

**UNDP MICROFINANCE
ASSESSMENT REPORT**

FOR

Uganda

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A. Overview

Uganda is trying to act on what is now a worldwide ideological shift to the decentralization of government involvement in many sectors and a shift of motivation and responsibility for economic growth to the marketplace, with government keeping responsibility for security, and among other things, establishing and maintaining an enabling environment. Privatization is everywhere being proposed in Uganda and some donors are trying to respond by planning integrated efforts to support private sector development. But behind these changes there are implications which in some quarters may not have penetrated very deeply.

In Uganda, liberalization and financial stabilization are being achieved and are "here to stay". Financial reforms are in progress, but the entire banking sector is in more or less the midst of struggling to comply with the new standards set in the 1993 FIS act. In the next three to four years, the formal financial sector will necessarily be preoccupied with rebuilding and guarding its own health. In the process, a country which has been severely underbanked has recently become even more so. This situation has been sometimes referred to in our discussions as "the gap" in financial services.

Decentralization and shifting to the private sector by definition mean less power and less control at the top. Not just the planning functions but the actual "ownership" of at least some of the efforts to assist the private sector must themselves be in the hands of the private sector. Still, there seem to be some understandable tendencies in government and among some donors to want to have things both ways (e.g., decentralize while keeping central control, and help the private sector with public sector planning and coordination from the top.)

These tensions however are to be expected and are being experienced nearly everywhere. In Uganda, a very poor and very vulnerable country with a troubled past, continuing to face insecurity in the North and North west, the stakes in decisions about policy and problem solutions, for government and for the donors (without which the country could not function) are unusually high. The result is that there is a great deal more pressure here than in many other countries to solve many big problems at once. Donors for their part, recognizing how much they are needed here, do want to respond. In general such a situation favors responses which are not well thought through or given time to be tested.

Small signs of some distortions in the new market for microfinance are now visible (clients dealing with more than one MFI at a time, staff salaries going up and hence raising intermediation costs). And the institutional mechanisms which might eventually be able to deal with these distortions are also only just beginning (e.g., the launching on Feb 21 1997 of the Association of Microenterprise Finance Institutions of Uganda). Moreover, the legal and regulatory framework that eventually could put new MFIs on solid footing and back-up voluntary standards of operation and conduct, is very much in process, with major issues still to be worked out.

At the "bottom" of the system, where the targets of microfinance live and work - the microenterprises themselves, the women's groups, the community based groups and so on, there are also important transitions taking place. First, as the result of Uganda's history of many poorly managed projects and programmes to provide subsidized credit if not outright grants to poor people, a real habit of credit service (in which one is committed to servicing the loan one takes) has to be rebuilt. That habit was initially eroded not by poor people but by the well off who took advantage of commercial loans and whose default rates are much higher than those of the worst off. But habits spread. The greatest contribution of the best-practice-based MFIs may well be not the credit they provide but the fact that they are rebuilding that habit, little by little. But to do this AND at the same time adhere to best practice standards aimed at financial sustainability, they must focus where their chances of getting their money back are the greatest, in urban and peri urban areas, or areas where trading and commerce provide the regular cash flow needed to service short term loans.

In the process, especially in group based lending models, people are learning writing, numeracy and record keeping skills in a culture with an oral tradition; women are finding social space in which to deal with other issues important to them; they are being empowered; the tenets and responsibilities of local democracy are also being absorbed, and most important a banking and credit service culture is being inculcated. All these building blocks of credit service are highly subject to damage by MFI newcomers who may not be engaging in microfinance with the same quality as the best practice based MFIs.

It is arguable that Uganda's best road out of dependency and towards sustainable economic growth is to mobilize domestic savings. The tradition of ROSCAS (informal rotating savings and credit societies) has always existed in Uganda and is still there. These roscas are not and have never been donor dependent. There is evidence that both the capacity to save and the propensity to save - not just in the form of cows and goats, but in the form of cash money is present and may well be greater than policymakers think.

Rural people who make up the majority of the population are often viewed as incapable of saving because of their low incomes. This is in fact not true. In fact, a recent World Bank household country study in Sub-Saharan Africa showed that rural households in Africa have a higher average and marginal propensity to save. For example, India, which has one of the lowest per capita incomes has one of the highest savings ratios in the world. ("The Nature and Determinants of Domestic Savings in Uganda, Economic Policy Research Bulletin, 9/96)

B. FINANCIAL SECTOR OVERVIEW

While the GOU embarked on Financial Reform (stabilization and liberalization) in 1993, the actual process of restructuring Uganda's formal financial sector institutions is far from complete. Likewise the policy dialogue on financial intermediation is still in process. And there is some informed opinion that this dialogue is not as coordinated as it could be. As for microfinance, clear responsibility for it in the ministerial system appears still to be in flux.

The significance of the current situation with UCB (Uganda Commercial Bank, the largest bank and still government owned) cannot be overestimated. UCB has closed 55% of its branches in the last 5 years and is now up for privatisation. In the view of those bankers with a pure commercial eye, its attractiveness on the auction block is low. Two major banks have just come out of a BOU (Bank of Uganda) interim management restructuring (Sembule and Nile), and are as is the case in the sector as a whole, now going to have to concentrate very strictly on their own viability.

With the exception of CERUDEB and COOP Bank, which have donor funding to do it, no bank in the system in the short term will have the luxury of devoting much of its own resources or energies to reaching out to rural areas, developing linkages with non-bank MFIs, much less actually beginning to provide true microfinance products itself.

As the PSDP Financial Sector Assessment Report said in August 1996, "the system is in distress." The problems banks face are large, and interestingly some of these problems are mirror images of what non-bank MFIs face. At the same time there is optimism and a genuine urge to move forward.

The formal financial sector also faces a large number of technical, historical and infrastructural problems:

1. Cash-based economy. To the extent it is monetized at all Uganda is a very cash based economy - as much as 40% of the cash is not only outside the banking system but outside the country itself. One banker talked of the "Afro shilling" referring to widespread use of the USH in TZ, RW and Zaire. This situation of cash not being in the banks relates partially to a liquidity problem in outlying banks, which is in turn related to the physical security problems in the movement of money between branches, in turn related to infrastructure. Old fashioned, telephone transfers of money from Kampala to outlying towns is still being done, and is a costly process. Moreover, there are only 8 currency "points" in the country.
2. A slow payment system. The payment system is slow and inefficient. The use of checks is growing but decentralization of the clearing system has not yet taken place.
3. Low savings rate. (1995 2.9%) This is a debated issue. In a country with a very low GNP/capita and where some 80% of the population is in agriculture and the majority at subsistence levels (below the 6000 USH (\$6.00) per month poverty line), one can argue that

there is not much disposable money available for savings. Yet there are examples of fast and large savings deposit mobilization which, despite inefficiencies and limited options, suggest that indeed there is underused capacity and . In short, there is serious money under the mattresses, whether it is under everyone's mattress or not.

4. Low banking density. As of 8/96 there were 155 bank branches, agencies in Uganda. Only four banks out of 21 had more than 4 branches and only 2 had more than 20 (UCB with 85 and COOP Bank with 24). 75% of all bank branches are in Kampala.

5. High intermediation costs are partly related to infrastructure demands, security, and personnel costs.

6. Lack of support institutions. Support institutions, especially credit reference bureaus, arbitration centers, and debt collection agencies are needed. Thus financial information is poor even for the big banks. Thus banks have to make the costly investment in their own credit checking. Even the Registrar of Companies is "ill equipped to circulate the information they do have." (p 32 in Fin Sector Assessment 8/96).

The Uganda Bankers Association (21 member banks) does have subcommittees working on a number of issues, including fraud, and how to share credit information.

7. Limited number of financial products and low outreach. If anything banking outreach and products have shrunk. Not only is there "lop-sided sectoral distribution of credit in favor of trade and commerce rather than production (which is also the case with non-bank MFIs engaged in microcredit), there is also lopsided geographic distribution of credit (also true of non-bank MFIs at this time). Moreover even the small but growing middle class in Uganda suffers from limited or no access to ordinary products like mortgages and consumer credit.

8. Limited access and product diversity for small and medium businesses. Approximately 2/3rds of the commercial banks, deposit base is demand deposits, which are not suitable to support widespread commercial lending. Thus the appropriate liquidity is simply not there even for lending to the better off small and medium businesses.

9. Human resource inadequacies. On the job training, the predominant form of financial skills training, is severely limited by the demands on those few with skills to do so many other things, and formal training institutions still lag behind the demand for skills. Low morale and inefficiency are thus common still in the formal financial sector.

10. Slow disbursement of donor funds. Finally at the government level, the disbursement of donor funds aimed at financial reform and credit programmes is reported repeatedly as cumbersome, inefficient and costly. As one of the more blunt people spoken with said: "There is an enormous constipation of money in the bureaucratic pipelines."

Banks are however restructuring, and new laws have put the system on the right road. Yet these laws are not appropriate to Non bank MFIS. Capital adequacy requirements for local banks require a paid up capital of \$500,000 USD and for foreign owned banks, \$1 million USD. In the

current discussions with the BOU on a possible law governing MFIS, \$50,000 has been proposed as the capital adequacy threshold. Most MFIs are arguing this is too high.

The Bank Supervision Dept of the BOU is in a reconsultation process with the AMFIU members (the newly formed Association of Microenterprise Finance Institutions in Uganda). In the last 7 months there have been 8 substantive meetings between the BOU Supervision dept. and AMFIU members. These appear to have been a genuine exchange, on substantive issues where much mutual education was achieved. Case studies were presented, the Bolivian legal structure regarding non bank MFIs was studied, and discussions held on the question of where the threshold of exemption from supervision should be.

While actual progress in sorting out some hard issues for microfinance is moving slowly, the interest in microfinance in top level government quarters seems to be rising. FINCA and PRIDE have been heard about by many, but surprisingly few people know anything about their methods or their performance. At the same time, there is also some sense that because it is a hot issue, many institutions in government are moving quickly to establish Microfinance units.

1) The government's own credit programmes (Entandikwa and PAP) suffer badly from being government run. Both are viewed as unsuccessful and as having contributed further to a dependency culture. While there is evidence that PAP has learned some lessons and has begun to achieve a minimum of financial success, there remain bureaucratic and political interference, operational inefficiencies, lack of logistical support, poor motivation among front line workers, and undue complexity of goals and missions.

2. The proposed Uganda Postal Bank. The present Uganda Post Office Savings Bank (UPOSB), a non bank financial institution operated on behalf of the Government by the Uganda Post and Telecommunications Corporation, has very high potential to fill at least two of the present financial service gaps –increasing rural access to banking branches, especially the opportunity to save relatively small amounts of money. Presently the UPOSB is close to dormant. But it is still operating and has 93 outlets (housed in post offices) and in 3 regions (Arua, Hoima and Masaka) UPOSB is nearly the only bank-like institution. However the UPOSB does not use the additional network of 237 existing sub post offices in Uganda. Were it eventually to do so, coverage would be extensive (330 branches), and unmatched by practically any other formal financial institution.

Since 1993 three feasibility studies have been conducted by different German consultancies. The present legal regime under which the UPOSB operates (which precludes it from lending) is not seen as an obstacle, since the first task is to get the postal savings system's deposit mobilization operations running again, and it is expected that eventually legal changes may be made which would permit (at a much later stage) the postal bank to offer consumer, housing, or personal loans. The proposed UPB may never be a microenterprise credit intermediary, but right now the potential is there for it to provide basic financial services in the form of secure and accessible savings.

The studies have shown a weakened and tiny institution. As a department of the UPTC, UPOSB has only 35 employees; has mobilized about 11 of all savings deposits in the country (one of the

3 studies refers to the UPOSB deposits as "petty cash"), has extremely low productivity, operates a manual accounting system and has not posted interest in passbooks in 12 years. At the same time, deposits are on the increase as are the number of withdrawals, even though high turnover is somewhat penalized by the need to purchase a new passbook at USH 500 when the old one is filled up, all of which suggests a high demand for savings facilities, no matter how poorly run they may be.

C. THE CURRENT POLICY DEBATE AND MICROFINANCE

At the macro policy level, there appears to be a great deal of agreement on what the problems are. No one shies away from issues like privatization, restructuring, regionalization, open borders, infrastructural challenges such as feeder roads, poor communications, being underbanked, and the exclusion of whole parts of the country from development efforts, nor from the need to develop tourism, high value export crops and other sectoral competitive advantage. At the same time there is agreement centered around the common usage of terms like liberalization, private sector, cross-cutting issues, collaboration and participation, demand-driven solutions, sustainability and the end of most subsidies.

As indicated in the previous chapter, policy makers do not mean the same thing when they talk about microcredit.

Policy makers are still debating issues that have to do with equity. To the extent distributive concerns dominate the debate, there will continue to be talk of subsidies, even on interest rates. But certainly "incentives" for financial intermediaries to go where others fear to tread is being talked about and should be. Likewise, the view that micro credit should be part of a package, packaged with other services like marketing and production technology (which is correct in theory) will result in policy makers favoring integrated approaches even though these are highly problematic to implement. To the extent the debate becomes dominated by harder headed views such as having to accept inequalities in Uganda for some time to come and worry about distributive issues later, the climate for microfinance will be strengthened.

The UNDP is about to embark on a new CCF. The 5th Country Coop Framework (1997-2000) had been delayed by about 2 months. The evaluation mission for the 4th CCF did not occur until January. While officially the Programme Support Document and the Project Support Implementation Arrangement may be near or at completion, it seems realistic to expect that in practice new "bugs" will have to be worked out as the programme gets underway. It appears that the new CCF is a departure in that a programme rather than a project based approach is being used and two major themes are being introduced, which while not entirely new, are still relatively new for the Government and for some donors, as discussed above: Decentralization and Private Sector Development.

D. THE MICROFINANCE MARKETPLACE: DONORS, THEMES, SHORT TERM PROSPECTS

The short term (3 to 5 year) need for both microcredit funding and Institutional Capacity Building appear to be already sufficiently covered for Uganda.

The principal donors in micro and small enterprise finance are the Austrians, USAID, ODA, EDF and Norad. Those donors alone have over \$25,000,000 already committed to microcredit and institutional capacity building, of which only a small percentage has been disbursed.

There is general agreement among key informants on the donor side, people who understand micro-finance and have experience with it that the question of oversupply and overlap, and various pressures to disburse more credit, could be problems in the making, though this does not mean that all of their parent institutions share this view. Two of the major donors in this field in Uganda have or are trying to put some things on hold or slow things down: the Austrians, and to some extent the World Bank.

The Austrians view the current situation as "overpacked" and feel things are moving too fast on the microcredit front. They are concerned about MFI absorptive capacity. As a result of this they themselves began to draw back from putting more money into microcredit capital. Instead they are filling in holes in the larger microfinance system, and in particular are looking into long-term financing, leasing, and loan guarantee schemes. These are high risk areas, but they recognize the need for these kinds of interventions in what some call the "missing middle", (neither very poor microenterprises nor well established larger businesses). They hope to find out for example if 3 year financing at the level of \$10 to \$20,000 is viable, and will try to set up a FUNDES type foundation (FUNDES is a Swiss based organization which has successfully operated long term financing for small enterprises in Latin America.) They are also looking into possibilities in the field of non financial assistance, which incidentally, almost all who are close to enterprise realities say is much needed, but which most donors are hesitant to support because such services must be subsidized.

A view expressed at the World Bank is that there is considerable confusion on the institutional framework. \$4 million is on hold in the World Bank IFAD cotton sector project for rural finance under the agricultural secretariat in the Min of Planning. Moreover, informed opinion at the Bank is that the dialogue on finance has not been consistent. Apparently the direction of movement at the moment is even more towards fragmentation of the dialogue as there is discussion of a possible office of Rural Finance under the Agricultural Secretariat.

A few International NGO players on the scene have chosen not to get into microcredit. World Learning and CARE (which in effect chose to get out of microcredit after participating in the UNCDF/CARE/ CERUDEB project in Arua). The latter is particularly, noteworthy because CARE as an int'l NGO has growing experience behind it in microfinance in Guatemala, West Africa, Kenya and Southeast Asia. Its view is that savings mobilization is key and the Arua- case is often mentioned as an example (skewed though it might be by location near the border where

much illegal trade goes on). But the record shows that 1.3 million USD in savings was mobilized in 2 years. Lending activities however did not apparently result in significant penetration to rural areas.

Other important donors are also cautious about absorptive capacity in microcredit.

EDF (European Development Fund)

EDF's Microprojects between 1984 and 1990 were all on a grant basis. Only in 1990 was the idea of credit brought on board. The first loans were disbursed in 1992 (using a fund of ECU 1 million). An external advisor was brought in to help formulate a new credit policy. EDF is the only donor (and may well be the only financial actor in Uganda) currently doing long term investment credit of from 1,000,000 to 20,000,000 Ush (\$1000 to \$20,000) over 1 to 3 years. Originally thinking it would do this through an intermediary it decided to keep the portfolio in its own hands. EDF has evidence to suggest that investment credit makes sense in terms of business transformation impact, and can have relatively high recovery rates, but at a very high cost and not sustainable in terms of Internal Rates of Return. It is also slow in building this type of clientele. At the end of 1.5 years EDF has 200 investment credit clients in Luwero and 75 in Kabale and is accruing new ones at the rate of 7 to 10 per month.

At the same time it is also involved in microcredit as a lender to FINCA, PRIDE and CERUDEB. EDF's microprojects leadership is convinced that absorptive capacity for credit funds even among the best of the best-practice based players is limited, and takes a strong view on the need to support savings as a first priority.

On the capacity building side of the picture, the biggest change in Uganda is the start up of the long delayed PRESTO project.

The Presto Project

The Presto project officially began during this consultancy mission, in mid-February. Its microfinance office opens today, March 3, 1997. PRESTO has 3 components: i) A 4 year microfinance component which will be housed in a center for Microfinance in Kampala. The center will provide/offer training to all MFIS, providing there is organizational commitment to best practices. Not only is it mandated to include the newer and weaker of the MFIs in Uganda in their training and institutional development with, but right from the beginning it will include institutions in levels i through iii in the typology of NGOs presented in Chapter VI. Its first Module will be a primer for inexperienced microfinance institutions. It will also provide for on site consultancies (and cross visits) on subjects deemed necessary in individual cases (such as a system for loan tracking), and these too will be available to all on a graduated fee basis). Subsector studies will be undertaken to determine the potential for micro and small business growth in a limited number of subsectors which will then be targeted through a small grants program, and finally there will be an information and resource library, including an online service/center for institutional building. This microfinance component has a \$3.5 million budget for 4 years plus an additional \$5 million available for onlending (to be disbursed by USAID), to organizations that have proven to qualify, which is to say are committed to and have been adequately exposed to best practices. The Center will have a director, a Microfinance expert, an information services officer and 2 training officers. Two training modules are already in process

and two course modules will have been implemented by December of this year. ii) The second part of Presto is devoted to regulatory and policy reform. This is funded for 3 years at \$2.1 million. iii) The third part is for 2 years and is for assistance to business associations. This is for \$2.8 million. In total the Presto project brings \$8.4 million dollars in training and technical assistance plus \$5.0 million in credit funds.

ODA has only begun operating with a person in Uganda directly. But Hugh Scott anchors ODA's efforts in Nairobi, and is a strong presence in microfinance in East Africa having been in the region for some time. ODA's support for Uganda seems realistic and sensible. Basically in the next 4 to 5 years ODA's level of Microfinance support in Uganda will be in the \$500,000 to \$1 million range per annum. Its approach could be characterized as a deliberate attempt to be flexible, responsive, and fill in important space that can create greater efficiencies. Scott puts it as "the cement between the bricks". An example of this is the transfer to Uganda of the Financial Systems ratio analysis system which ODA has been instrumental in funding and disseminating in Kenya. This is a system that Presto is apparently interested in instituting. ODA will work very closely with Presto and relationships are already strong. Therefore it does not think in terms of a tightly defined program "design" or plan, but rather open ended possibilities based on agreements on fundamental principles.

E. ENTREPRENEURS, MICROENTERPRISES, And LENDING GROUPS IN UGANDA

An important issue in Uganda now is the expectation (and the resultant pressure on donors and policymakers), that microfinance, especially credit, will solve a great many of the country's difficulties in extending poverty eradication efforts to under-served populations. The most commonly heard expectation is that microcredit will fill the "gap" that has been left by the significant reduction in bank branches outside Kampala, in a country that even when it had those branches was seriously underbanked.

In the last 5 years alone, the international consultant has questioned at length and visited the business premises or locations of at least 400 microenterprise (defined as ongoing businesses with less than 5 employees) in 10 countries on 3 continents. Most of these were in fact sole proprietorships, or had 1 or 2 or 3 employees. Some were clients of microfinance institutions and some were not. A minority had a relationship with a formal bank (usually a savings account). Only a minority of these had ever taken a bank loan. In virtually every case, the capital requirements to start the business came from the operator's own resources - either savings, family assets/loans or occasionally from supplier credit. These enterprises have had two common characteristics (i.e. those which cut across all the societies and economies involved):

- 1) a demonstrable element (in the form of owners, equity) of commitment and motivation.
- 2) a structural (organic) limitation on rapid (or over) expansion of capacity, thus permitting learning to take place, some improvement of skills, and in turn minimizing but not eliminating personal risk.

These enterprises are by definition self-screening. That is to say that the operators tend to know (albeit imperfectly) what level of debt they can service. Those who are in the self-financed start up or early stages of their businesses, and who are likely to survive, are usually those who do not jump at the first opportunity for credit, even if it appears affordable.

When they have more experience under their belts, in most cases, their transformation to somewhat larger, more efficient, more productive businesses, if that is what the operator wishes, depends on access to working capital if one is in trade, and a combination of working capital and long term financing (investment credit or fixed asset capital) if one is in production or service. Some of these enterprises finance this next stage again on their own. This stage can be termed business transformation. And enterprises at that stage would like access to financial products offered by external intermediation institutions and will pay for it. It is this level and type of financing least available in Uganda. Most NGO type microfinance operations do not offer it (almost by definition) and commercial banks in Uganda are less likely now than ever to offer it without full collateral of the sort few have.

By contrast, in the last 15 years or so, the international consultant has visited, observed, or spoken with at least 1000 "beneficiaries" of micro credit projects and programs aimed at helping

people get more income from their enterprises or income generating activities. These have tended to have the following characteristics:

- The possibility of financing often stimulated the idea for and motivation for the business activity or the addition to the activity.
- Even when an asset or savings needed to be pledged as a proxy for owners' commitment, or when group based forms of lending were instituted, enterprise activities tended to be:
 - based on low levels of skill
 - part-time
 - based on low barriers to entry, thus subject to much competition
 - restricted to petty trade
 - very low or nil in employment, creation
 - easily abandoned in favor of going into a different activity with a subsequent loan, thus lacking a key characteristic of true business buildup, namely its "ongoingness".

Finally loan usage tended to slip fluidly from investment in the business activity to consumption spending and back again.

While in the first years such microcredit can and does demonstrate high repayments (because of the short loan terms, nature of cash flow in trading, group pressures, and high frequency of collections), in subsequent years because of the inherent limitations to even minimal business transformation at this level, lending programs tend to expand to scale laterally, (that is by simply acquiring more clients) without business activities themselves expanding to scale. There are few MFI institutions which have as yet expanded vertically (by acquiring bigger borrowing clients) and drop out rates of borrowers in later higher loan cycles are evident in many programs in which these conditions prevail. And while it has been the hope of micro credit institutions that they are there only to prepare enterprises to graduate to banks for higher loans, few of their clients actually do.

In Uganda, as explained elsewhere, state of the art microfinance is very new and the number of clients under the handful of programs following best practices we estimate to be no more than 8,000 to 10,000. The very oldest of the Best Practice programs is only now ready to expand to new branches. So the early signs of success must be taken as tenuous predictors of future success, especially because of the kind of culture of expectations that seems to have arisen in Uganda over its troubled history. There are extremely positive side benefits of such lending besides increases in household income and some small changes in business activity. In fact the group based systems applied by Finca, Pride, Faulu, Ugafode, CRS, and to a certain extent CERUDEB are creating a number of effects, particularly among women, that can be termed social intermediation functions. There is evidence of democratization in the group process itself, as there is of empowerment among women. People are learning genuinely new skills, not the least of which is the culture of writing, numeracy and record keeping.

Given the environment in which these programmes operate in Uganda, there is some danger that the poorest of the poor will not be reached with poverty alleviation lending, because the pressure

to perform financially by the lender is high, and as a result lending to the poorest has inadequate returns. And if greater numbers of low income people are reached, which is inevitable in the short term, donors and others may believe that they have accomplished their goals. Credit for the high repayment rates and institutional sustainability will go to the MFIs and the donors, while banks will pay attention to their own problems in the short and medium term, since they will believe that non-bank MFIs are taking care of the poor. In the meantime, those enterprises which right now, have the potential for greater productivity, will be missed.

Several examples:

1. A metal work shop with 8 employees full time, several old but working machines. The owner is capable of small manufacturing, but operating in a small poorly organized space, with inefficient machine's. He has only been able to get working capital when he had a big contract with Shell. Production of a block machine (based on prototypes which have been tested) which he believes has a market cannot be financed. Rent has gone up from 100,000 to 400,000 per month in the last 3 years subsequent to the Asian owner taking back the building. Taxes are also not only going up but collection efficiency and enforcement are also. Whereas this entrepreneur was on his way up (tenuously) 2 years ago, he is now on his way down. He believes that 2 to 3 year term financing would enable him to produce and sell the block making machines he has designed.

2. A 22 year old high school graduate who quit her job in a local company because wages were stagnant, used her own savings to begin selling second hand clothing in a space about 30 sq feet. She operates entirely on a micro version of just-in-time inventorying. She buys stock in the morning, sells it and buys again the next morning. She has opened a savings account in Greenland Bank and saves monthly. She has not heard of any credit opportunities but would not want to borrow anyway, as she says she is too small a business to carry the debt.

3. A woman in her 30s with 5 children and a husband cultivating their land elsewhere, started a woodworking manufacturing business with no capital and no technical skills. She describes herself as someone who can organize things. She gets a commission to build (standard design beds, coffee table sets and bureaus) takes a deposit and then buys the materials and hires itinerant labor to do the job. She sits on a bench watching 5 workers who supply their own tools. She would like working capital to buy and stock materials so she could make furniture to display, and also capital to buy a large planer. Based on 5 years of experience she believes that 2 million USH (\$2000) every 6 months would enable her to move up in her business significantly. She has two savings accounts, one at UCB and the other at Gold Trust. She has been approached by Plan International which has told her to get together a group of 25 persons. She says she will participate in this but is not' enthusiastic about it as the maximum loan offered is 300,000 USH.

How do the above observations tie in with the overall data available on the SME economy in Uganda?

USAID estimates based on a 1995 baseline survey suggest about 800,000 off-farm micro and small scale enterprises in the country with 80% operating in rural areas, 10% in towns over

4000, 2% in smaller towns, and 8% in the Kampala-Entebbe corridor. 63% are in Trade & Commerce, 29% in production or manufacturing, and 8% in services (though definitions used are questionable in some of the sub-categories). 37.5 % of SMEs are owned by women. 9% of the total are estimated as having 6 or more employees, thus 91% have 5 or less. Enterprises have relatively short life spans, the shortest on average 2.6 years in commerce and trade, 3.2 in services and 4.6 in manufacturing.

In terms of subsectoral categories, the estimates of MSEs per subsector are that 45% are retail, 27.3% beverages (of which a large % are locally made beer and waragi), 5.90% forest based, 4.9% textile. (the beverage figure is suspect and does not tally with other figures in the survey). Greatest growth (measured by employment) has been in retail trade and repair work (auto and bicycle). The survey found a generally low rate of backward and forward linkages, thus suggesting very low value added in the way MSEs relate to one another, with especially low maturity in this regard in manufacturing.

One of the interesting findings of the survey (which covered 5143 enterprises) is a high degree of suspicion and resentment of the surveyors. Apparently there is awareness that aid agencies promise something as the result of surveys but produce nothing. Moreover, because of the increasing presence of the Uganda Revenue Authority, respondents were widely distrustful of the surveyors. This situation will have implications for any microfinance effort that has initial baseline work as part of its planning. Any before the fact reliable analysis of needs, effective demand, and debt capacity will be hard to determine.

Given all this, surprisingly, 29% of those surveyed said they did not need or want any type of assistance; 25% stated credit as a need, 23% technical assistance, 8.5% marketing assistance, and 11 % social assistance. Moreover when asked about problems faced in the last year, production constraints were more important (23.3% than capital (22.6%) with problem of limited markets just behind (21.5%).

While figures on past credit experience are highly unreliable, in gross terms, it appears that most MSEs have never borrowed money, and of those who have, 90% have done so in the informal market (family, money lenders, roscas). However, 17% did report having a bank account.

Several hypotheses are raised by this survey: The SME sector is the largest employer in the country. The sector is vibrant-and especially the commerce and trade subsector has been showing high growth. At the same time the SMEs are immature, and not contributing to the productivity of the economy, nor is there evidence of economic articulation in the SME sector.

The high number of estimated SMEs in beer and sheen production, food stalls, petty retail trade and vending, small low skill manufacturing from scraps, etc. suggests a vibrant economy but one that is growing laterally, by atomization and fragmentation, rather than by adding value, innovation, efficiencies, or labor productivity. What we see is a locally based landlocked, non export economy of low income producers serving people like themselves, low income buyers. Increasingly, more and more people are both buyer and seller in the same setting. In that sense, everyone is an enterprise of sorts. Taking the round figure of 800,000 non farm SMEs in the country, with an average household of 4.8 persons, the SMEs in Uganda, before counting

additional employment affect over 3.8 million people, which means that virtually everyone not connected with agriculture is involved in the SME economy. As more people enter into this low-barriers-to- entry SME economy daily, bringing no new skills, infusions of small amounts of credit will enable more to begin trading the same kinds of goods along side others. Some will do a little bit better, others will do the same, some will do worse.

In Uganda, it is not yet self-evident that microcredit is a key to unlocking the potential that resides in this economy. while entrepreneurs' stated need for credit is increasingly questioned by those who think carefully about microcredit (e.g. JD Von Pischke at the World Bank), in Uganda, some enterprises themselves are perceiving that this is not all they need, and may not right now be something they need at all.

Finally, there is strong reason to believe that the give away culture remains entrenched. Some examples:

In a Parish based lending group in Kampala with 50 members (using a village bank methodology) most of the borrowers are small scale traders. The group lending meeting is unusual in that the visitors. are asked not to give speeches but to answer questions. First it should be understood that the MFI's own credit officer staff have been working with this group for some months and have carefully explained the MFIs strict policies. Therefore it-is revealing that member questions seem to be their way of continuing to test how real and how strict these policies really are. These were the questions asked:

"Will this MFI begin offering materials instead of just credit?"

"Why can't I repay every two weeks instead of weekly. My business makes it hard for me to repay weekly.?"

"Why won't you allow us to invest our credit in raising animals or in brewing beer?"

"Could you tell us please if in future you will be bringing anything else to us besides credit?"

"What is the highest amount this MFI can lend?"

"Would it be possible for me to get credit so I can build a house, rent the rooms as a business and then pay you back 6 months later?"

In another program, we visited a client of the program who is in fact a medium size business owner. He runs a significant brick and tile making company with 30 to 40 employees and has been in business 18 years. He has three accounts in three commercial banks. He is willing to be part of a PRIDE 5 person solidarity group which restricts him to beginning loans of 150,000 Ush for which he has to attend a minimum of 8 meetings before he can even access this small amount. What he openly says he wants and can use are loans in the range of 50, 000, 000 USH (\$50, 000) , rather than \$150. Why then is he a member of this PRIDE microfinance credit group? He replies that he is in effect hedging his bets, in the expectation that in future, PRIDE

will become a bank, and as he understands that banking on a local level is often about personal relationships he is investing in a relationship with a future bank, at relatively low cost.

We have here two phenomena that are common in microfinance programs in a number of countries. In the first example, there is some evidence that no matter what people are told about the new rules, they still have some old expectations, and will continue to test the system to see if there is indeed a loophole. To the extent that those hidden expectations are not eventually met, some of those people will drop out (a good sign from a microfinance best practices standpoint, though not from the standpoint of the costs of building to scale). And in the present microfinance environment in Uganda where so many new programs are beginning and a few are poised (this very month) on the edge of major branch expansion (FINCA and PRIDE) these expectations will make the hill that these new institutions hope to be climbing that much steeper.

In the second example, we have evidence of how very limited access really is for even medium size businesses. So much so that they will mix themselves in with much worse off people, hoping to get access to big money at a future time. This phenomenon also contributes to a small distortion of microfinance aims, and because of the nature of the expectation, if more such clients become participants in group based programmes, this can have some negative consequences as the best programs expand.

A third example, of a FINCA group Village Bank, shows less evidence of these tendencies (though still some), but shows other real life problems that even the best programs have to face. A women's group called Agalia Awamu with 26 members (4 dropped out for various reasons including moving away) is now in its 4th loan cycle. While the group is supposed to preexist, evidence in this group suggests that it came together in order to be eligible for FINCA. 3 of the 26 already had savings bank accounts. There have been some problems with attendance and some late repayments, but these are handled as they are supposed to be, within the group itself. Still there is an investment in maintaining the group as the staff member needs to ensure that the record keeping (a relatively new skill) is properly done and that the group does indeed remain disciplined. The savings component is the backbone of this and other groups, and is perhaps as much appreciated a service offered here as the loans. Even though there are these real signs of self-reliance, such groups are vulnerable to collapse, and hold together for many reasons including in part because there is in the first year an expectation of something bigger at the end of the tunnel. one woman did ask if FINCA will stick with them beyond the 9th cycle (all they were originally told to expect) They were reassured that FINCA is here to stay and would still be "with them".

The tendencies, expectations, and the problematic day to day nature of real life microcredit programmes described above, which are common to many countries, are heightened and exacerbated in Uganda. The road ahead for the best Microfinance organizations is by no means a smooth one, and the rough spots will only be overcome if best practices are adhered to and safeguarded.

This chapter has tried to show not only the limits of microcredit, but also that doing it well is not a "bed of roses".

F. EXISTING AND POTENTIAL MFIs IN UGANDA

This annotated listing attempts to analyze the short and medium term capacity to deliver financial service in the MFI sector in Uganda. The full range is covered, though of course not every institution. The intention here is to create a typology according to likely and unlikely targets for eventual capacity building and other external support. The gap in access to financial services in Uganda and in particular, rural finance, is unlikely to be easily filled soon, (unless policy makers and donors rush to implement programs similar to ones which have failed in the past), though savings mobilization is the place to begin servicing rural areas. As this chapter will show, of all the bank and non bank financial institutions in the country, those conducting best-practice based microfinance are very few and very new, and as a result credit outreach is quite limited thus far. Even expansion plans (which are ambitious . though achievable) will not produce dramatic numbers, and will not reach all levels in the country.

There are now no more than 10 MFIs undertaking microfinance with all or some of best practice in mind, much less fully internalized. At present the number reached by the 5 best of these is between 8,000 and 10,000 and the total number reached by-all ten is maybe 25,000, though this last figure is very much a estimate and could be off by a factor of 2 or 3. If we take the expansion plans of PRIDE, FINCA, UGAFODE, FAULU and CRS, and a few others, add the newer organizations who will be entering this field now or soon (e.g.,World Vision, Plan Intl) and take into account the present plans of COOP Bank's USAID funded agency project, CERUDEB's expansion (using somewhat modified best practices), at best in the next 3 to 5 years best-practice based microfinance lending will reach perhaps between 150,000 (in a worst case scenario) and 250,000 (in a best case scenario). And most of these clients will be in the trading and commerce sectors.

At the same time, the projections we might make regarding responsible savings mobilization can be with little doubt much higher in terms of number of clients. Moreover, both geographic and sectoral outreach can be expected to be far greater than that of best practice based microcredit. Baroda Bank in the first 6 months after putting its new CAPLINK savings deposit product on the market place (with 6 branches) opened 10,000 accounts begun with \$5. 00 each. Granted these were in predominantly urban areas. But if efforts were made to get the proposed Uganda Postal Bank off the ground (a goal within the present grasp of government and the donors) and work with the new COOP Bank management to increase branches and hence savings outreach, and through them improve the management of deposit mobilization in, for example, primary cooperative societies, the number of new savers entering the financial system in Uganda in the next 3 to 5 years could be (quite conservatively) in the 1 million range.

A. Banks

of the 21 banks in the country now, only 2 can be considered to venture in varying degrees into small lending, though not necessarily micro credit. These are CERUDEB and COOP Bank.. Kigezi Bank has been involved in some donor funded pilot programs, and Bank of Baroda has recently developed new savings products aimed at the micro market. (It can be argued that Greenland Bank, Gold Trust, and a few others have done some savings outreach, and Nile Bank's mobile bank experiment continues). To review a few:

UGANDA COMMERCIAL BANK

The UCB story is well known. UCB's rural farmers lending schemes between 1987 and 1994 did poorly. Procedures were changed in 1994 to secure loans by savings using a 3 to 1 ratio. This helped but not enough. In part perhaps because this change came in at a time when interest rates were very high and devaluation was still going on, the picture may thus be distorted. In any case under the present restructuring, the policy is to withdraw from small direct credit in agricultural production.

BANK OF BARODA

Bank of Baroda makes it clear that foreign banks are the least likely banks to go into microfinance, though at the same time Baroda is unusual in its 50 year long presence in Uganda and its branch network (7 branches of which 5 outside Kampala). Baroda does lend to the small and medium entrepreneur but only fully collateralized. But it will lend, as do many other, as little as 1 million shillings and has a number of 3 year loans in the 1 to 15 million range (\$1000 to \$15,000) But it has been innovative in savings and in the opinion of the chairman of the bank, savings is now a competitive game among commercial banks, resulting in a minor interest rate "war". In August 1996 Baroda launched the Caplink (Capacity Linked) Deposit plan allowing an initial deposit of 5000 shillings (which can also be deposited in installments). The requirement is that this amount be deposited monthly. Interest rates offered vary between 8 and 126 depending upon the term the deposit is left in the bank. In short this allows a fixed deposit of 12, 24 or 36 months at the choice of the saver. Since September 1996 10,000 such accounts have been opened.

CERUDEB

CERUDEB was started explicitly to contribute to economic development in rural areas by mobilizing savings and rechanneling that money to small scale productive enterprises. Initially a savings and credit institution, in 1992 it received a license to operate as a commercial bank. It too, like Coop bank, has received significant funding for projects as well as international shareholding partners such as the French organization SIDI. The bank now has 8 branches. Since 1993 Cerudeb has applied lessons learned over the years to reforming its credit operations more in keeping with best practices in microfinance. It now has a \$650,000 current loan portfolio with 801 of borrowers borrowing amounts of 1,000,000 USh or less. It uses several different kinds of, and levels of security, and has been most innovative in allowing for chattel mortgages (cows, goats, furniture, small equipment); the involvement of local councils to sign off on applicants and group guarantees. By the end of 1995 it had over 8 billion Ush in deposits having seen a 31 % growth in savings in that year. Similar growth is reported for 1996.

COOP BANK

The Coop Bank is part of the overall national structure of the cooperative movement. It is an independent bank, and has the second largest bank branch system (24) in the country after UCB. It is not without problems, and is like other banks, in a process of transition and some

restructuring (a shift from the COOP Act to the Companies Act with capitalization funded by the US Govt. is underway) That restructuring may mean a slight movement away from the coop movement. Over the years COOP bank has been the recipient of donor monies for a number of projects, which is logical given its natural connection with the cooperative structure. A major USAID effort with COOP Bank (CAAS) is now ending. COOP Bank's involvement in various donor projects over the years is complex and this consultancy was not able to get into these details. But among other experiences was a project of \$3 million in production credit to 40,000 small farmers since 1990. Like virtually all other such projects enormous problems were faced. Nonetheless the project appears to have ended with about a 76% recovery rate.

What is of interest now is that COOP Bank has just taken on new acting management with significant experience in microfinance with some of the most successful microfinance experiences known the BRI and BKK systems in Indonesia. Mr. Robinson is also committed to savings mobilization. Moreover, USAID is beginning a new project with Coop Bank - a 2 year project for \$1 million (with part of that money perhaps coming through Presto) which is aimed at opening up 6 agencies in new areas of the country. In effect these would be new pilot offices BF the bank with an explicit microfinance mandate. The pilot effort will involve designing new projects and procedures, with a strong emphasis on savings mobilization, and an explicit intention to increase outreach. At this point no decision has been made on whether to try an individual lending methodology or a group lending model or both. Richard Onyang, dep Gen Mgr for Branch supervision, will be managing this with help from an expatriate expected to arrive in mid March. Robinson will oversee. The first steps will be identifying locations and then undertaking training, some capacity for which the bank has in house. Coop Bank will support \$64000 of costs for each of these agencies with USAID putting up \$400,000 in fixed costs, \$400,000 in loan funds, \$90,000 for training and \$142,000 for technical assistance. The general areas where the 6 agencies will open will be Owino Market in Kampala, Makono, North of Mbarara, West of Arua and West Nile. Some of the funds may also be on-lent to some Cooperative S&C societies.

G. PRIMARY COOPERATIVE SOCIETIES

The Uganda Cooperative movement goes back to 1913. The subsequent history shows as spotty a record of success as any in East Africa. In the 60s the movement was genuinely supported by government and much progress was made in terms of rural infrastructure development, membership, and savings and credit. With the political changes in the 70s and early 80s, government interference with coops and top down efforts to run them, inherent weaknesses (poor management, illiteracy among members) were exacerbated. In particular demonetization and currency reform brought the movement as a whole into serious trouble, and attempts to fix it are said to have made things worse. There is considerable documentation on this history. For the purposes of this report, the salient particulars have to do with the S & C coops.

UCSCU, the national union of S&Cs, was founded in 1972. S&C coop registrations went from 20 to over 850 by 1985. After the NRM came in with currency reform, the value of member savings plummeted and S&C coops since have had a hard time attracting members. UCSCU presently counts 212 active S&Cs with a total membership of 200,000 with approx \$100,000 in total share value. 40% of members are women. 6.6 million dollars in deposits are recorded as of end 1996. Most financial activity is in the urban or peri urban S&Cs, especially the employee owned ones, though 70 % of the S&Cs are rural. But S&Cs are poorly positioned in today's finance market. They have a very low historical recovery rate, membership is flat because overall faith and confidence in Coops remains low. Problems of safety and fraud remain, and most important the incentives for loans are not attractive with a general 2 to 1 ratio of loan to savings being the requirement. Still S & C societies charge lower loan rates (15 to 22%) than others while offering OK rates on savings of 5 to 12%.

The 1991 COOP act was instrumental as the first step in turning the tide around in the movement as a whole. This separated coops officially from the government. However the progress made in the last 6 years, with help from a number of prominent donors, has been apparently slow and uphill. The danger is that the restructuring of the movement may be coming too late, since liberalization (which all believe is here to stay) is creating competition across the board, not just in financial markets, but more importantly in the growers coops who will begin to lose their share in the benefits from the big Ugandan agricultural commodities (e.g. coffee). Aware of this, the movement's apex body UCA (Uganda Coop Alliance) is talking about seeking alliances with strong companies in agro processing and doing some joint ventures. At the same time UCA talks of getting into piloting of village banks which will cater to non members. And other projects involving credit are also underway (e.g. The UC/CCA Women's credit project which has \$CAD 200,000 from CIDA to set up revolving loan funds for small holder on farm projects such as zero grazing (approximately 600 borrowers to date).

Under the apex Uganda Coop Alliance are five National Coop Organizations, including UCSCU (the apex for Credit unions), Coop Bank (about to move from the coop act to the companies act), and an Coop insurance company. Then there are District Unions and finally the primary cooperative societies. But the movement overall contains many pockets of dormancy. Of 5062 societies registered as of 9/95 only 28.2 % are deemed active and 35 % semi active. Of the total

457 are Savings and Credit societies of which roughly 50% o 70% are rural, and of which 212 are deemed active by UCSCU (though UCA claims that 171 are active and 117 semi active). Moreover not all registered S&Cs belong to UCSCU. Of the 457 S&Cs listed by UCA only 247 belong to UCSCU, while 588 of total coop primary societies belong to Coop Bank (non S&Cs may also engage in S&C activities). More important is the fact that overall membership is low. UCA figures say there about 30,000 ACTIVE members in S&C primary societies, while UCSCU claims 3 to 4 times that number.

S&C societies operate now under the 1991 Coop Societies Statute (apparently there have also been recent changes in the law). But in that statute S&Cs can accept deposits from non members, but cannot loan to non members. As average membership of all primary societies in the country is low (about 67 members per society), outreach is limited. S&Cs can lend up to So-. of the Society's total assets in an individual loan with approval of the credit sub committee, which has the right to ask for or not ask for security. Shares may be used to secure a loan. But the rules are quite loose.

Coops in Uganda are in general undercapitalized at an average of \$1070 per society (with 2921 societies reporting data in 9/95);, with the mean value of shares being \$4.72.

The 3 coop societies this consultancy visited in the Mbarara region have a combined total of 976 members. These were not S&C societies, and yet each had engaged in some lending. A rough estimate suggests about 50i of the members in these 3 societies were paid up shareholders, and shares vary from 5000 to 15000 Ush. Though one of the three societies is 40 years old, its records and books were no different or better than the other two. In the total of 3 meetings held with us about 60 to 70 people were present. We roughly "polled" those present on 2 questions: How many had borrowed from their coop and how many had savings accounts? Though these are poor areas on feeder roads, a minimum of 20 kilometres from the nearest bank branch (one about 25) more than half of those present had bank accounts and at least one third said they had borrowed repeatedly from their coops. In the case of the largest and oldest (also located in the subcounty seat-village) those who said they had borrowed had done so as many as 10 times over the years. It is not clear to what extent some members in reporting sums taken from their coops may have been mixing up their loans with their commissions on sales of coffee, but in any case closer questioning on those who clearly had taken loans, showed amounts of 100,000 to 500,000 Ush with annual effective interest rates of 25 % (payable in lump sum at the end of 12 months). This is a highly favorable rate compared with say, PRIDE. In one meeting with at least 40 members present, the consensus was that while some borrowers may have been late in paying back their loans, it was "very 'very rare that anyone ever defaulted.

That there is savings and lending going on through rural coops of different kinds is clear. Most important however, is that capacity to manage this type of operation cost-effectively is extremely low and is not likely to be worth a direct donor investment in the coops to raise this capacity other than to ensure better record keeping. Record keeping was uniformly bad (missing pages, minutes not up to date, arithmetical mistakes, and no clarity on exactly what share capital balance existed) . In no case could we get a clear answer on the current share capital of the societies. It also became clear that monies are mixed in the same coop bank account. Finally crop

buying and other agribusiness functions in these coops should be kept separate from figures on lending.

While specialized S&C coops generally may do a better job with their financial management, all informed people seem to agree, that capacity building is needed across the board. The bottom line is that the cooperative movement has potential only in theory at this point and should be approached very carefully.

UGANDA NATIONAL FARMERS ASSOCIATION

This 5 year old organization is an attempt to set up a new and more genuinely grassroots organization as a counter to some of the abuses in the coop movement and government run programs to assist farmers. UNAFA has a layered structure and claims about 40 ' -000 members in 36 districts, with full fledged offices in 5 districts and volunteer manned offices in 4. 7 Field production advisors have just been recruited to do credit with a Ecu 500,000 grant from the EU and technical assistance/training provided by DANIDA. Credit methodologies appear not yet entirely formulated. Apparently talks are going on between UCB (Uganda Commercial Bank) and UNAFA about the possibility of UCB keeping a hand in rural lending by going through intermediaries such as UNAFA.

Government Run Programmes

PAP

PAP was started in November 1994 with an African Development Fund commitment of \$15 million of which 66% was for on lending. Here too the project designers appeared relatively unaware from the outset of certain lessons learned elsewhere, in particular that group based lending can work, but enterprises jointly run by the group usually cannot. Seeking local Community Based NGOs as intermediaries PAP began with a government list of 717 NGOS. It initiated a survey to find if these really existed. Out of the 717 many were found not to exist other than in name, and only 18 NGOs were found with sufficient capacity to be onlenders. After some months this number was reduced to 12, and PAP eventually found that its own staff had to be active in the lending process. As a result lending has been slower than anticipated. By the end of 1997 \$2.24 million will have been lent. The PAP staff now includes 19 persons equipped with motorcycles to cover its 4 area offices. The loan approval process involves district level approval committees. There are 3 loan ceilings with the max loan being 10 million USH (\$10,000) . The district loan committee can approve up to \$2000 loans. From \$2000 to \$6000 the loan approval has to come to Kampala and above \$6000 it requires approval from the National Steering Committee of the Programme. Recovery rates. hover in the 70%- . range, and there are no figures to indicate the programmes potential for financial sustainability. All told there are about 8000 clients, of which 10-. have taken a repeat loan. But as PAP is scheduled to end in about a year and a half, with a considerable amount of its initial fund still not absorbed, the effort being made now is to get the grant continued and to institutionalize the programme, but apparently this is happening slowly as there is lack of clarity as to which ministry should control it.

PAP's advisor has said that one of the main lessons regarding institutional capacity (and this is heard repeatedly) is that front line loan officers must ensure that the entire process of group formation, group sensitization, loan appraisal, and loan approval is carefully followed; that steps in the process are not omitted or skipped. PAP's loan officers, as happens in other projects, made the mistake initially of listening to client demands for maximum permissible loans in the very first cycle.

In short, with roughly 2/3rd of the project's life behind it, it is only now that a few difficult lessons have begun to be absorbed.

ENTANDIKWA

Entandikwa, a government administered programme under the Ministry of Finance was apparently proposed by Parliament in 1993 as a way to cover the credit needs of war-ravaged areas (originally slated for 14 districts). Probably due to political pressure it was extended to all districts (in fact to all 214 constituencies) in the country with a fixed (and equal) amount of loan capital being provided per constituency, thereby confirming the political nature of the change. It began lending in 1995 and by June 1996 had disbursed \$7.42 million in GOU money (there is no donor support to this programme). The secretariat in charge of the administration of the programme appears to have no figures on arrears or recovery rates, but judging by some districts where reports have been put together one of the economists involved in the programme estimates that at best the recovery rate is about 400-.. The programme appears to have been from the beginning heavily politicized and it is not surprising, especially given the coincidence of the programme start with the national elections that many people saw these loans as grants.

Unfortunately the programme has no fixed term and will continue to operate. It is likely that by the end of 1997 an additional \$2.5 million will have been disbursed. Moreover, interest rates are now set at 16% for a one year loan (with no clear cut loan maximum) and MPs are complaining that these rates are too high.

The President's Office

The President's office has recently been involved in some pilot efforts in stimulating high value crop innovations among some model farmers. We were taken to see several of these in Mpigi area. The impression gained was that officials had encouraged some fairly prominent local farmers to put up special purpose structures for either poultry, zero grazing or silkworm production, at their own expense and were promised credit (we were unable to determine on what terms) and some informal brokering in the case of the acquisition of silkworm cocoons from the Govt. research station, in order to move to the next stage of production. However, in the case of the silkworms, one of the two farmers had already had to begin harvesting his mulberry leaves and the promised credit had not come through. In the case of the two poultry producers, the costing of the venture did not seem to include the cost of credit.

Development Finance Dept., BOU.

Under the Agricultural secretariat at BOU, this partially GTZ funded AFRACA linkage programme (partly related to the Cotton Subsector Project basically began in 6/96. Little

information was obtained on this, but it appears to be moving slowly. Basically a savings to Loan ratio scheme, which will involve COOP bank, UCB, and UWFCT.

NGOs

In Uganda right now an appropriate typology of NGOs involved or thinking about being involved in microcredit would be four fold:

i) Those NGOS, whether directed or advised in Uganda by, expatriates or Ugandans which are linked to an international "Family" or network that focuses on microfinance:

- Pride linked to Pride in Guinea and Kenya,
- FINCA, linked to the world wide Finca network.
- Faulu, linked indirectly to Food for the Hungry, but in microfinance terms linked to Faulu Kenya and Ethiopia.
- CRS, linked to CRS operations worldwide, but specifically Senegal, Benin in microfinance.
- Foccas linked to the Freedom from Hunger world network
- Ugafode, linked to the Opportunity Intl network including South Africa and Zimbabwe.

ii) Those NGOs which are international in character; have done some credit work, and are part of an international network but which is not yet a microfinance-oriented network (examples in Uganda would be Plan Int'l, World Vision, Christian Children's Fund, Feed The Children, World Learning Inc.)

iii) National NGOs which cover part or all of Uganda, may have tried or are doing some credit work, but are not part of any international network or family.

iv) Localized, and sometimes community based NGOS, generally small, with few if any linkages to outside. There are hundreds of these registered. The consensus among those who seem realistic about the matter is that no one really knows which of these is more than an address, which are "briefcase NGOS", which have come into existence just to capture funds.

The first of these categories represents a new phenomenon in Sub Saharan Africa, the beginning of a strong network of technical capacity and growing learning related to best practices. In Uganda specifically, they may be start ups, but they start with the advantage of a family which can help raise them, as long they have money to pay for the help available.

The second group is still behind in terms of best practices but seems to be very aware of them. They cannot benefit directly from within their families, yet, but in some cases may be able to soon, and in others what they get from their networks will be other kinds of support. They also have multiple agendas including relief.

The third group may be worth exploring in some detail here. Examples would be:

VEDCO

Volunteer Efforts for Development Concerns began in 1992. They have been involved in credit in Luwero, doing single sex groups aimed at smallhold farmers. Using an integrated approach, they provided training, savings and credit promotion, agricultural-and marketing services. Groups were formed of 5 to 8 people, and as of the end of 1996 total clients numbered about 500. Loan size range from 120,000 to 700,000 (maximum) Loans below 300,000 must be secured by 30% of the loan amount in savings (roughly a 3:1 ratio) and loans above that require 40% in savings. Supported thus far by Dutch and other European donors, the lending component involved the use of 3 Loan officers who also undertook other functions such as agriculture and marketing assistance. According to the person who had been in charge of the Savings & Credit component of VEDCO, the program had serious problems with repayment because borrowers, business activities were not viable, and the cost of lending was very high because of the intense monitoring required, which could not be sufficiently done in any case because of the other duties of the officers.

St Mulumba Friendly Society, now the St Malumba S&C Society

This is a higher level S&C, one that has some characteristics of both a primary society and a Microfinance NGO. It covers 3 districts, was started in 1984 by the Catholic diocese in Jinja as a vehicle for development, its HQ are there and it has established 22 branches. A member of AMFIU, it was registered as a coop in 1992.

Its book membership is 4800 but based on regularity of monthly savings (compulsory of 500 Ush per month) only some 1500 members are considered active. The common bond is residence in any one of the 3 districts. There are 6 staff in the headquarters. Branches used to be independent with no central accounting system. This is now in the process of change. But all systems are manual and it was clear that the state of MIS is abysmal. All figures were suspect and record keeping has been minimal. A best guess is that perhaps \$150,000 in loans to members have been "given out" with a loan term of 12 months and an 180-. rate on declining balance with monthly installments. There are perhaps 800 borrowers. At best, while a rough 65% recovery rate is claimed, it could easily be closer to 50%.

Lira District Development Agency

LIDDA is a well-established local NGO based in Lira. It is an example of a respected and capable local NGO, with a basically welfare orientation, but which can tend to be seen as a possible participant in schemes which involve credit. LIDDA's Board is composed of teachers, religious leaders and members- of Parliament. It has received assistance from International NGOs such as World Learning Inc. (with USAID funding) to undertake a program of orphans care by providing farming implements and seeds to foster families so they can better provide for the orphans in their care. LIDDA was also provided with a grain cleaning machine and is presently under discussion as a possible link in a food security effort which would involve supplying credit (in the form of farm inputs) to local farmers to grow maize and sorghum for eventual sale to the World Food Programme.

The fourth NGO group is the weakest by far, may well be ephemeral, and would need an investment in study to understand more precisely their characteristics. But two cases in point may represent the spectrum in this last NGO category:

iv. a. The Poverty Alleviation Credit Trust in Masindi (P.O. Box 61, phone 20157). As reported by this organization's Executive Chairman, Mr Kabuijamu, this is a newly registered NGO (1995) which came into existence to do only microlending along Grameen lines, and apparently has Grameen Trust funding (The Grameen Trust was established by the Grameen Bank in Bangladesh to enable replication of the Grameen methodology) . This NGO claims to have given loans to 235 clients since August 1996. But its statement of methodology notes that it uses a 50 week loan term. After one half that time - in other words before its very first loans are due to be paid off fully, it claims a 1000i repayment rate. It also claims that it is prepared to target 200,000 clients by 2005 if it gets donor support.

iv. b. The Mbende AIDS Care Association (Mbende, Po box 77). This very local organization claims 20 volunteers and 5 staff and works with people who are HIV positive. Its representative with whom I met, could not supply me with data or any documentation about their lending program. He could only say that they wished access to funding for lending, and to date had lent 20 loans, 'some of which had been returned'.

There are clearly far more of the (b) type than the (a) type in this fourth category. The (b) type is truly unclear about what microfinance is. it would be a waste of resources to begin working, with them. Instead these should be directed to put themselves on the mailing list of AMFIU and receive regular information about microfinance while being discouraged to enter into this field right now.

The a) type often has an important characteristic, which is good leadership. Unfortunately the leadership is not only the driving force but often the entire management of the organization. it should be the job of AMFIU to sort these out and see which can be directed to other links, or other types of training.

Basically in the medium term in Uganda (now to the end of 2000), most active technical and capacity building support should and will be the first second and third category. Presto has the mandate to undertake this.

What follows is a description of some of the best-practice-based MFI NGOs who fall mostly in category i).

UGAFODE - Kampala (an Opportunity International affiliate)

UGAFODE began lending to individuals in 1995. This did not work. The NGO switched to groups in July of 96 when it brought loan officer staff to 4 credit officers (staff is now 4 COs, Exc. Dir, 1 Acct and 3 office staff). The present method involves finding pre existing groups, building them to 50 or so (expecting to drop back to 25 to 30) within which self-selected solidarity groups of 5 to 9 persons are formed). 600 loans were made in last qtr of 96. Present clients number about 900 with cumulative total of about \$225,000 lent. Ugafode now have the

capacity to do 200 loans or so per month. They operate up to 50 Kms from Kampala but largely in northern Kampala and among roadside traders, and also Entebbe road. Using church groups as a base has proved problematic.

Ugafode's first loan maximum is 300,000 Ush, and overall max is 2,000,000 Ush; the loan period is 4 to 6 months, with 30 day grace period, repayment weekly, biweekly or monthly; interest is 4% per month flat rate (which may soon be reduced to 3%). There is a not' refundable application fee of 1000 Ush plus 2% commission of amount of loan up front. Compulsory savings are required up to total of 10% of the loan amount. Local council leaders must endorse the loans.

Ugafode estimates expansion to 30,000 clients by 2001. Its 5 year plan calls for \$3.4 million of which 1.9 will be needed from external sources. Its 97 budget is \$755,000 of which 28% will be internally generated. Projections for the end of 97 outcome is 4025 loans. They expect sustainability by the end of 5 years. Intentions are to open Rakai branch in late 97; Bushenye branch in 1/99; Soroti branch in 2001. They foresee Gulu and Arua after that when instability in the North will presumably have died down.

An important lesson learned Ugafode's director says has been learned is that using church groups as a base from which to build local groups is dangerous in terms of repayment culture. Churches are associated with charity and Ugafode's early attempt to build on these showed higher tendencies to default.

UGANDA WOMEN'S FINANCE AND CREDIT TRUST

UWFCT is the oldest of the NGO MFIs in Uganda, having started as an early affiliate of Women's World Banking. It has established a network of branches and has been involved in a number of UWFCT came under new projects funded by donors. Recently, UWFCT came under new leadership and prospects for adherence to best practices are high.

FINCA

FINCA the oldest of the best practice based MFIS in Uganda took slightly over 4 years to reach its present 4720 clients. This is with the backing of an international organization with many years of learning under its belt, not to mention significant, donor support and encouragement. FINCA Uganda is about to begin its expansion phase in early 1998. It is also aware that others will be expanding often in the same locations. However, it is stating. publicly that it is "not worried about quality competition". It is worried about competition from MFIs which will distort the market. But Finca is mandated under the part of its funding that comes from USAID to open 276 village banks in the '-DISH districts of Uganda. Yet even as it expands FINCA will face some difficulties, since if it were to adhere to its own choices, it probably would now choose not to face this part of the planned expansion. This is because DISH (Delivery of Improved Services for Health) districts are not necessarily the ones where the best conditions for institutional sustainability prevail.

FINCA's methodology is called Village Banking. Its clients are all women and it develops Village Banks out of preexisting groups (women's groups of various kinds). To date it has set up 154 village banks from its head office in Jinja and is active in 6 districts. It will be soon setting up a new central office in Kampala. The average first loan to individuals is \$82. The loan cycle is 16 weeks. There are two accounts. FINCA lends to the group (the external account) and the group makes its decisions to on lend to the members (the internal account). But guidelines are recommended and generally followed up on by the FINCA credit officers. First loans are 50,000 to 100,000 USH. Payments are weekly, and there are two kinds of savings, compulsory savings (20%-. of the loan amount) and voluntary savings. Portfolio value to-date is about \$300,000 and the value of savings mobilized is about \$313,000. Finca's operations to date have reach 86% of operational self-sufficiency. Members make many of their own decisions about loan appraisal, fines, and penalties for lateness and poor repayment behavior within their internal account.

FINCA has almost doubled its field staff having just added 16 new loan officers to the 18 already with it. A side effect of the growing number of programs in microfinance is a slight rise in loan officer salary levels which Finca has had to do recently to prevent poaching of staff by new MFI entrants in this field. This issue has been raised by at least two other MFIs we met with, and is a reasonably good indicator of the relationship of supply and demand in human resources for microfinance.

PRIDE Africa

PRIDE, relatively newly operating in Uganda (first loans were in April 1996) is building on experience learned in Kenya and Guinea. Its approach is a modification of Grameen bank, and requires strict adherence to procedure. PRIDE's first branch in Uganda, in Mbarara, has a branch manager and two credit officers. The latter go to markets and communities within 5 kms of the branch (this restriction cuts down on transaction costs both for client and lending institution) to promote the approach. An interested person has to form a 5 person "enterprise group". After this process of self selection, PRIDE would then put together 10 groups to form a 50 person Market Enterprise Committee. Within the 5 person group members will select officers and likewise the 50 person group would have a leadership comprised of the chairmen of each smaller group. After Each 50 person group is registered and the 5000 USH per person membership fee is paid, the group is assigned a specific day and hour to come to the branch once a week to attend a meeting. For 8 weeks the group undergoes training, engages in cross visits to other groups, and each member opens an individual bank account in the Mbarara branch of the COOP Bank with a minimum of 10,000 USH. In addition, at each weekly meeting the members must each put 2500 USH into the Loan Insurance Fund. Thus there are 3 levels of loan security: the LIF, the members' savings, and the 5 person solidarity group mechanism.

In the 8th week 2 people from each 5 person group who are not officers (not the chairman or secretary) receive the first loans, presently capped at 150,000 USH. These two begin paying back in the 9th week and will repay principal and interest weekly for 25 weeks. The effective interest rate is considerably higher than 30%. In addition, the member must continue putting 2500 Ush per week into the LIF.

In the 10th week 2 more members put in their applications which are appraised in the 11th week, and they receive their loans in the 12th week. The process continues until the last person in the 5 person group (the chairman) receives his or her loan in the 16th week. Pride calls this the 8-4-4 system. No lending takes place in the interim weeks reserved for appraisals and approvals. There is no discount for early repayment.

To date Pride has lent \$81,600 and including 3 new groups of 50 which are in the pre registration stage, has a total of about 450 clients. There have been about 50 client exits so far at this first branch, some were expelled by the groups for persistent lateness or non attendance or other evidence of lack of commitment; and some dropped out on their own. (351 had received first loans at time of this report). PRIDE intends to have a minimum of 1000 clients per branch in order to support the cost of the branch. 5 new branches should be on line in Uganda by April of this year (Masaka, Kampala, iinja, Mukono, and Mbale). The majority of PRIDE's clients in Mbarara are in used clothing and shoes trading. PRIDE has the advantage of an East African training center in Arusha Tanzania and trains its credit officers there. PRIDE intends to continue expanding in Uganda and eventually has plans to become a licensed bank.

FAULU - Affiliated with Food for the Hungry Int'l.

FAULU began in Kenya 5 years ago and now has 4 branches in Kenya. It is expanding to Ethiopia and Uganda. Faulu began in Uganda in 1995, with its first lending in June 1996. To date about 1480 loans have been made to about 1000 clients. Total lent is about \$400,000. (USAID, and Canadian Compassion funding). There is a staff of 17 of which 8 are loan officers. Faulu uses the KREP solidarity model (pre-existing groups of about 40 divided into sub solidarity groups of 5. There are currently 32 of the larger groups involved. First loans range from 20000 to 300,000 Ush; 2nd up to 500,000; 3rd to 700,000 and max is now 1,500,000. They have just raised their interest rate from 24 to 270-. flat rate (higher effective) plus 1% app fee, 2000 Ush registration fee, payment book fee 1000 and 1% to the Loan Insurance fund. Right now about 60 to 70% of members are women. Average loan term is 6 months. The programme is still new and as a result arrears rates are not yet where they are expected to be.

Faulu's goal is branch sustainability after two years of operation, based on about 10,000 clients per branch.

Currently it promotes its programme in all the major markets in Kampala. It has expansion plans for Uganda and its budget for 1996-2000 is \$2 million.

Like all the other programmes run along Best Practices' guidelines, even when the Uganda program has the benefit of the organization's experience elsewhere, start up problems in Uganda appear somewhat similar, and have to do both with the difficult credit culture among potential clients, as well as the inexperience of new front line staff. Loan officers must be good communicators (and Faulu and others find that former teachers do well at this). But they must also be good informal auditors and fact checkers, as well as firm in their approach to the rules. Very often, Faulu and others report, new loan officers are too willing to please the clients, and are simply "too nice".

CRS

CRS has operated in Uganda for 10 years, but managed from Nairobi. Only in August 1996 did it open an office in Kampala. It is moving into microfinance, an area where it has considerable worldwide experience, and has had respected African programs in Guinea, Senegal and Benin. In Uganda it intends to focus on small community groups in the areas where others are not working. Its present programme is in Hoima, an underserved district in the North west. It uses the Village bank methodology and in the last 3 years has established 22 such banks in Hoima with a total of about 450 clients. This slow rate is partly a function of having managed things from so far away before opening in Kampala.

CRS has strengthened its capacity in Uganda and has one full time Ugandan professional who will support micro credit. The assistant Country Rep is also an experienced microfinance person. CRS's approach is an unhurried, more or less organic one, perhaps because it has steady privately generated resources, it can afford this approach. Ms. Joseph (the asst Country Rep) was clear that they make no promises on when sustainability might be achieved. They recognize that when working in underserved areas with, less than optimal amounts of economic activity, loan rotations are turning out to be slower than expected, and thus sustainability appears to them to be somewhat a far off goal. At the same time group formation can take place according to their targets. The immediate problem seems to be that many clients especially women cannot absorb larger loans than 50,000 Ush (some do not even want to take this much at first) and as they do not want to or don't know how to diversify their economic activities, no business transformation takes place. As for institutional capacity building, CRS will use an organic approach, visiting Hoima from Kampala at least monthly, supporting the 3 staff in their counterpart in Hoima, and as Ms. Joseph put it, "just being there and being responsive."

Associations

AMFIU:

Amfiu is one of the good advances made in Uganda and UNDP PSDP moral and institutional support in bringing about this association is to be commended. The association is brand new, having been launched officially during this mission (2/21/97). Preparations for it began in August 1996 and between then and February 97 about 6 meetings were held. The committee of the Association has been active in the dialogue on MFI legal regulation with the BOU. There is lots of enthusiasm for the Association, though one of its leaders is concerned that this may be because some members have an expectation that benefits might be sourced through it. Moreover there is also concern that once standards, codes, and regulatory issues are gone into in detail and some members come to understand the implications of these for their own operations, there may be some drop outs and dissent. AMFIU will have lots on its plate, including encouraging a data base on MFIs, formulation of and promotion of standards, wrestling with finding a computer loan tracking system that works for Uganda. (A number of ones are and have been tried such as Microbanker, with apparently mixed opinions about their value). Not to mention bringing the wide range of members into closer intellectual agreement. with these challenges in front of it, the key question right now is whether to make AMFIU into a permanent secretariat with offices, equipment and staff, or whether to allow it to remain (what some derisively call) a briefcase

organization, without high costs. There is already a falling into two camps on this issue, one arguing that AMFIU should remain entirely member funded in order to grow from the start with the discipline of the private sector; the other and apparently majority view is that it must become a secretariat in order to function and this means taking donor monies.