDE Africa, the expansion and development of the industry commenced. Early on, key donors started a dialogue with strategic government representatives and tried to sensitize them to microfinance issues. While all MFIs were still quite far away from self-sufficiency, some crucial practitioners, like FINCA and PRIDE, as well as donors clearly promoted a financial systems approach from the mid-1990s on, stressing institutional and financial sustainability of MFIs and the importance of a viable financial sector. The USAID sponsored microfinance seminar in January 1996, which brought together a number of practitioners and exposed them to international microfinance know-how, can probably be considered as the first broad-based coordination effort.

From 1997 onwards, a strong collaborative effort emerged among donors, government, the central bank, practitioners and capacity building providers. In 1997, the Association of Micro Enterprise Finance Institutions of Uganda (AMFIU) was set up to serve as a MFI platform and advocacy body. One year later, a consultative working group was established and developed into the Microfinance Forum, which meets monthly to exchange information, share ideas and initiate collaborative efforts. It is chaired and hosted by the Ministry of Finance, Planning and Economic Development, with an average number of 60 participants from all stakeholder parties. The Microfinance Forum has formed two sub-committees, one on lobbying and one on the question of financial and capacity building apexes. Each committee is mandated to develop strategies and recommend actions for the Forum's approval.

The most important mechanism for **donor coordination** is the Donor Group and its Private Sector Donor Sub-Group (PSDSG). The PSDG meets monthly or as per need to discuss and form concerted opinions primarily on the policies and strategies proposed by the Government of Uganda on issues like private sector development, deregulation, privatization, environmental conditions, etc. Often, GoU and delegates of the private sector, represented through the Private Sector Foundation, are invited to the meetings. Rather informally, an internal microfinance donor coordination group has been established as sub-group of the PSDSG, bringing together the most important and active donors in this field, including USAID, EU/SUFFICE, GTZ, DfID and ADC.

The single most important recent donor meeting was the donor workshop facilitated by AFCAP in April 2000. After a period of less intense cooperation mid 1999, the workshop brought people together again and donors mutually agreed on a joint vision for the sector. Donors sketched very ambitious plans regarding client growth rates (50% per annum) and rural outreach expansion (from currently 80% urban and 20% rural to 60% to 40% respectively) for the next five years. In order to meet these targets, donors agreed that a coherent strategy for demand-driven capacity building and an active promotion of product development for rural areas would be needed.

Another donor led initiative to strengthen the Ugandan microfinance industry is the current attempt to develop and adapt a set of uniform performance indicators and reporting standards – which are acceptable to all current and potential stakeholders, i.e. donors, wholesale lenders, investors, depositors, regulatory authorities, and the MFIs themselves. This set of indicators and reporting standards would be used by microfinance institutions to apply and report to donors, lenders, government and networks using one format, hence streamlining the information flow and saving valuable time and resources for the MFIs. Donors and other promoters of microfinance would be assisted in their assessment of performance among MFIs, as well as in the comparison and general assessment of the developments in the industry. New donors would get an up-front tool to direct their assessments of needs and performance, which would in turn decrease inconsistencies and distortions in an industry characterized by a mix of competition and subsidies. Moreover, the government and central bank would also be assisted by a uniform set of performance standards in their need to obtain more reliable and useful data, as more and more MFIs learn to report in accordance with agreed standards. This donor initiative will be integrated with AMFIU's effort to establish a format for reporting by MFI members to the GoU and the Uganda Cooperative Alliance (UCA) initiative to develop a set of performance indicators and a rating system for good practice SACCOs in Uganda (*SUFFICE* 2000).

Another example of a donor joint activity is the co-funding of a study visit of key executives of the Ugandan Institute of Bankers and the Bank of Uganda to sister institutions in Denmark and Germany in June 2000. However, there were also some initiatives where cooperation among donors and other stakeholders has been less constructive. For example, in both the District Resource Endowment Profile Survey (DREPS), supported by UNDP and the GoU, and in the microfinance study conducted by COWI and funded by the GoU, little efforts have been made to integrate the donor community and learn form their experiences.

As can be seen from the Table 2 below, donors currently support a broad range of microfinance activities and initiatives.

Tabelle 2: Donors and their initiatives[3]

USAID	PRESTO/Center for Microfinance with follow-up project SPEED (Support to Private Enterprise Expansion and Development); support to several individual MFIs
EU	Support for Feasible Financial Institutions and Capacity Building Efforts Programme (SUFFICE)
DANIDA	Agricultural Sector Programme Support with Rural Financial Services Component (RFSC)
DfID	MicroSave; Support to BoU
GTZ	Financial System Development Project with BoU, Uganda Institute of Bankers (UIB), Uganda Security Exchange (USE), Postbank and Capital Markets Authority (CMA) as main partners
ADC	Support to several MFIs and flexible funding for strategic efforts
ADB	Rural Microfinance Support Project (RMSP)
GoU	SUFFICE ; RMSP
UNDP	Private Sector Development Program (PDSP); MicroSave

As far as gaps in donor funding for microfinance are concerned, many stakeholders are of the opinion that despite announced commitment to rural outreach expansion, there are still not enough resources channeled into this area. While initiatives like RMSP and DANIDA's Rural Financial Services Component have the potential to reach a considerable number of rural borrowers and savers, it is not clear whether USAID, the biggest microfinance donor in Uganda, will step up its efforts to promote rural finance or reduce its commitment. Most donors are aware that in order to reach the target of 60% urban to 40% rural clientele, support for rural outreach expansion and rural product development will have to be increased. While most donors feel that MFIs should continue to receive subsidies for pushing the frontier and venturing into risk areas like product innovation for agricultural finance or expansion into underserviced areas, no coherent strategy to do so has yet been defined.

A particular dilemma facing donors in Uganda is how to use subsidies in a competitive environment. Withdrawing subsidies from individual MFIs gives a competitive advantage to the others. Currently, all MFIs, including the commercial ones, receive subsidies in various forms, most often including funds to cover operational cost. Only very few MFIs, like FINCA and PRIDE, are nearly subsidy-free, but have to compete against

[3] See Annex I for more details on donor initiatives.

providers which are still heavily supported by donors. The transformation from grant or soft loan funded operations to commercially funded institutions has proven difficult in other parts of the world and will require substantial capacity building and a revision of MFI ownership and management structures. The donor community is currently working on donor guidelines, which will include entry and exit strategies as well as a code for grant usage, so that market distortions and biased competition can be minimized. However, most stakeholders are aware that these guidelines will probably not solve the problem of subsidy provision in a competitive environment entirely.

Coordination among capacity builders, with support from donors, has resulted in the current attempt to locate capacity building providers under one roof in order to improve visibility, access, standardization of trainings and marketing. Along with the joint effort of capacity builders to establish a national certification and accreditation system for independent microfinance trainers and consultants, this initiative will be discussed in more detail in the next chapter.

The main **coordination mechanism at MFI level** is the Association of Micro Enterprise Finance Institutions of Uganda, which was set up to serve as a MFI platform and advocacy body. However, AMFIU has not lived up to expectations and is considered to need more institutional strengthening. Efforts to set up a credit information bureau to exchange information between MFIs in order to identify bad borrowers have been thwarted by the lack of a national system of identification cards.

7 Microfinance Capacity Builders

Much of the growth and vibrancy of the microfinance industry in Uganda can be attributed to international organizations providing capacity building to their affiliated national MFIs and the initiative of national capacity builders like CMF-PRESTO, the Rural Microfinance Support Program (formerly PAP) and MicroSave Africa. The national organizations have provided training and technical assistance to a large number of Ugandan MFIs, increasing their knowledge about best practices and improving their skills to apply these. CMF-PRESTO alone has worked with over 40 microfinance institution. Capacity builders have linked a great deal of MFIs to the national microfinance industry and integrated them into policy, vision and strategy discussions. Moreover, many stakeholder coordination and cooperation initiatives have been initiated and implemented by capacity builders. For example, as regards the proposed microfinance legislation, capacity builders took a lead role in the policy dialogue between the GoU and central bank on the one hand, and the practitioners on the other, actively sensitizing policy makers and practitioners on regulation and supervision issues.

The Center for Microfinance under PRESTO is widely acknowledged to have been the leading provider of capacity building services in the microfinance industry since its inception as a USAID project in March 1997. PRESTO has trained managers, loan officers and accountants of MFIs, conducted seminars, provided on-site technical assistance to microfinance operators, offered grant assistance to MFIs to scale up their programs, and run a microfinance information center. MicroSave has mainly focused on pro-poor savings initiatives and community-based organizations and has thereby exerted a considerable influence on practitioners, donors and other stakeholders to give more attention to client-responsive services and products. UNDP's Private Sector Development Program (PSDP) has made some impact by training savings and credit associations and other community-based microfinance organizations, but has been limited by its narrow financial and technical base.

Other national capacity builders include the Development Finance Department of the BoU, which has piloted basic MFI training courses, the Uganda Cooperative Alliance (UCA), which has mostly replicated and adapted CMF materials for SACCOs, and the Uganda Rural Development Trust. However, these service providers have had little outreach and are generally considered as weak. The Microfinance Competence Center (MCC) has recently been established within the Ugandan Institute of Bankers. The MCC plans to provide training and technical assistance to larger MFIs that request a license to operate as deposit-taking microfinance providers under the proposed legislation.

While the positive impact of national capacity builders can not be underestimated, international microfinance organizations were the first to capacitate and professionalize Ugandan MFIs. Parent companies and international alliances (like FINCA International, PRIDE Africa, IPC for CERUDEB, Women's World Banking for UWFT, Freedom from Hunger for FOCCAS, etc.) continue to provide critical inputs in terms of capacity building, technical assistance, human resources and exposure to international experiences to their affiliated national MFIs. Advisors and program managers with international expertise have allowed many MFIs to leapfrog the long learning process that has gone on in the region and around the world. As a result, MFIs with international alliances were at the forefront of Ugandan microfinance development. The importance of international expertise in the Ugandan financial sector is also highlightened by the fact that all 18 commercial banks have expatriates as CEOs.

The major coordination initiative currently under way among national capacity builders is their effort to locate their offices together. Six capacity building providers, including all larger ones, agreed to move together into the premises of the Ugandan Institute of Bankers. The rationale is to improve visibility and enhance access to capacity builders, facilitate joint development and standardization of trainings, to enable joint marketing of services, and to improve the effectiveness of joint lobbying for the industry. Moreover, a physical point will provide the possibility of growing these initiatives into a regional reference center for best practices in capacity building and thus positively influence the microfinance industry in the other countries of the region. Another joint effort of the major Ugandan capacity builders currently in discussion is the establishment of a national certification and accreditation system for independent microfinance trainers and consultants. The initiative will adapt AFCAP's approach of training and certifying trainers, hence the working title U-CAP. The aim is to develop a cadre of apt and high quality private sector capacity builders for the Ugandan and possibly regional microfinance industry.

8 Microfinance Providers and their Services

Uganda is endowed with a variety of microfinance operators offering a broad range of products. Currently, there is one commercial bank providing microfinance services (CERUDEB), one privately owned microfinance institution (CML), about 15 larger MFIs and around 80 NGOs and CBOs providing savings and credit services on a smaller scale. New operators continue to enter the market and join a relatively mature and professional industry.

Most of the **commercial banks** are concentrated in Kampala and only two of them provide financial services to microentrepreneurs and poor households. The large majority of banks have neither the know-how nor the commitment to serve theses client groups. The poor themselves hardly use formal banks as they are intimidated by the banks' appearance and staff attitudes, tend to lack the required collateral, and are not able to afford the high transaction costs. The amounts saved by the poor are usually too small to meet the minimum balances of savings accounts at mainstream commercial banks. The Cooperative Bank used to provide savings and credit services to the poor, but it became insolvent for reasons having nothing to do with microfinance, and CERUDEB took over many of its branches. CERUDEB and CML are the only commercial operators that offer microfinance services. CERUDEB developed its services with donor support and technical assistance from an international microfinance organization (IPC). By offering individual loans to micro and small entrepreneurs, it is also able to skim off those – very lucrative – costumers from its competitors, that have graduated from group-lending schemes. Although the bank did not have a special strategy to reach small depositors, by lowering its minimum balance requirements to approximately USD 6, it has been able to attract a large number of small savers. CERUDEB is also one of the few lenders which offer agricultural production loans, and it is developing agricultural insurance, home improvement and investment credit products. CML has only recently opened its doors and is funded by private social investors.

The **insurance industry** does not provide services responsive to the needs of the poor. The tainted reputation of the industry has hindered the use of insurance companies as savings services (*Mutesasira* et al 1999). However, one commercial insurance provider has worked in partnership with a microfinance institution (FINCA) to extend life insurance to clients. The pilot has been considered successful and other MFIs are thinking about introducing similar products.

Savings and Credit Cooperatives (SACCOs) are user owned and managed organizations under the Cooperative Act, and range in size from a handful to several thousand members. Most SACCOs are organized around the work place (formal employers), markets among vendors or around a specific product (the most prevalent being coffee) in rural areas. SACCOs are, in many ways, well poised for providing savings and credit services to the poor, especially in rural areas, but are fraught with historical problems ranging from management capacity weakness to fraud (*Mutesasira* et al 1999). According to the Uganda Cooperative Alliance (UCA), there are currently approximately 500 SACCOs countrywide. With ten SACCOs registering per week, they are the fastest growing sector of the cooperative movement. About 65% of members are men and 35% women.

Some SACCOs receive technical support from the Uganda Cooperative Alliance or the Uganda Cooperative Savings and Credit Union (UCSCU). Out of the 500 or so registered, only 60 are considered "functioning" in one form or other. The majority of users are net borrowers with as few as 10% being net savers. Among members, SACCOs are popular because they are sources of easy and cheap loans compared to banks, are accessible and often located near member workplaces and homes, provide daily deposit collection services, and extend quick short-term loans that can be used to ease cash flow pressure and smooth consumption. From a legal point of view, SACCOs have the advantage of being entitled to mobilize savings and use them for on-lending (*Mutesasira* et al 1999).

As in most other parts of the developing world, SACCOs in Uganda have faced a series of problems that have tainted their reputation as financial service providers. Traditionally, they suffer from opaque governance and lack of simple and transparent rules. The separation of ownership and management often does not work and some chairmen consider themselves as owners of the institution. The lack of involvement of the membership in the affairs of the institution regularly provides opportunities for the Board, management and their friends to take loans without living up to their repayment duties. Accounting systems are usually unnecessarily complex and often only half understood and half followed. Audits are infrequent and incomplete. In addition, as most members of SACCOs are generally net borrowers, they seek to minimize their interest rate charges on loans – resulting in inadequate incentives to save and insufficient revenues to run the organization. SACCOs often lend out both share capital and savings, leading to frequent liquidity management problems. Lending policies are usually poorly enforced and systems to track and manage arrears hardly exist. As a result, most SACCOs in Uganda have large portfolios in arrears, with overdue loan repayments stretching back into the distant past. Many if not all SACCOs have experienced considerable difficulties realizing collateral – as community-based, community-owned and managed organizations, the officers responsible are reluctant the seize and sell the assets from their relatives or neighbors (*Dichter* 1997; *Mutesasira* et al 1999, *Wright* 1999).

Most key players in the Ugandan microfinance community believe that SACCOs and other community-based organizations have in theory the potential to contribute to the expansion of financial service provision to the poor, especially in rural areas. However, due to their poor performance to date and their inherent governance problems, most stakeholders, including government officials, are wary about the future of CBOs. One executive manager of a large microfinance provider declared that democracy was fine in the polling booth, but that it did not work well in financial institutions.

Both the Uganda Cooperative Alliance and the Uganda Cooperative Savings and Credit Union are considered weak and struggle with methodological and capacity building issues (*Wright* 1999). However, UCA is following a revised and potentially successful approach and a growing number of SACCOs, currently around 20, appear to perform well. In general, there seems to be some renewed interest in community based savings and credit organizations. The restructured RMSP as well as DANIDA's RFSC initiative will increase support to CBOs. Also, the World Council of Credit Unions (WOCCU) is planning to come to Uganda by the end of 2000, funded by USAID, to work with SACCOs. Savings and credit associations collaborating with WOCCU will have to hand over their operation and management to WOCCU and commit themselves to a comprehensive restructuring effort.

Other CBOs, like Financial Service Associations (FSAs), have faced similar problems like SACCOs. However, owing to their different institutional set-up and management structure as well as to technical assistance, some FSAs have performed remarkably well, in spite of operating in difficult rural environments. Their more business-oriented approach gives them a comparative advantage over SACCOs and makes them potential vehicles to provide financial services to clients and areas that are usually not served by traditional mainstream MFIs (*DIFID* 2000).

As already pointed out in Chapter 2, the **informal sector** is considered more vibrant than the formal financial sector. As the poor have extremely limited access to formal financial institutions and only limited access to the new breed of MFIs, most people rely on the informal sector to manage their money. Often clients of commercial banks and microfinance institutions continue or sometimes even intensify their involvement in informal financial arrangements like ROSCAs. These group-based devices satisfy social needs and appeal to the poor due to their flexibility, speed and proximity. However, informal savings and credit mechanisms are often characterized by high transaction cost and high risks. As a consequence, the poor regularly lose their savings to fraudulent schemes, dishonest “friends” and neighbors, to thieves, to unnecessary spending or (in case of in-kind savings systems such as livestock) to illness. Moreover, informal credit arrangements often do not provide the liquidity and reliability the enterprising poor need (*Mutesasira* et al 1999).

Microfinance institutions offer credit services and to some extent savings facilities to micro and small-scale entrepreneurs and poor households who cannot obtain these services from the formal financial sector. MFIs now cover the whole country, although in some districts only one provider operates. Microfinance providers are concentrated in the central region, which can be explained by the high rate of economic activity prevalent in this part of the country. Some MFIs, like FINCA, PRIDE and UWFT, have close to or even more than 15 branches. With approximately 150.000 clients now using microfinance services, national coverage is still low in comparison with the population (about 21 million). However, competition in Kampala and the surrounding region is becoming strong and some providers fear that some urban areas in these parts of the country might already be close to saturation (*MFPED* 2000c; *MFPEF/UNDP* 2000).

As already described in Chapter 2.1, clients of MFIs tend to cluster around the poverty line and primarily engage in commerce, followed by agriculture, services and manufacturing. A recent study (*MFPED/UNDP* 2000) revealed that the clients of the 42 MFIs supported by the largest capacity builder, CMF-PRESTO, borrowed around USD 250 on average. Savings per person in these MFIs was only approximately USD 40. The entire credit portfolio of all MFIs corresponds to more than 6% national domestic credit and the savings portfolio makes up 15% of the national financial savings, showing the importance of the microfinance sector (*MFPED* 20000c).

According to PRESTO's unpublished information, there are presently around 17 well established and well performing MFIs in Uganda. Although there is no official classification of microfinance providers yet, MFIs in Uganda could be broadly categorized according to their respective stages of development as follows:

Tabelle 3: Categories of MFIs in Uganda

Category	Number	Characteristics
"A"	5	Includes one commercial bank (CERUDEB), one specialized privately owned microfinance bank (CML) and three top MFIs (FINCA, PRIDE-Uganda and UMU); at or nearing financial self-sufficiency; advanced operational and management systems; well qualified staff; good leadership
"B"	12	Mainly NGOs, also registered as companies limited by guarantee; charging market interest rates; have adopted a business-oriented approach to financial service provision; moving towards operational self-sufficiency; fair operational and management systems
"C.1"	43	Mainly small local NGOs with limited resources and clientele; most have attended microfinance training courses and some have tried to implement good practices; are fairly exposed to the industry's information loop; most have only a modestly qualified management and are still far from operational self-sufficiency
"C.2"	40 (Estimate)	Very small community based organizations; generally not well known in the sector; largely outside the national microfinance information loop; most are untrained and generally little aware of best practices

Most Ugandan microfinance institutions follow the mainstream minimalist approach and offer only a single product. Also for legal reasons, savings are usually compulsory, blocked and used as guarantee for outstanding loans, providing little incentive to save more than necessary. A whole range of possible products has not been explored at all or is offered by only one provider, including payment systems, emergency loans, housing loan products, investment loans, insurance products, agricultural loans, leasing, etc. Only few MFIs provide additional services. For example, FOCCAS uses a village banking model combined with low-cost nonformal education with the overall objective to improve household food security and nutritional status, particularly for rural women and children. During the weekly group meetings, which are used for repayments and savings, the field agent conducts interactive learning sessions on health and nutrition topics, group management and microenterprise development.

A number of key players in the Ugandan microfinance community feel that quantity in terms of client numbers has received more emphasis than quality, and that blueprint replication, without reference to the local situation and environment is the norm. Many MFIs offer financial services following the Grameen-type approach, developed in distant lands and cultures, with little consideration of the clients' needs or the Ugandan context. Recent research indicates that conservative systems and products not responsive to the needs of the clients are the main reason for high drop-out rates, which all larger MFIs are faced with and cost them dearly (one provider calculated that a new client costs them 17 times more than a retained client). Relatively well-off clients primarily leave to seek larger loans, usually on an individual basis. The not-so-poor seem to leave or are forced out as the loan and thus weekly repayment size mounts. Poorer clients drop out from MFIs primarily because they find problems repaying their loan, having fewer, less diversified sources of income and thus being vulnerable when illness or death strikes. So far, most microfinance providers have not responded to the different client characteristics and adjusted their products accordingly (*Mutesasira* et al 1999; *Wright* et al 1999c). However, some observers of the Ugandan microfinance industry feel that it has to be acknowledged that the methodologies used in Uganda have proven to attract significant numbers of clients and that the rigidity applied may have been quite appropriate for the start-up and learning period of the industry.

Box 2: Uganda Microfinance Union – a spearhead of innovation in Uganda

The Uganda Microfinance Union (UMU) was set up by two friends – one Ugandan and one American – who decided during their student days to re-invent microfinance in Uganda. After extensive preparatory work, UMU was established with the help of a USD 50.000 grant from the Bank of Uganda as a locally owned, non-governmental organization in the summer of 1997. Feeling that most microfinance providers, especially the well-established bigger ones like FINCA and PRIDE, offered only inflexible and restrictive products, the two founders wanted to do microfinance in a different way.

UMU now provides a whole range of products, including current accounts, fixed deposits, working capital loans, individual lending with employer guarantees and capital asset loans. Solidarity groups exist for working capital loans as well as for capital asset loans, with the latter being larger and having longer loan terms than the former (1-6 months for working capital loans and up to 1 year for capital asset loans). At disbursement, each member of a solidarity group can decide for herself (70% of UMU clients are women) how much she wants to borrow (within certain limits), how long she wants the loan for (e.g. from 1 to 6 months in the case of working capital loans) and how she wants to repay: weekly, bi-weekly or monthly. UMU does not ask for blocked savings, weekly meetings or formal collateral, and it allows prepayments. The pre-credit training only takes 1-2 hours and loans are disbursed three days afterwards. Once a month one or two members from each group have to attend a meeting, which is more of a forum for discussion and exchange of experiences than a monitoring meeting.

UMU also offers loans to employed individuals without physical collateral, provided that their employer guarantees the credit. These loans are very popular among the working poor in urban areas. For example, half of the staff of one of the biggest microfinance capacity builders in Uganda has such a loan outstanding with the Uganda Microfinance Union. Currently, UMU's 10.000 clients are evenly spread around urban, peri-urban and rural areas. In spite of the fact that UMU is offering considerably lower effective interest rates (40% to 52%) than almost all other MFIs in Uganda, the MFI is close to operational self-sufficiency – after only 3 years of operation. UMU believes that its secret of success is that it is offering products that clients actually like and need. Moreover, UMU is cross-subsidizing loans to poorer clients with the low maintenance and more lucrative employer guarantee loans.

When UMU opened its doors three years ago, very few wanted to believe in the concept. It took UMU at least 2 years until it became accepted by the microfinance community and donors are still far from swamping UMU with money. However, nowadays the Ugandan microfinance industry has realized that UMU has set standards for client responsiveness and rapid progress and many MFIs have started to copy UMU's innovative and flexible approach.

Partly following innovators like UMU (see box 2 above), partly due to increased competition and donor pressure, several microfinance providers have started to experiment with new products more responsive to the needs of the clients. For example, FINCA is trying to broaden its product range to reach clients both up-market and down-market from its original village banking product. Individual lending will be introduced in early 2000, mainly to retain those clients that graduate from groups and that would otherwise be skimmed off by providers offering larger individual loans. In response to internal studies, which found clients to complain about the burden of lengthy pre-credit training, FINCA plans to reduce its training sessions from five weeks to four or even less. Moreover, FINCA has introduced a health insurance scheme, which is especially attractive to poorer clients more vulnerable to external shocks. The launch of an agricultural lending product has also been considered, however, no appropriate methodological approach has yet been found. Other microfinance providers, including well established large MFIs as well as smaller ones, also think about introducing new products, or are already experimenting with them, including emergency loans, drought insurance and attractive savings facilities.

9 Competition and Commercialization of Microfinance

Competition for clients among microfinance providers is a relatively new phenomenon in Uganda and the degree of competition is not as intense as in other well-advanced microfinance countries like Bolivia, Chile or Paraguay. However, the forces of competition have already changed the face of the Ugandan microfinance landscape. In Kampala, all large MFIs (CERUDEB, FINCA, PRIDE, UWFT, UMU, FAULU) and a number of smaller microfinance providers have set up branch offices and compete head-on against each other. Even in a smaller city like Masaka, six MFIs offer financial services to more or less the same client group. However, competition is only prevalent in the urban areas of the central region, especially along the Kampala to Jinja and Kampala to Entebbe, Mbale and Masaka corridors. Some MFIs fear that these markets are already close to saturation, however, most key players believe that as long as providers keep growing, as they do, and until no microfinance institutions have to close down or merge, saturation may still be far away. By way of contrast, in the rural areas only very few microfinance providers operate, thus leaving most of the rural population without access to MFI services.

Nearly all key players of the Ugandan microfinance industry, including all larger MFIs, believe competition is a good thing.

While most providers find the growing competition challenging, everyone agrees that clients benefit from it, receiving more and better services. So far, the large majority of microfinance institutions has offered similar services and products, with little consideration for the diversified needs of diversified client groups. With usually only one supplier offering microfinance services in one area, clients were not in the position to make a choice. Along with growing competition, MFIs are now forced to give more attention to the needs and preferences of the clients and have started to craft products more responsive to these needs and preferences. Microfinance providers have began to examine their own products vis-à-vis the products of their competitors. As urban clients of the central region have started to exert consumer preference, what CGAP's Robert Christen calls the "yellow pajamas" myth – that clients would respond to nearly any requirement that microfinance programs imposed, even standing outside in yellow pajamas – is disappearing in this region.

While the large majority of Ugandan MFIs are still providing a single product or a very restricted range of standard products, most larger MFIs have started to consider, or are already adopting, new strategies to attract and retain clients. Among the early responders, UMU has been innovative from the very start and CERUDEB has had a competitive advantage over non-bank providers, being able to offer various savings facilities. FINCA is putting increased emphasis on understanding its clients and is now conducting comprehensive market research before opening new branches, establishing focus groups for service assessments, and conducting client impact and preference studies that include drop outs. FINCA is also developing a culture of marketing within its staff. Among its market strategies adopted are: promoting and professionalizing its public image through higher quality passbooks and promotional materials, sponsoring public events, training its staff in sales techniques and the importance of service quality, and using impact and preference studies to craft appealing services and messages. While some of these changes may have been made in any case, the competitive environment has pushed organizations to do so more urgently.

Competition has also led MFIs to reinforce their sustainability efforts. Microfinance providers are no longer in monopoly position, neither vis-à-vis their clients nor in relation to donors. MFIs are now trying to provide credit and savings facilities more efficiently and increase cost-recovery, thus having more resources available to improve their service quality. Moreover, as donors willing to support microfinance are now able to select from a broader range of providers, MFIs have become more mindful of donors' preferences for sustainability. Along with the pending regulation and other factors, this has increased the industry's cohesiveness and drive for sustainability.

Box 3: The Effects of Microfinance

In recent years, the market for microloans in Bolivia's cities has reached a high degree of saturation. On the order of 300,000 loans are outstanding, against a population of microentrepreneurs estimated at 600,000. The resulting intensive competition among microfinance institutions and consumer lenders reveals effects that may occur elsewhere when competition increases.

Bolivian microentrepreneurs are taking advantage of their choice of several providers to be more demanding and to access more credit. One notable effect has been a race to provide faster, more convenient services. Loan approval times are now measured not just in days but in hours. Customers have shown a strong preference for individual rather than group loans: most group lenders are adding individual loan products to protect themselves against client desertion, and individual lenders are growing faster than group lenders.

Customer loyalty has faded, as clients sample various institutions, attracted to whichever lender offers the largest loans. It has even become a status symbol to have more than one loan at a time. Loan size escalation and multiple loans have created a dangerous syndrome of *sobreendeudamento* (overindebtedness) in which clients exceed their debt capacity. As a result, delinquency and default have surged throughout the system. Improvements in the credit bureau (*Central de Riesgos*) and tightening of regulations have helped but have not eliminated the problem.

These conditions, combined with a recession, are creating great stress among Bolivian microfinance institutions. Profits are down, and several institutions are seeking merger partners. Most institutions are developing new products to attract customers. Some observers worry that competition will drive microfinance institutions away from the poor. Although it is clear that most lenders are making more large loans, they do not seem to be abandoning low-end customers. Bolivia's experience shows that competition brings better services to clients, but makes life much more difficult for providers.

Unlike in Bolivia (see box 3 above), where intense competition has increased delinquency and default, no serious negative consequences of growing competition can yet be observed in Uganda. Clients have become more experienced and cognizant about their choices, sometimes threatening to leave and switch to other providers. In response, some MFIs have loosened their formerly rigid procedures and rules. For example, one large provider seems to have accepted higher in-cycle delinquency, provided that clients pay at the end of the term. As most MFIs are faced with a considerable drop-out problem, client retention has become one of their key concerns. Microfinance operators feel that they can no longer afford to push out all clients that miss some payments or attend meetings only irregularly, as long as they keep paying their dues.

Clients are starting to take advantage of increasing competition also in other ways. In areas where competition is most intense, multiple lending is becoming a problem. Some clients seek multiple loans which exceed their repayment capacity, or move to new institutions to escape bad credit histories. Efforts to identify bad borrowers systematically have been thwarted by the lack of a national system of identification cards. Borrowers can simply change the names they use. Microfinance institutions have attempted to get hold of regular defaulters by circulating photographs or attending each other's meetings, without too much success, though. However, multiple lending seems to have had little effect on delinquency indicators yet, but providers are aware that it could endanger the health of their institution in the future.

Observers of the Ugandan microfinance scene are also concerned that competition could result in MFIs concentrating on the wealthier and thus more profitable clients, leaving the poor behind. However, there is little evidence of such a trend. So far, only CERUDEB focuses primarily on upper-level borrowers by providing individual loans against collateral. CERUDEB is partly skimming off the most profitable clients from its competitors, which offer only group-based credit. As already mentioned above, many MFIs operating in competitive environments have already reacted and are planning to introduce individual loans, too.

However, competition has so far not led providers to stop lending to the poor. FINCA, for example, is not only trying to grow up-market, but also attempts to serve more clients down-market. Among the strategies to do so, FINCA has introduced a health insurance scheme, moves its operations to areas ever less prosperous, and generally putting more emphasis on understanding the true needs of poorer clients. FINCA's average first loan has not grown over the past two years, clearly demonstrating that FINCA is not moving away from the poor. Other providers have also indicated that their response to competition is more product and client diversification – in order to serve formerly untapped markets – than moving up-market. In addition, competition is strongest for larger loans in Uganda, providing less incentive to concentrate on wealthier clients.

Critics of commercial microfinance usually mention that competition in microfinance may result in less attention to social goals and participation. In a competitive environment MFIs may not be able to afford maintaining the extra non-financial services that support social goals like better nutrition or empowerment (*Marr* 2000). In Uganda, most larger MFIs follow a minimalist credit approach and concentrate on the provision of credit and savings services. Additional services hardly exist and can therefore not be eliminated. Those microfinance institutions that do provide extra services, like FOCCAS providing credit with education, usually operate in rural areas where little or no competition exists. The general manager of UWFT even believes that competition and commercialization enables the institution to better meet their social goals, because the attainment of these goals is based on institutional sustainability and maturity. Moreover, the coming legislation will permit sustainable MFIs to become licensed to provide savings facilities. As outlined in Chapter 4.2, it will especially be the poorer households that profit from access to savings facilities.

Another area where competition might have negative consequences is client participation in governance. Some providers, especially the community-based organizations, see grassroots participation in governance as a core value. Commercialization may render such organizations less competitive, as they tend to be less technically versatile, less flexible and endowed with less resources to respond quickly to new market situations (*Rhyne* and *Christen* 1999). In Uganda, savings and credit associations and similar community-based organization have been fraught with a number of management and governance problems, and have therefore had little significance as financial service providers. Currently, a number of initiatives are under way to strengthen and professionalize these organizations. Whether competition and success in urban microfinance has in the past been detrimental regarding support to rural community based initiatives and/or is now increasing interest in CBO-approaches, is open to speculation.

Client participation in governance also plays a role in mainstream microfinance. In keeping up with the village banking movement worldwide, FINCA has phased out its internal loan product in response to insufficient capacity of groups to manage their own loans. FINCA has recognized that the original objective of creating self-sustaining village banks is difficult to achieve, and has moved away from it. Moreover, FINCA has also come to the conclusion the internal loans are competing with the MFI's own loans to the groups and denying the MFI the opportunity lend more and earn more. Most other MFIs regard client participation in governance as difficult to attain and even potentially dangerous when clients have too much control over operations and management.

The current drive of the Ugandan microfinance industry for sustainability and commercialization is a response to the coming legislation, which provides that only sustainable MFIs will be granted licenses as deposit-taking microfinance institutions, as well as a result of an increasingly inherent commitment of MFIs to sustainability, fostered by donors and capacity builders. However, a number of MFIs complain that the donor community is putting too much pressure on them, asking for sustainability and expansion at the same time, without providing the necessary resources. Especially when asked to expand into rural areas and develop new products, providers feel that donors should continue to support them. Also, microfinance providers state that they will need extra resources to meet the possibly very stringent requirements to become licensed under the new law. Most of the donors and capacity builders agree that MFIs need further support for the development of new products and for pushing the frontier of finance into more rural areas. However, they also feel that microfinance institutions should increasingly look for commercial funding sources.

Already, a number of Ugandan microfinance institutions have lines of credit with commercial banks, however, fully guaranteed by donor initiatives. Attracting private capital for microfinance will be very difficult in the prevailing weak state of the Ugandan financial sector, but it has been set as a goal by the microfinance industry. So far, savings mobilization as funding source has only been available to commercial banks. Those MFIs that plan to apply for a license as soon as the new regulation is in force, intend to make use of savings as funding source. One MFI, the new Commercial Microfinance Limited bank, has managed to attract social investors, which might inspire other investors to join the bandwagon. Other funding sources, such as issues of bonds, have not yet been tried for microfinance in Uganda. Some donors are thinking about setting up a joint guarantee fund, so that a common set of standards applies for all credit requests. The proposed donor guidelines will also help to reduce subsidies and promote access to commercial funds in a consistent way.

10 Conclusion: Why is Uganda ahead?

While four to five years ago only a few moderately performing MFIs existed in Uganda, the country is today endowed with one of the strongest and most dynamic microfinance industry in Africa. Uganda's microfinance providers still do not serve as many clients as similar institutions in Asia and Latin America, but the industry has reached a stage of development in terms of sustainability, outreach and coherence that is unmatched in other parts of Africa. The principle reasons for this success include:

Enabling environment

Macroeconomic stability, high population density in urban, peri-urban as well as some rural areas and favorable ecological conditions have provided a favorable economic and physical environment. An enterprising population combined with massive formal sector lay offs has resulted in the rapid growth of the micro and small enterprises sector. The population's experience with informal financial arrangements has further assisted its willingness to access microfinance services.

Weakness of formal financial sector

With a substantial number of bank failures, microfinance became to be viewed as the most obvious vehicle for delivering financial services to the poor and became expected fill the finance gap.

Government commitment

Besides ensuring macroeconomic stability, the Government of Uganda has been committed to private sector development. While the government's approach to microfinance was initially less beneficial (supporting bad practice and politicized credit programs), the government is acknowledging that the its role in microfinance is mainly limited to the provision of an appropriate legal and policy environment. The GoU has also become more accessible to the needs of the microfinance industry and is now actively encouraging stakeholder coordination.

Donor commitment

Early on, key donors supported the development of a healthy microfinance industry and pushed MFIs towards sustainability. Donor support and commitment to microfinance has increased over the years.

Committed MFIs with strong international alliances

International microfinance organizations have provided critical inputs in terms of capacity building, human resources and exposure to international experiences to their affiliated national MFIs.

Strong national capacity builders

National capacity builders have provided training and technical assistance to a large number of Ugandan MFIs, increasing their knowledge about best practices and improving their skills to apply these.

Stakeholder coordination

Stakeholders, including practitioners, capacity builders, government and donors, have increasingly learnt to listen to each other, learn from each other and coordinate and cooperate.

Competition

More recently, growing competition has forced microfinance institutions to become more responsive to clients' needs, put more attention on service quality and engage in the development of new products.

While it is not possible to gauge precisely the contribution of each of the above mentioned factors to the observed microfinance success in Ugandan, it is obvious that all stakeholders involved performed very well. Donors and particularly governments can learn that support and commitment to the creation of a favorable environment pays off in microfinance and thus poverty reduction. Factors like population density and climatic conditions can hardly be influenced, but governments, supported by donors, can promote macroeconomic stability, financial sector reforms, conducive regulatory policies and private sector development in order to make microfinance work. Uganda could be pictured as model for donors to follow. Donors have not only supported government in their effort to create enabling conditions, but have also displayed commitment to coordinate with stakeholders and invest significant resources into capacity building.

11 Remaining Challenges

As outlined throughout the report, Uganda has a well-established and vibrant microfinance industry. However, some challenges remain to be tackled, including:

- reaching out to **rural areas** in a sustainable manner;
- strengthening **community based organizations** so that they can become a viable option to reach poorer and more remote clients;
- **developing new products** more responsive to the needs of different client groups, including savings services, payment systems, emergency loans, housing loan products, investment loans, insurance products, agricultural loans, leasing, etc.;
- preparing MFIs for the **transformation** from NGOs to licensed microfinance providers;
- exploring and promoting **commercial funding sources** and reducing subsidization by donors;
- developing a stronger **MFI network** able to effectively coordinate the industry;
- educating stakeholders in order to prevent **negative publicity** from the press, politicians and the public;

Annex I: Donor Initiatives in Microfinance

USAID/Uganda was the first donor to provide substantial support for the development of microfinance in Uganda. USAID started to fund MFIs in the early 1990s and sponsored the microfinance seminar in January 1996. The Center for Microfinance under PRESTO has been set up in 1997 with the help of the Americans and has since than acted as the lead training and technical assistance provider for MFIs. The project will be succeeded in 2001 by SPEED (Support to Private Enterprise Expansion and Development), which is still in the design stage and will probably have a broader scope than PRESTO-CMF. In general, USAID puts microfinance in Uganda in the context of its wider private sector development program.

With its Financial System Development Project (FSD), **GTZ** strives to contribute to a stable, efficient and competitive domestic financial sector. GTZ does not support individual MFIs but follows a systemic approach and puts considerable effort into policy dialogue. As part of the program, BoU is supported by a GTZ team in the modernization of the national payment system. FSD also cooperates with other actors in the financial sector in order to contribute to the development of sound and sustainable institutions, including the Uganda Institute of Bankers (UIB), which is currently setting up a Microfinance Competence Center (MCC), the Uganda Security Exchange and the Capital Markets Authority. Finally, as one of the main FSD project activities, the GTZ team is supporting the Bank of Uganda to develop the legal framework for the regulation and supervision of microfinance.

The **European Union** has a rather unsuccessful history of credit interventions in Uganda. It's Microprojects Program, started in 1984 and implemented in cooperation with the GoU, was characterized by politization, poor portfolio quality and little efforts to apply good practices. In 1999, the program was restructured to fold all microfinance related activities into one program. SUFFICE now follows a financial system approach and supports the development of an inter-linked chain of sustainable and efficient MFIs. SUFFICE provides lines of credit to microfinance institutions, matching grants to MFIs to cover costs of training, technical assistance and institutional strengthening, and promotes research, documentation and coordination.

Of all donors, **DANIDA** is currently implementing the most extensive program for agricultural credit in their Rural Financial Services Component (RFSC). Besides support to MFPED, working with the Uganda Institute of Bankers to assist MFIs, and promoting CBOs that provide microfinance services in rural areas, their largest contribution will be expanding the licensed bank Commercial Microfinance Limited (CML).

With a loan provided by the **African Development Bank**, the GoU is restructuring its PAP project and is currently in the process of transforming it into the Rural Microfinance Support Project (RMSP). The project will operate as an apex organization, providing capacity building as well as lines of credit to MFIs. The **Austrian Government**, which used to be one of the key donors in the early stages of the microfinance industry, has lost some of its influence due to budgetary restrictions. It continues to support several MFIs and provides flexible funding for strategic efforts.

Part II:
Structure of the Austrian Develeopment Cooperation in relation to microfinance in Uganda

1 The Austrian Development Cooperation in Uganda in difficult times – effects of budget cuts

In 1999, the budget of the Austrian Development Cooperation was severely reduced. With 60% less disbursements for programs and projects than in 1998, Uganda experienced the sharpest drop of all countries supported by ADC, resulting in severe problems for the Austrian Development Cooperation and some of its national partners. The crisis situation was compounded by two more factors. First, Austria held the presidency of the European Union in the second half of 1998 and stepped in for Finland in the first half of 1999 in Uganda, which lacked an appropriate representation in Uganda. By assuming this very time-consuming extra function in 1999, the Austrian Regional Bureau could spend less time for its programs and projects in a period when an intensive dialogue would have been of special importance. Second, the long-time micro, small- and medium enterprise development (MSM) sector consultant left Uganda in mid-1999 and was not replaced until early 2000. While the coordinator and other staff members of the Regional Bureau tried to take over some of the private sector responsibilities, the program and the project partners could not be given sufficient attention. As a result of these factors, Austria was not able to compensate the negative effects of the budget cuts through an intensified dialogue with its partners. Consequently, Austria lost reputation and influence at three levels:

The massive and sudden withdrawal of resources has markedly weakened the Austrian **position vis-à-vis the Government of Uganda**. The GoU is closely following such events and responds to them. While the former sector consultant had good relations with several key officials related to the private sector and microfinance, his departure and non-replacement for over half a year damaged the relationship with the responsible Ministries. The efforts of the new sector consultant to rebuild these relations are constrained by the lack of resources available to the Regional Bureau. While in the past, the RB could support initiatives of the Ugandan government relatively spontaneously – as long as they were in conformity to the

Austrian sector policies – and thereby build up considerable good-will and reputation, it has now lost this option to a large extent. Moreover, the GoU has tentatively started to coordinate donor initiatives in the private sector and has designated Austria, in accordance with the intentions of ADC, to continue its support for PRIDE. Austria has not been able to live up to this plan and thus lost some reputation. The process of the marginalization of the Austrian Development Cooperation in Uganda makes evident the connection between financial input and significance at the government level.

Simultaneously, the budget cuts as well as the temporary absence of the sector consultant changed the position of the **ADC in relation to other donors**. Austria was one of the smaller donors but not amongst the smallest. Due to the commitment and expertise of the MSM sector consultant, Austria was perceived as an important player, especially in the field of microfinance. The budget cuts and the absence of a sector consultant tarnished Austria's good reputation. For example, when Austria was no longer able to provide the promised support to FINCA, the RB was compelled to address to the Norwegian government with a request to step in. While the Norwegians followed this request and thus guaranteed the survival of the MFI, Austria clearly suffered in terms of influence and reputation in the donor community. The current sector consultant is trying hard to re-establish Austria's reputation by engaging pro-actively in donor dialogue, however, in order to regain profile The Regional Bureau needs funds to back up the current efforts.

While all donors interviewed agree that the RB and especially the new sector consultant are very committed to the development of the private sector, particularly in microfinance, and are also very dedicated to donor coordination, it also became clear that the standing and influence of an individual donor is dependent on the financial resources invested in this field. According to the donors interviewed, small donors should also perceive themselves as small donors and act accordingly. While larger donors welcome contributions and coordination efforts from smaller donors like Austria, they feel that larger donors should be granted the proper visibility in joint initiatives. The Regional Bureau seems to heed this principle and no interview partner complained about inappropriate flag posting from the Austrian side.

The budget crisis has also affected Austria's **relations to microfinance institutions**. For a long time, the extent of the budget cuts and their effects on the financial resources available to the Ugandan Regional Bureau were not known. The RB was therefore not able to inform its microfinance project partners whether and when the promised funding would be forthcoming or to what extent it would be reduced. For PRIDE, this had severe consequences. When the promised funding of USD 600.000 was not forthcoming, PRIDE suffered a liquidity and crisis that almost brought the organization down. The only way out of this crisis was to approach the central bank (Bank of Uganda) and ask permission to on-lend a proportion of client savings. This is strictly illegal for non-formal banks under the Ugandan banking law. However, there was no other option apart from closing PRIDE, which would have shaken public confidence in microfinance very badly. Bank of Uganda gave permission to do this and PRIDE is still on-lending some of its savings to its members, in contravention of the law.

In addition, the final, fairly small tranche of the Austrian funding prior to the budget crisis was not forthcoming, which caused some difficulties for PRIDE. This incidence seems to have happened due to a misunderstanding between the Austrian Ministry of Finance, which disbursed funds to PRIDE, the microfinance institution and the Regional Bureau. The situation was compounded by the departure of the sector consultant without someone feeling responsible or having the necessary information about the procedures and agreements between Austria and PRIDE. While PRIDE is still hoping that Austria will one day continue its support, there seems to be little financial room for this on the Austrian side at the moment.

As already mentioned, the Norwegian government stepped in and compensated Austria's failure to fulfill its funding pledge in the case if FINCA. The third MFI supported by Austria, FOCCAS, received its funding also later than promised, with negative consequences for the planning and budgeting of the microfinance organization. In summary, Austria lost considerable reputation and standing among its partners – government, donors and MFIs – as a result of the budget cuts and the failure to replace the country sector consultant in time, and is currently obliged to put a lot of time and effort into rebuilding confidence and strong working relationships.

2 Perspectives for the Austrian Microfinance Interventions in Uganda

Due to an active and knowledgeable country sector consultant on the one hand, and the provision of relatively large sums to the sector, at least for a small donor, Austria was at the forefront of microfinance development in Uganda in the mid-1990s. Austria's pioneering role was mentioned by all stakeholders interviewed during the evaluation. It is generally acknowledged that Austria pursued the right strategy to support microfinance development in Uganda. The RB was one of the first donors to support MFIs in Uganda and put a strong emphasis on institution building. Austria supported only those MFIs that had strong international alliances with track records as technical implementers. These alliances (FINCA International, PRIDE Africa and Freedom from Hunger for FOCCAS) could provide the necessary input in terms of capacity building, technical assistance, technical advisors and expatriate managers, and exposure to international experiences. This support enabled their national affiliates to leapfrog the long learning process that had gone on around the world. Both FINCA and PRIDE now belong to the most advanced microfinance institutions in Uganda. Austria's support to these institutions has certainly contributed to demonstration effects, with a number of MFIs having replicated their model and other donors and even private (social) investors having developed interested in microfinance.

It is also acknowledged that Austria supported these MFIs in a beneficial way. ADC not only provided funding for institution building, but also support for outreach expansion and product development. Austria chose MFIs that had the capacity to develop their own strategies and methodologies. While the Austrian sector consultant actively looked for dialogue with the partner MFIs, he did not design the programs or intervene at management level. Agreements were established on few but important performance targets that embodied the goals of both ADC and the MFI. The Regional Bureau viewed its main role as monitoring MFI performance and holding the organization accountable for the results agreed upon in project targets.

Similarly, the RB understood that an enabling environment is key to national microfinance development. The country sector consultant realized that the responsible government body for regulating the sector, the Bank of Uganda, lacked capacity and needed support. The Austrian Development Cooperation initiated a microfinance policy discussion by funding the preparation of a rating system. Although this rating system did not come into effect, the initiative is considered as one of the first earnest attempts to collaborate with BoU on microfinance and open a policy dialogue. Moreover, Austria has been one of the first donors to venture into microinsurance in Uganda by supporting a stand-alone community-based microinsurance project, implemented by ILO in 1998.

However, during the late 1990s more donors entered the field and stepped up their funding to microfinance initiatives. At the same time, Austria's contributions remained at more or less the same level and experienced a sharp cut in the last year. Austria is therefore in a comparatively much weaker position than some years ago. This has been compounded by the departure of the long-time country sector consultant. While the new consultant appears to bring all qualifications necessary to become an accepted and strong player in the sector, she is severely hampered by the budget constraint and the long period without serious Austrian participation in the Ugandan microfinance industry.

Especially in view of a very limited budget for microfinance, the Austrian Regional Bureau is in the process of defining a new microfinance strategy and re-positioning itself in the microfinance arena. The goal of this process is to find a suitable role as small donor and increase the effectiveness and visibility of Austrian microfinance interventions. In general, the MSM country sector strategy (program) is prepared by the country sector consultant and discussed with the MSM sector consultant, who prepares the overall MSM sector policy following the international discussion and the Austrian MSM experiences in the field.

While some funds have just been disbursed to FOCCAS, and FINCA will probably also receive some more funding, the RB considers direct support to individual MFIs not as one of its future main strategies. First, Austria is not in a position to provide relevant financial support to MFIs. Second, in view of the unstable budgetary situation, ADC does not want to commit itself to long-term support, thus avoiding the dependency of MFIs from regular financial contributions, which might again not be forthcoming in a timely fashion. The Regional Bureau rather views its possible role as a strategic and flexible supporter of the Ugandan microfinance industry. Currently, there Bureau follows three levels of intervention:

- Supporting innovation in MFIs. The RB continues its support of FOCCAS and FINCA by funding product innovation and covering operational costs to increase outreach
- Support the establishment and improvement of the microfinance sector framework, mainly by providing policy and strategy inputs to the GoU and other stakeholders of the industry
- Supporting market and strategic studies. This third level of intervention should strengthen the product innovation as well as the framework support intervention level
- Support and promote cooperation and collaboration efforts of the microfinance industry

The Austrian Regional Bureau has prepared these strategies in response to (1) the budget constraints, (2) according to the Austrian comparative advantage at the current stage of development of the Ugandan microfinance industry (3) and in relation to the framework of existent initiatives and strategies of other donors. Already in the past, Austria acted as a flexible and strategic supporter of the industry and the current Regional Bureau tries to make use of these experiences and resume this orientation. While the current efforts are adapted to the new budgetary situation, the performance and success of these efforts will continue to be related to the funds invested. The new country sector consultant is putting a lot of emphasis on strategic issues and is committed to joint donor initiatives dealing with microfinance support structures, like guarantee funds and training packages for MFIs graduating from NGOs to formal banks. The Regional Bureau also considers to act as flexible funder willing to fill gaps where they arise, provided the initiatives are in conformity with Austrian microfinance policies and strategies.

3 Structure and Actors of the Austrian Development Cooperation

As far as the instrument of microfinance is concerned, the structure of the ADC includes on the side of the Ministry of Foreign Affairs, Department for Development Cooperation: the

Regional Bureau with the country MSM sector consultant and the head of delegation in the Regional Bureau, one sector consultant responsible for MSM sector policy, and one country desk officer in Vienna responsible for all East African countries. Outside the Ministry, project partners are implementing Austria's microfinance interventions. As far as the three microfinance projects looked at in more detail in this evaluation (FINCA, PRIDE and FOCCAS) are concerned, the Austrian Ministry of Finance transfers the funds on behalf of the Austrian Ministry of Foreign Affairs directly to the Ugandan Ministry of Finance and Economic Planning (MFPED), which then disburses the funds to the microfinance institutions.

3.1 Country Desk Officer

The country desk officer is responsible for all activities in the countries he is assigned to, including microfinance programs. Although the country desk officer has the final authority as regards individual projects, he usually decides according to the recommendations of the MSM country sector consultant. Following the decentralization approach, an large part of the administration tasks are also performed by the country sector consultant.

The evaluation team views the role of desk officer in Vienna as an information consumer and distributor of information, rather than as an crucial partner involved in decision making. This means that the current effort of Regional Bureau to reposition itself strategically regarding microfinance interventions is partly carried out without the assurance that these decisions are in conformity with the views of the headquarter. Thus, decisions may be taken and implemented in Uganda with the risk that they might have to be amended at a later time, in case other actors in the Ministry view them as not corresponding to overall policies or positions of the Austrian Development Cooperation.

3.2 MSM sector consultant

The MSM sector consultant's main task is to prepare and coordinate the overall MSM sector policy and to endorse country sector programs. The sector consultant participates in the international sector discussion and coordination, distributes sector relevant information and responds to enquiries of the country sector consultant. In the past, the cooperation between the MSM sector consultant and the former country sector consultant in Uganda was severely hampered by personal disparities between the two actors and the ensuing breakdown of communication. Between these two actors hardly any exchange of information took place. The country sector consultant did not place attention on policy papers prepared by the sector consultant and the sector consultant had only limited knowledge of the sector interventions and the strategies pursued in Uganda.

Most actors of the Austrian Development Cooperation agree that the role of the sector consultant as a hub for information exchange is sufficient. The sector consultant functions as a service provider and has no authority to intervene at the project level. The responsibility for programs and interventions lies with the Region Bureau and with the desk officer. The sector consultant only provides additional input or becomes more involved at project level when asked to do so by the Regional Bureau or the desk officer.

According to the Regional Bureau, the role of the sector consultant could be broadened by making her not only responsible for the distribution of sector relevant information but also for a structured exchange of information. If this function would be linked to certain criteria, for example commenting reports and adding additional information, the information system would gain in quality. According to the Regional Bureau, this would assure more headquarter involvement in policy discussions.

3.3 Regional Bureau in Kampala

It is the opinion of the evaluation team that the good standing and reputation of Austrian Development Cooperation in microfinance in Uganda until the budget cuts is closely related to the ability of the well-staffed Regional Bureau with one staff member being only responsible for the MSM sector, to intensively deal with the microfinance sector, build up strong personal working relations, participate in coordination efforts, and contribute to the development of the microfinance sector. Moreover, a well-staffed Regional Bureau facilitates mutual support, broad-based policy discussions and reciprocal monitoring of all staff members. The evaluators gained the impression that working relations within the Regional Bureau are good and that the coordinator has been able to build a strong team.

Under the present circumstances, a strong Regional Bureau is of particular importance. The strategic re-positioning of the sector program will only be successful when sufficient staff resources will be made available. Especially in a situation where financial resources are no longer a means of control, interventions can gain visibility up to a certain extent by adequate human resource input. In order to allow substantial contributions in a field as vibrant and complex as the Ugandan private sector and in particular the microfinance industry, the sector must be attended by at least one Austrian sector consultant.

3.4 NGOs

The strategic re-positioning of the Regional Bureau in response to drastic budget cuts also impinges upon the role of Austrian NGOs in microfinance. As discussed in the first chapter and the sector overview, Uganda is endowed with a large number competent microfinance providers, partly supported by international capacity builders. For the Regional Bureau, the main partners in microfinance have therefore been national providers and not Austrian NGOs. Confirming this strategy, most microfinance intervention supported by Austria and implemented by Ugandan partners have been successful.

According to the Regional Bureau, Austrian NGOs could become more involved in microfinance in Uganda if they would engage in competitive bids put out in Uganda. If Austrian NGOs would place competitive bids, the Regional Bureau would be willing to support them. However, most actors of the Austrian Development Cooperation agree that Austrian NGOs might find it difficult to stand up in competition against international highly experienced and specialized microfinance organizations and technical implementers.

4 Information Flows and Systems

The current effort of the Regional Bureau to re-position itself in the private sector has to be based an stable system of information and cooperation between the Austrian actors involved in the sector. However, information deficiencies exist at three levels:

- technical information system
- documentation of sector interventions
- policy and program discussions and coordination

4.1 Technical Information System

Information and communication between the Regional Bureau and the relevant departments of the Austrian Ministry for Foreign Affairs are hampered by a deficient technical information system. The Regional Bureau has no direct access to parts of the data bank in Vienna. As a consequence, the country sector consultant in Kampala has no information regarding, for example, the status of funding proposals and dates of disbursements. This is especially problematic when disbursements are delayed and the Regional Bureau is not able to give accurate information to its project partners, as it happened with the last tranche to PRIDE Africa.

4.2 Documentation of Sector Interventions

The efforts of the Regional Bureau to define its new role are also constrained by the fact that no systematic and preset reporting system existed. As a consequence, the new country sector consultant found no hand-over notes and the documentation on the initiatives promoted and supported by Austria was deficient. Moreover, this lack of documentation made it difficult for the new sector consultant to refer to former communication networks and re-establish strong working relations.

4.3 Policy and Program Discussion

The evaluation team believes that the sector policy and program discussion among the responsible actors of the ADC is not sufficient in its current form. Especially when confronted with serious legitimacy problems in Uganda and the resulting effort to develop new strategic positions, a close cooperation and matching of interests between the headquarter and the Regional Bureau is of particular importance. Otherwise, the current delicate re-positioning of ADC in microfinance is endangered by information gaps and decisions may be taken in Uganda without full support from headquarter. Moreover, close cooperation and continuous dialogue are especially important in a new field like microfinance, where the pace of innovation is rapid.

Currently, the foci of intervention seem to be set by the Austrian Regional Bureau without much participation and contribution from the desk officer. While the Regional Bureau informs the desk officer about its strategies and asks for consent, no discussions in substance seem to take place. This also means that the consequences of the budget cuts on policy and program issues have to be borne to some extent by the Regional Bureau without sufficient backing from headquarter.

During the times of the last country sector consultant, the country desk officer and the country sector consultant had an informal agreement that the desk officer would concentrate more on Tanzania and the country sector consultant more on Uganda. While such arrangements are a result of time constraints on both sides, they also preclude substantial policy and project discussions. A similar arrangement has not yet been made with the new sector consultant.

This lack of information may impinge on crucial decisions taken by the headquarter, for example in relation to financial and human resources necessary to implement policies and programs that meet the Austrian requirements of significance and visibility. Insufficient information may lead to the failure of the headquarter to realize the importance of a particular approach or strategy and thus to the lack of appreciation for financial and human resources necessary to pursue this strategy.

For the headquarter to fully understand and appreciate the developments of the sector and in order to participate in policy and program discussions with the Regional Bureau, headquarter has to be furnished with more sector information and included more closely into the information system. This is even more important in times of strategy developments and when the focus of interventions switches from project to sector and product support. While the support of individual projects is much easier to administer in terms of finances and reporting, new ways of communication and reporting have to be developed for initiatives on a more strategic level like donor coordination and policy development.

However, information flows have to be two-way. The headquarter including the sector consultant should provide regular information on sector discussions within and outside the Ministry, report on important meetings like the Monday-meeting, inform about decisions taken that could impinge on the situation of the Regional Bureau and the sector, comment on the information provided by the Regional Bureau, etc.

6 Structure of Cooperation

As regards microfinance in Uganda, the structures of cooperation within the Austrian Development Cooperation are formalized only to a small extent. While the structures seem to be clear on paper, most actors agree that they are less so in reality. For example, there are no guidelines regarding the scope and content of reporting between Kampala and Vienna and vice versa.

As a result, the quality of the information flow and thus the decisions based on this information is highly dependent on the quality of the relationship between the actors involved. In order to start information flows and keep communication going, close personal relations are necessary. This implies that personal conflicts may lead to a considerable loss of information, possibly impinging on the quality of sector interventions – not only in the country concerned but in all countries with Austrian initiatives in this field. As already mentioned, this is what happened in Uganda between the MSM sector consultant and the MSM country sector consultant. As a result of this conflict, very little exchange regarding MSM sector policies, country sector policies and programs, and microfinance experiences in Uganda and other countries with Austrian MSM interventions took place, resulting in a huge loss of information and experience for the entire Austrian MSM sector.

In this context, arrangements should be made that give more weight to the MSM sector policy with regards to individual MSM sector interventions. Currently, the MSM sector consultant has no means to enforce sector guidelines. While in Uganda the microfinance interventions promoted by the country sector consulted were consistent with international best practices and therefore in general also with Austrian guidelines, in other countries Austrian supported microfinance initiatives sometimes do not meet international and Austrian microfinance guidelines.

7 Recommendations

The following recommendations relate to the structure of the Austrian Development Cooperation with regards to microfinance interventions in Uganda.:

- Systematization of reporting in order to professionalize communication structures
- Decision-making mechanisms promoting sector coherence
- Stabilization of the Regional Bureau

7.1 Systematization of reporting in order to professionalize communication structures

One of the most essential findings of this evaluation is that information flows between actors of the ADC are deficient. This deficit results in:

- the impression of actors to be not sufficiently informed
- the lack of documentation of interventions, which can, for example, make it for new consultants very difficult to familiarize her/himself with the program
- insufficient knowledge and understanding of the headquarter about the local framework in which sector strategies are pursued, which may result in deficient backing from headquarter

- insufficient knowledge of the Regional Bureau about discussions and decisions in the headquarter, possibly causing incoherence and loss of efficiency
- communication structures being highly dependent on personal relations between the actors involved

Especially in view of the difficult situation currently faced by the Regional Bureau in Kampala, mainly caused by budget cuts, and the resulting strategic re-positioning of ADC, this information gap is very problematic. In a transition period it is of utmost importance that all actors involved have the same information at their disposal in order to assess the relevant processes, form opinions, and make joint decisions.

There is also an urgent need to de-personalize communication between the actors and pursue the professionalisation of information flows. The evaluation team thus recommends:

- to dispose of the current highly informal information system prone to inaccuracies
- to establish a structured reporting system defining content and organization of information flows

Content-related systematization of reporting is taken to mean that reports about sector developments and interventions in Uganda have to be prepared according to agreed criteria, for example requiring strategic decisions to be explained. An stipulated number of persons (in particular the country desk officer and the MSM sector consultant) will then be obliged to comment on these reports. Moreover, the information flow from headquarter to Kampala should also become more systemized, for example requiring headquarter staff to report on important decisions and discussions, like the Monday meeting, or developments of other Austrian and international microfinance interventions. A possible approach could be the weekly and/or monthly preparation of a list of all relevant discussions and decisions taken in headquarter, with references to the persons involved and the probable consequences, which is then distributed to all decentralized structures like the Regional Bureau.

Organizational systematization will require the actors involved to provide reports and comment to these at preset intervals of time. Moreover, the information flows will have to be systematically documented.

However, the formalization of information flows should not be interpreted or used as an instrument of control. The Regional Bureau should not loose the autonomy granted to it as a result of decentralization efforts. Decisions about a systematization of reporting and communication should be made in mutual agreement of all actors involved. Intensified and systemized reporting should not result in less responsibility and decision-making power of the Regional Bureau, but provide a clear framework for discussions and decisions.

The evaluation team believes that a systematization of reporting will not work unless someone is explicitly made responsible for it, for example the MSM sector consultant for all sector relevant issues and someone within the Ministry for the dissemination of reports on overall discussions and decisions.

7.2 Decision-making mechanisms promoting sector coherence

Currently, there is no structured arrangement to assess whether MSM sector interventions correspond to Austrian sector policies and guidelines. This means that one the one hand the MSM sector consultant has no means to enforce sector guidelines, and on the other hand sector experiences on the ground can only partially be fed back into the sector policy. Thus, the evaluation team suggests to implement a structured decision-making mechanism, for example:

- the sector consultant can initiated a decision-making process if she is of the opinion that the MSM instrument is not applied according to Austrian and/or international principles and guidelines;
- thus, the sector consultant can call upon a team of Ministry employees to review the intervention and assess whether the instrument is applied correctly;
- in the course of this analysis, the team has to seek the opinion of the actors involved (for example the country MSM sector consultant);
- the MSM sector consultant does not participate in the assessment, she can only initiate this decision-making process;
- the team has to state the reasons why it came to a specific conclusion

7.3 Stabilization of the Regional Bureau

The evaluation team is of the opinion that the current situation requires a strong Regional Bureau, because:

- the loss of reputation and standing of the Austrian Development Cooperation due to the budget cuts can only be curtailed with the help of extensive human resource input from the Regional Bureau
- the Austrian Development Cooperation needs the Regional Bureau, which in spite of the budget crisis still has considerable reputation in Uganda, if ADC continues to view visibility and a certain degree of flexibility as an important element of its development cooperation
- the standing of the Austrian Development Cooperation can only be consolidated if more financial resources will be made available to the Regional Bureau in the near future

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