Uganda

Country-Level Savings Assessment
CGAP Savings Initiative

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## CONTENTS

**EXECUTIVE SUMMARY** ....................................................................................................................................... 1

**INTRODUCTION** ................................................................................................................................................. 3

**OVERVIEW OF THE UGANDAN FINANCIAL SYSTEM** .......................................................................................... 3

**CLIENTS: DEMAND FOR DEPOSIT SERVICES** ........................................................................................................ 5
  - Savings Habits and Preferences are Relatively Well-Documented ........................................................................ 5
  - Small Savers Hold Mixed Liquidity Preferences .............................................................................................. 6
  - Low Formal Sector Penetration ......................................................................................................................... 6

**MICRO: INSTITUTIONAL CAPACITY AND SUPPLY OF DEPOSIT SERVICES** ..................................................... 7
  - Overview of Deposit-taking Institutions in Uganda .......................................................................................... 7
  - How Do Ugandan Institutions Stack Up Against Demand? ......................................................................... 9
  - Security and Accessibility: Tradeoffs, and Opportunities for Linkages ......................................................... 12

**MESO: SUPPORTING INFRASTRUCTURE FOR DEPOSIT MOBILIZATION** .................................................. 13
  - Wholesale Funding and Liquidity Management Mechanisms ........................................................................ 13
  - Capacity-Building Resources on Deposit Mobilization ................................................................................ 15
  - Lack of Reliable Information for Consumers and Investors ........................................................................ 16
  - Payment Systems and the Promise of Technology ......................................................................................... 16

**MACRO: POLICY AND REGULATORY ENVIRONMENT** .................................................................................. 17
  - MDI Act and Implications for Rural Outreach ............................................................................................... 17
  - Regulatory Vacuum for SACCOs .................................................................................................................... 18
  - Getting the Recipe Right for New Delivery Channels .................................................................................. 19

**STRATEGIES TO IMPROVE SMALL-BALANCE DEPOSIT MOBILIZATION IN UGANDA** .............................................. 19

**ANNEXES** ......................................................................................................................................................... 22
  - Annex I: Summary Matrix of Findings and Suggestions ........................................................................... 22
  - Annex II: Sources Consulted on Deposit Mobilization in Uganda ............................................................... 23
  - Annex III: Map of Population per Branch of Deposit-Taking Institutions by District in Uganda ............ 27
**LIST OF ACRONYMS**

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMFIU</td>
<td>Association of Micro Finance Institutions of Uganda</td>
</tr>
<tr>
<td>ASCA</td>
<td>Accumulating savings and credit association</td>
</tr>
<tr>
<td>ATM</td>
<td>Automated teller machine</td>
</tr>
<tr>
<td>BoU</td>
<td>Bank of Uganda</td>
</tr>
<tr>
<td>CDFU</td>
<td>Communication for Development Foundation Uganda</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
</tr>
<tr>
<td>COMESA</td>
<td>Common Market for Eastern and Southern Africa</td>
</tr>
<tr>
<td>DFID</td>
<td>Department for International Development (United Kingdom)</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FSDU</td>
<td>Financial Sector Deepening Project Uganda</td>
</tr>
<tr>
<td>GTZ</td>
<td>Deutsche Gesellschaft für Technische Zusammenarbeit (Germany)</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and communications technology</td>
</tr>
<tr>
<td>IFAD</td>
<td>International Fund for Agricultural Development</td>
</tr>
<tr>
<td>MDI</td>
<td>Micro-deposit taking institution</td>
</tr>
<tr>
<td>MFI</td>
<td>Microfinance institution</td>
</tr>
<tr>
<td>MIS</td>
<td>Management information system</td>
</tr>
<tr>
<td>MoFPED</td>
<td>Ministry of Finance, Planning and Economic Development</td>
</tr>
<tr>
<td>MOP</td>
<td>Microfinance Outreach Program</td>
</tr>
<tr>
<td>MSCL</td>
<td>Microfinance Support Center Ltd.</td>
</tr>
<tr>
<td>PAR &gt;30</td>
<td>Portfolio at risk rate greater than 30 days</td>
</tr>
<tr>
<td>RFSP</td>
<td>Rural Financial Services Project</td>
</tr>
<tr>
<td>ROSCA</td>
<td>Rotating savings and credit association</td>
</tr>
<tr>
<td>Rural SPEED</td>
<td>Rural Savings Promotion and Enhancement of Enterprise Development Project</td>
</tr>
<tr>
<td>SACCO</td>
<td>Savings and credit cooperative</td>
</tr>
<tr>
<td>Sida</td>
<td>Swedish International Development Cooperation Agency</td>
</tr>
<tr>
<td>SUFFICE</td>
<td>Support to Feasible Financial Institutions and Capacity Building Efforts Project (European Union)</td>
</tr>
<tr>
<td>UCA</td>
<td>Uganda Cooperative Association</td>
</tr>
<tr>
<td>UCB</td>
<td>Uganda Commercial Bank</td>
</tr>
<tr>
<td>UCSCU</td>
<td>Uganda Credit and Savings Cooperative Union</td>
</tr>
<tr>
<td>UWFT</td>
<td>Uganda Women’s Finance Trust</td>
</tr>
<tr>
<td>UGS</td>
<td>Ugandan shillings</td>
</tr>
<tr>
<td>UMU</td>
<td>Uganda MicroFinance Union</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
<tr>
<td>USD</td>
<td>U.S. dollars</td>
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</table>
EXECUTIVE SUMMARY

This report summarizes the results of the fifth test of the Country-Level Savings Assessment Toolkit under development as part of CGAP’s Savings Initiative. The purpose of the toolkit is to help government agencies, donors, and others identify opportunities and constraints in increasing poor people’s access to high-quality deposit services. The methodology examines client demand for deposit services and the capacity of the financial system to meet that demand at three levels: financial institutions (micro), supporting infrastructure (meso), and policy (macro). It concludes with suggestions for strategies to improve the quality and quantity of deposit services available to low-income households.

The report builds on the findings of CGAP’s 2004 Uganda Microfinance Sector Effectiveness Review, which highlighted the need to improve rural access to financial services and increase the safety of poor Ugandans’ savings. Despite high awareness of client demand for secure, convenient, and affordable deposit services among microfinance stakeholders, usage of formal sector deposit services is extremely low, especially among rural Ugandans. The market appears wide open for institutions that can design cost-effective deposit services tailored to low-income savers’ preferences.

At the micro level, the primary obstacle is lack of secure deposit-taking institutions in rural areas and extremely low density of financial service access points throughout the country. Linkages between SACCOs and regulated institutions offer promise in this area; incentives and competition could also draw banks downmarket. At the meso level, resources for communicating institutional soundness, consumer education, and access to the payment system are under-developed. A large amount of donor resources is poised to flow into wholesale lending facilities targeted at Tier 4 institutions, with potentially negative consequences for SACCOs. At the macro level, the MDI Act has been a substantial investment in extending secure deposit services, but stakeholders are increasingly aware of remaining challenges to rural outreach, including slowed pace of MDI expansion, inadequate regulation and supervision of SACCOs, and lack of clarity on regulation for new high- and low-tech delivery channels.

Seven strategies to improve small deposit mobilization in Uganda emerged from the assessment and warrant further research and reflection.

1. **Create smart consumers of financial services** by investing in financial literacy and a complementary system for disclosure of pricing and performance by institutions.

2. **Size the market and clarify client savings behavior to design competitive products** by investigating the level of unbanked liquidity and clients’ risk, return, and liquidity profiles.

3. **Link SACCOs that operate in rural areas to more stable, regulated institutions**, channeling excess SACCO liquidity to safer institutions such as MDIs, which are in need of deposits in order to expand.

4. **Invest in further developing new high- and low-tech delivery channels for MDIs and Tier 1 and Tier 2 institutions with an interest in microfinance** to engender increased access for savers.

5. **Explore innovative ways of managing SACCO liquidity** to create low-risk, high-return investments that attract low-income people’s deposits into the financial system.

6. **Promote active dialogue with BoU on new methods of increasing outreach** and construct a mutually-acceptable balance of systemic protection and expanded access.

7. **Focus support to SACCOs on better monitoring, regulation, and supervision, rather than on-lending**, in order to build a more robust network of institutions that are both accessible and secure under strengthened regulation and supervision.
INTRODUCTION

This report summarizes the results of the fifth test of the Country-Level Savings Assessment Toolkit under development as part of CGAP’s Savings Initiative.¹ The purpose of the toolkit is to help government agencies, donors, and others identify opportunities and constraints in increasing poor people’s access to high-quality deposit services.

The toolkit examines evidence of demand for deposit services among low-income clients and identifies opportunities and constraints to meeting that demand. It examines three levels of the financial system: (1) the capacity for small deposit mobilization among financial service providers (“micro” level); (2) financial infrastructure and second-tier support for micro-level institutions (“meso” level); and (3) public policies and government entities that create an enabling environment for savings mobilization (“macro” level). It concludes by identifying promising strategies to improve the quality and quantity of deposit services available to low-income households.

The assessment draws on (1) analysis of existing studies and information on demand levels, institutional capacity, and the macro environment in Uganda (see Annex II for the list of documents consulted); (2) interviews with 67 informants related to small deposit mobilization in Uganda during the fieldwork carried out October 24-28, 2005 (see Annex II for the list of individuals consulted); and (3) visits to financial institutions to collect information on savings products.²

Overview of the Ugandan Financial System

Uganda is often regarded as one of Africa’s best economic performers. Following many years of civil war, hyperinflation and economic mismanagement, Uganda embarked on an ambitious reform policy in 1987 to rehabilitate the economy. GDP grew at a healthy 6.5 percent annually from 1990 to 2000,³ benefiting from strong export performance, liberalization of the economy, and restoration of macroeconomic stability. Inflation was brought under control in the post-war period, declining from greater than 100 percent in 1987 to single digit figures where it has remained (5.2 percent in 2004). The percentage of individuals in absolute poverty decreased from 56 percent in the late 1980s to 34 percent in 2000.⁴

However, data suggests the pace of poverty reduction may be slowing or even reversing. Between 2000 and 2003, the bottom 80 percent of the population experienced a 2-4 percent decline in consumption,⁵ even as the economy grew at a steady annual pace of 5.5 percent.⁶ The proportion of people living beneath the poverty line has increased to 38 percent in 2004, primarily resulting from a 10 percent slide in the agricultural terms of trade. This deterioration hits hardest among the 75 percent of Ugandans living in rural areas, who are already poorer on average than their urban counterparts.⁷

¹ For further information on CGAP’s Savings Initiative and information on savings mobilization, visit the CGAP Savings Information Resource Center (SIRC) at www.cgap.org/savings.

² The assessment team consisted of CGAP staff Rani Deshpande, microfinance analyst, and Mark Pickens, associate microfinance analyst; and Hermann Messan of SIOM Consulting. The USAID Rural SPEED Project organized meetings and mission logistics for the team, and assisted in gathering information on savings products. Both Rural SPEED and DFID’s FSDU project provided valuable guidance throughout the assessment.

³ World Bank, African Development Indicators 2003.


⁷ Ibid.
The financial system in Uganda has undergone major restructuring in recent years, with a number of bank failures eroding public confidence. The largest jolts included banking authorities’ seizure of a trio of banks in 1999 (Cooperative, Greenland and International Credit banks), followed two years later by the privatization of Uganda Commercial Bank. Together, Cooperative Bank and Uganda Commercial Bank held 70 percent of assets in the Ugandan banking sector. In 2002, the central bank ordered the restructuring of Post Bank, including a reduction from 91 to 20 service locations. Among member-owned institutions, many rural savings and credit cooperatives (SACCOs) have fallen victim to poor management compounded by the economic stress on members.

These successive collapses have shrunk financial sector outreach. Although 12 new banks were licensed in the past decade, density of service points has not recovered to mid-1970s levels. There were 133 commercial bank branches in Uganda at the end of 2004, compared to 290 in 1972. The ratio of population to commercial bank branches has therefore deteriorated, from 34,000 in 1972 to 194,700 in 2004. When all branches of deposit-taking institutions are considered, this ratio becomes 26,155:1. As a comparison, this is approximately two and a half times worse than the same ratio in Benin, which has a roughly similar per capita GDP. The assessment team identified 1.94 million deposit accounts, meaning an estimated 12.5 per cent of economically active adult Ugandans have direct access to a deposit account.

The ratio of liquid liabilities to GDP is low compared to neighboring countries: 17.6 percent in Uganda versus 40 percent and 35 percent in Kenya and Tanzania respectively. The ratio of savings in banks to GDP is 13.7 percent, but bank lending to the private sector is only 5.3 percent of GDP. This significant over-liquidity in the banking sector is largely absorbed by government borrowing, which has increased five fold since 2000. Until recently, 91-day treasury bills offered rates as high as 20 percent, presenting a risk-free placement opportunity with yields competitive to private sector lending. Rates have dropped considerably since 2003 and were at 8.1 percent for 91-day T-bills at the time of the study.

<table>
<thead>
<tr>
<th>Table 1: Key Economic and Banking Indicators</th>
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<tbody>
<tr>
<td>Population (2004)</td>
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<tr>
<td>Economically Active Population</td>
</tr>
<tr>
<td>Total number of households (2002)</td>
</tr>
<tr>
<td>% Population under national poverty line (2003)</td>
</tr>
<tr>
<td>Economic Growth Rate (real) (2004)</td>
</tr>
<tr>
<td>Average US dollar exchange rate (2005)</td>
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<tr>
<td>Inflation (2004)</td>
</tr>
<tr>
<td>91-day treasury bill rate (21.10.05)</td>
</tr>
<tr>
<td>National savings rate (2003)</td>
</tr>
<tr>
<td>Liquid liabilities/GDP (2003)</td>
</tr>
<tr>
<td>Savings in Banks/GDP (2003)</td>
</tr>
<tr>
<td>Cash in circulation/deposits in banks (June 2005)</td>
</tr>
<tr>
<td>Private Credit/GDP (2003)</td>
</tr>
<tr>
<td>Savings in Banks/Private Credit (June 2005)</td>
</tr>
<tr>
<td>Bank lending to government/private credit (Nov. 2005)</td>
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<tr>
<td>Number of deposit accounts in financial institutions</td>
</tr>
<tr>
<td>Total Branches of Deposit Taking Financial Institutions</td>
</tr>
<tr>
<td>Population/Financial Institution Branch</td>
</tr>
<tr>
<td>Financial Institution Branch/Million Inhabitants</td>
</tr>
</tbody>
</table>

Sources: BoU; MoFPED; Uganda Bureau of Statistics; World Development Indicators Database; World Bank Financial Structure Database.
**Main Finding:** Demand for deposit services among low-income Ugandans is well-documented, but usage rates are low, suggesting a wide-open market for formal deposit services.

**Savings Habits and Preferences are Relatively Well-Documented**

Multiple studies show the prevalence of saving among low-income Ugandans. Respondents in one study of urban and rural Ugandans reported saving an average of USD 132 during the prior 12 months, primarily via informal means. Informal savings mechanisms include conversion of cash into assets that are a reliable store of value (livestock, land); participation in *ebibiina* (ROSCAs, ASCAs and similar groups); using a money guard (a family member or other trusted individual); and saving in cash at home, often in clay jars or *mukandala* (money belts worn under clothing). A second survey focused solely on rural households found 80 percent of respondents had saved some money in the past year using a combination of formal and informal mechanisms. Evidence also indicates many Ugandans value savings more than loans: 57 percent of respondents in one study said a secure and convenient place to save money was more important than the ability to obtain a loan.

Studies of client preferences reveal that the top qualities poor Ugandans seek in a savings mechanism are security and accessibility – both physical (proximity) and financial (affordability).

**Security**

Security weighs in as the most significant factor for small savers, with some 60 percent of survey respondents ranking this as their top priority. Despite the rash of bank closures in the past decade, small savers still see banks as substantially more secure places to deposit money than saving at home or in semi-formal institutions. High rates of loss in non-regulated savings mechanisms help explain the preference for banks. A survey of 1500 people found 99 percent of respondents who saved in the informal sector had lost some money in the past year, as had 26 percent of savers in semi-formal institutions (MFIs and SACCOs). In member-owned financial institutions, security of savings is viewed as highly contingent upon the honesty of managers. In the absence of detailed information about the financial health of different institutions, small savers equate modern, strong-looking physical premises with institutional stability, a factor which works against SACCOs and, historically, MDIs.

**Proximity**

In one survey of rural Ugandans, 87 percent of respondents said that a service delivery point in their sub-district would satisfy their needs as savings clients. However, many rural Ugandans find the nearest financial institution can be up to 60 kilometers away. As a result, informal and semi-formal savings mechanisms can out-compete formal sources on proximity, helping explain why relatively risky informal mechanisms are still the most widely used by low-income Ugandans.

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Proximity also affects transaction costs for savers. The cost of transportation can make formal institutions prohibitively expensive for low-income people who save small amounts. One study found transportation costs for savers to be UGS 7,000 (USD 3.90) for an average savings transaction—over five times daily per capita income.\textsuperscript{25}

**Affordability**

Once proximity issues are addressed, the next threshold of affordability is minimum opening balances. In a survey conducted by USAID’s Rural SPEED Project, 65 percent of respondents preferred a minimum opening balance of less than UGS 10,000 (USD 5.65). Non-clients showed the strongest preference for opening balances of UGS 5,000 or less, suggesting that the minimum balance threshold may play an especially large role in excluding the poor.

High fees were the second and third most cited hindrance to using formal savings among non- and exited clients, and (according to interviewees) were a major source of dissatisfaction among small savers.\textsuperscript{26} Anecdotal evidence suggests clients often do not know the necessary questions to ask when opening an account, and bank staff sometimes fail to adequately explain fee structures on savings accounts.\textsuperscript{27}

**Small Savers Hold Mixed Liquidity Preferences**

Rural Ugandans save for a mix of life-cycle events, asset acquisition, and emergencies, suggesting a range of liquidity preferences (see Table 2). In one study, savers indicated a preference for liquid savings mechanisms which could be easily accessed in response to an emergency.\textsuperscript{28} This is in contrast to the results of a nation-wide survey that found rural Ugandans preferred making withdrawals monthly or quarterly but deposits more frequently, suggesting a preference for illiquidity.\textsuperscript{29} A study in the Kibaale District found that people saving for life-cycle events have the highest preference for illiquid savings products.\textsuperscript{30}

<table>
<thead>
<tr>
<th>Table 2: What do Rural Ugandans Save For?</th>
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<tbody>
<tr>
<td>School fees 45%</td>
</tr>
<tr>
<td>Medical emergencies 45%</td>
</tr>
<tr>
<td>Other unforeseen events 42%</td>
</tr>
<tr>
<td>Purchase business assets 20%</td>
</tr>
<tr>
<td>Housing 17%</td>
</tr>
<tr>
<td>Required to access loans 12%</td>
</tr>
</tbody>
</table>

*Source: Pelrine and Kabatalya, 2005*

Overall, individual households may hold different liquidity profiles for different parts of their economic portfolio, placing some resources intended for emergencies into highly liquid savings forms (money belts, cash in pots), while looking for a more illiquid means by which to save for other needs. This could have substantial implications for how institutions design products and expected customer response.

**Low Formal Sector Penetration**

Despite well-documented demand, relatively few low-income Ugandans channel their savings into the formal sector. The Rural SPEED study found that formal and semi-formal institutions are attracting just over 10 percent of rural Ugandans, who represent 75% of the total population (see Table 3).\textsuperscript{31} Urban Ugandans enjoy better, but still imperfect, access, with 55 percent of respondents reporting they used a bank, MFI, SACCO or other type of financial institution during the previous 12 months.\textsuperscript{32}

<table>
<thead>
<tr>
<th>Table 3: How do Rural Ugandans Save?</th>
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<tr>
<td>In cash or in kind 81%</td>
</tr>
<tr>
<td>ROSCA / ASCA 7%</td>
</tr>
<tr>
<td>Banks 6%</td>
</tr>
<tr>
<td>SACCOs 4%</td>
</tr>
<tr>
<td>MFIs / MDIs 2%</td>
</tr>
</tbody>
</table>

*Source: Pelrine and Kabatalya, 2005*

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\textsuperscript{25} Bakeine, 2001.
\textsuperscript{26} Pelrine and Kabatalya, September 2005.
\textsuperscript{27} A parallel could be drawn with loans, where one survey revealed that 69 percent of borrowers had not been made fully aware of all of the interest and fees charged. In institutions where product terms are not adequately explained, it is likely that this lack of transparency would also apply to savings accounts. See Musoke, Isaac, 2004.
\textsuperscript{28} Sebageni, Kaggwa and Mutesasira. 2002.
\textsuperscript{29} Pelrine and Kabatalya, September 2005.
\textsuperscript{30} Bakeine, 2001.
\textsuperscript{31} Pelrine and Kabatalya, September 2005. Note: Percentages should not be read cumulatively, as some respondents indicated they use more than one means.
Micro: Institutional Capacity and Supply of Deposit Services

Main Finding: No single type of institution meets rural Ugandans' demand for security, proximity and affordability, but incentives and competition could draw banks downmarket, and linkages between SACCOs and regulated institutions also offer promise.

Overview of Deposit-taking Institutions in Uganda

A diverse range of institutions are active in deposit mobilization in Uganda. Current financial sector regulation divides institutions into four “tiers”:

- **Tier 1:** Commercial banks are licensed under the Financial Institutions Statute of 1993. They are permitted to offer a full range of financial services, including deposits. Fifteen commercial banks operate in Uganda at present.

- **Tier 2:** Credit institutions are also licensed under the Financial Institutions Statute. They can take deposits, but are restricted from performing foreign exchange services. The seven Tier 2 institutions include Post Bank, and one institution which styles itself as a microfinance bank (Commercial Microfinance Ltd.).

- **Tier 3:** Four micro-deposit taking institutions (transformed MFIs authorized to take voluntary deposits from the general public) are licensed under the Micro Deposit-Taking Institutions Act of 2003. MDIs are prohibited from operating demand checking accounts and also can not perform any foreign currency operations.

- **Tier 4:** SACCOs and MFIs are grouped together in Tier 4. They operate under a variety of legal regimes including the Cooperatives, Companies, and NGO Acts. Tier 4 institutions share two key features: The Bank of Uganda (BoU) does not exercise prudential supervision over them, and they are forbidden to mobilize deposits from the general public. SACCOs can only accept only member savings (voluntary deposits and share capital), whereas MFIs can only collect compulsory savings from borrowers.

Tier 1 banks serve approximately two-thirds of all formal sector depositors in Uganda and mobilize more than USD 1.4 billion in deposits, nearly twice the volume of savings in all Tier 2, 3 and 4 institutions combined. Table 4 presents other key statistics on different tiers of deposit-taking institutions.

Which Institutions Serve Small Depositors?

The aggregate statistics above mask a complex and sometimes counter-intuitive landscape of deposit service providers in Uganda. Among banks, Stanbic and Centenary stand out for adopting strategies that penetrate low-income and rural markets. Approximately 93 percent of the 990,097 accounts in these two banks have balances of UGS 1 million or less (roughly USD 570). They appear to reach a great number of clients from lower economic profiles than other banks. Centenary Bank is a

<table>
<thead>
<tr>
<th>Table 4: Key Statistics for Deposit-Mobilizing Institutions in Uganda</th>
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</thead>
<tbody>
<tr>
<td><strong>Tier 1</strong></td>
</tr>
<tr>
<td>Number of Institutions</td>
</tr>
<tr>
<td>Branches</td>
</tr>
<tr>
<td>Savers/accounts</td>
</tr>
<tr>
<td>Savings (USD mil)</td>
</tr>
<tr>
<td>Avg. balance (USD)</td>
</tr>
</tbody>
</table>

Sources: Bank of Uganda, AMFIU, UCA and UCSCU. All figures are the latest available: Tier 1 and 2 numbers from end 2004, and Tier 3 and SACCO numbers from end 1st quarter 2005.

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33 Basic performance data was only available for 147 of the largest SACCOs in Uganda. This data set is used in most charts throughout the report, except in figures on the total branches of deposit-taking institutions (Table 1) and population per branch (Table 1 and Figure 3).

34 Accounts with balances under UGS 1 million are the lowest stratification of deposit balances tracked by BoU.
Ugandan-owned, Catholic Church-affiliated institution formed explicitly for the purpose of tapping underserved markets. Stanbic is a South African-owned bank which purchased the defunct Uganda Commercial Bank and its large rural branch network in 2002. Among Tier 1 institutions, Stanbic and Centenary possess more than a third of all deposits and two thirds of all branches.

Other institutions focusing on serving lower-income and rural depositors include a pair of Tier 2 institutions (Post Bank and CMFL), the four MDIs (PRIDE, Finca, UFT and UMU), and at least 750 active SACCOs. An interesting picture emerges when these institutional types are compared (see Figure 1). Stanbic’s USD 83 million in small-balance accounts exceeds the USD 59.5 million mobilized by Centenary, Post Bank, CMFL, the 4 MDIs, and 147 of the largest SACCOs combined. Further, account sizes in Centenary (USD 48) are smaller than all but one of the MDIs (UFT at USD 46). Surprisingly, the 147 SACCOs in the sample show an average account balance (USD 96) higher than all other institutions except for Stanbic.

Such figures counter common preconceptions about the best institutional types for extending access to deposit services. First, the comparatively high average balance in SACCOs may call into question assumptions about the relative poverty outreach of SACCOs versus other institutional types.

Second, the average balance figure for Centenary suggests that the commercial bank legal form does not in itself prevent either depth or breadth of rural outreach. Banks, in general, appear to have a relatively healthy appetite for deposits, driven by good investment opportunities in government securities. Interest rates on 91-day T-bills peaked at 21 percent in December 2003. Ugandan bankers tended to view this as an incentive to mobilize more

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**Figure 1: Distribution of Small Accounts and Average Deposit Balances Among Sample Ugandan Institutions**

Sources: BoU for Tier 1 and Tier 2 institutions (June 2005); AMFIU for MDIs (Mar. 2005); UCA and UCSCU for 147 SACCOs (Mar. 2005). Stanbic and Centenary deposits represent accounts with balances under UGS 1 million.

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35 Over 1400 SACCOs are registered in Uganda; however a recent census of Tier 4 institutions identified 750 to 900 SACCOs that were active. FSDU and MOP were completing analysis of this data at the time of this report. Their findings represent a significant increase over previous estimates of 300 operational SACCOs.

36 A large number of SACCOs were formed between 2001 and 2003 following announcements that the Government planned to inject USD 5,000 into each of Uganda’s 5,000 parishes to support Tier 4 institutions. Many ceased operating, or never became active, when the funding was not forthcoming. See Kohler, Wolfgang. Winter 2005. “Big Plans, Small Sums” in Akzente Special. Eischborn: GTZ. Also see Goodwin-Groen, Ruth, Till Bruett and Alexia Latortue. October 2004. “Uganda Microfinance Sector Effectiveness Review.” Washington, DC: CGAP.
deposits. Although rates have slid to 8.1 percent, treasury securities still comprised more than a quarter of commercial bank assets as of June 2005. In addition, banks have discovered the market for salary loans, and are aggressively seeking deposits to fund those. Some banks offer rates as high as 14 percent for two-year certificates of deposit.

However, most banks besides Centenary and Stanbic do not appear to have strong incentives to mobilize small deposits. They have traditionally located their core customer segment in the middle- and upper-income brackets, and at present primarily mobilize larger balance deposits, as evidenced by the average balance of USD 1,068 for Tier 1 institutions as a group. Perception, and some evidence, suggests that mobilizing smaller deposits at scale could require a substantial investment. One bank reported efforts to reach the unbanked resulted in more than a five-fold increase in its per client cost-to-income ratio, at least during an initial pilot program.

What then drives Stanbic and Centenary to locate in relatively underserved markets? For Centenary, the answer has to do with a social mission deriving from its religious affiliation, as well as assistance in opening branches received from local churches. This acts as a subsidy that helps branches to become viable. Incentives play a role in Stanbic’s case as well: after the purchase of UCB, the government channeled its salary payments through Stanbic and gave it exclusive operating rights for three years where rural branches were located, as incentives not to close them. The experiences of Centenary and Stanbic may not be directly replicable (one relating to an affiliation with the Catholic Church, and the other to a one-time-only privatization). But in light of the considerable subsidies which donors are currently committing to increase access to financial services, the outreach achieved by Centenary and Stanbic may hold a lesson.

Increasingly fierce competition could eventually lead other banks further down-market. The “high street” banks, such as Barclay’s and Standard, are seeking increased market share and pushing into the middle-income customer segment, historically the preserve of smaller banks. In turn, smaller banks have invaded the top end of MDIs’ customer base. Some stakeholders believe competition will eventually force weaker banks to merge. Alternatively, competition could press one or more banks to seriously consider lower-income clientele as a viable market, particularly if the newly minted MDIs prosper and demonstrate the market’s profitability, or if banks note Stanbic and Centenary’s comparative success in serving rural areas.

How Do Ugandan Institutions Stack Up Against Demand?

This section evaluates the performance of Ugandan financial institutions relative to the characteristics valued most by clients: security, proximity and affordability.

Security

Regulation and supervision bolsters security in formal deposit-taking institutions. Within regulated institutions, however, one of the main determinants of security is the institution’s ability to manage its assets. Figure 2 shows volume of deposits against PAR >30 in seven institutions representing the major types of deposit-taking institutions in Uganda. Two groups of SACCOs are included: one set of 37 working with UCSCU, and a second group of 14 participants in a USAID-funded SACCO strengthening project which ended in 2003.

Figure 2 shows deposit volumes and portfolio delinquency in regulated institutions (Centenary, CMFL, Pride, UFT, Finca and UMU) and SACCOs, which are unregulated. As illustrated, regulated institutions seem to manage their asset quality relatively well, implying security for deposits. In addition, Tier 1 and 2 institutions fall under the BoU’s deposit insurance scheme. Plans are underway to extend deposit insurance to deposits in MDIs as well.

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The relatively solid nature of regulated institutions contrasts with that of SACCOs, which have highly variable performance as illustrated by the wide gap in delinquency rates between the two groups of SACCOs. Weak governance, transparency and management know-how are widely known to plague many SACCOs. In many cases, SACCOs are not safe repositories of poor people’s money. Data on client attitudes indicates that low-income individuals recognize this, as they tend to view SACCOs as less secure than formal, regulated institutions.

Proximity

Uganda has at least 991 points of service which provide access to deposit services, including 133 bank branches, 28 branches of Tier 2 institutions active in microfinance, 80 MDI service points, and approximately 750 active SACCOs. Combined, this translates to a ratio of one point of service for every 26,155 people, reflecting extremely limited physical access to financial service providers as compared to a number of other countries (see Figure 3).

Sources: MixMarket for Tier 1, 2 and 3 institutions. Data for 37 SACCOs from UCSCU. Data for 14 SACCOs in Meyer, Roberts and Magume, 2004. Centenary deposit volumes represent accounts with balances under USD 500.

Figure 3: Population per Branch in Selected Countries

Sources: CGAP Country-level Savings Assessments for Mexico, Philippines, Bosnia and Benin, using data from central bank and other sources. US and Kenya figures based on authors’ calculations.

One of the most salient features of the savings landscape in Uganda is the concentration of regulated institutions in urban and peri-urban areas. Among Tier 1 banks, only Stanbic and Centenary have any substantial presence in rural areas. The 13 other banks operate just 11 branches outside of Kampala, Entebbe, Jinja, Mbarara, Mbale and Masaka. While Post Bank and CMFL also have 28 branches, 11 are located in and around Kampala. Over 80 percent of the 80 MDI branches are outside of Kampala and its

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immediate environs, but mostly in secondary and tertiary towns. Most SACCOs are located in rural areas.

Mapping of access points by district illustrates this wide disparity between urban and rural areas. As illustrated in Annex III, density ranges dramatically from 17,961 persons per institution in Kapchorwa, to 338,122 in Apac District. Thirteen districts appear to have no financial institution branches at all. Thirty-six districts have 100,000 or more persons per financial institution access point, and 52 have a ratio greater than 50,000.40

Affordability

Table 5 compares the features of deposit products at seven financial institutions. Five of the institutions surveyed offer entry-level accounts that require UGS 10,000 to UGS 12,000 or USD 5.65 to USD 6.80 to open or maintain, indicating that they are just at the threshold of what is acceptable to most clients. Increased competition in the past three years pushed financial institutions to aggressively lower their minimum opening balances, bringing them down from levels in excess of UGS 200,000 (USD 113).

Although remuneration tends to be less important than access costs for low-income savers, it does affect overall affordability. Interest rates for the products surveyed were set below inflation, leading to negative returns on deposit balances. However, rates on term deposits were substantially higher, which may help to explain the sizeable proportion of savers who expressed a strong illiquidity preference – at least for those who can accumulate the higher minimum balances required.

<table>
<thead>
<tr>
<th>All Figures in UGS</th>
<th>Stanbic</th>
<th>Post Bank</th>
<th>Centenary</th>
<th>Finca</th>
<th>Uganda Finance Trust</th>
<th>PRIDE</th>
<th>UMU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum balance to open</td>
<td>10,000</td>
<td>10,000</td>
<td>50,000</td>
<td>12,000</td>
<td>20,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>ID and other requirements to open account</td>
<td>References from 2 Stanbic clients, ID, photo</td>
<td>Letter from employer or LC1 Chairman, 3 photos, ID</td>
<td>Letter from employer, ID, 3 photos, 2,000 for passbook</td>
<td>Letter from LC1, reference from client of any other bank, ID, 3 photos</td>
<td>Letter from LC1, ID, 3 photos</td>
<td>ID, 2 photos</td>
<td>Letter from LC1 or employer, 2 references, ID, 2 photos</td>
</tr>
<tr>
<td>Minimum maintaining balance</td>
<td>10,000</td>
<td>10,000</td>
<td>n.a.</td>
<td>10,000</td>
<td>n.a.</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Minimum withdraw</td>
<td>5,000 on ATM, 1,000 in banking hall</td>
<td>None</td>
<td>n.a.</td>
<td>None</td>
<td>5,000</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Minimum balance to earn interest</td>
<td>200,000</td>
<td>20,000</td>
<td>n.a.</td>
<td>100,000</td>
<td>n.a.</td>
<td>150,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Interest rate</td>
<td>3%</td>
<td>2%</td>
<td>2.5%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Debit card</td>
<td>Yes, 30 ATMs</td>
<td>No</td>
<td>Yes, ATMs at 24 branches</td>
<td>No</td>
<td>n.a.</td>
<td>n.a.</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Survey of financial institutions. N.a. indicates information could not be obtained from the relevant financial institution. “LC1” refers to the village which is the smallest governmental unit in Uganda.

40 Annex III is based on collected data for branch locations of all banks, Post Bank, CMFL, the four MDIs and 147 SACCOs, as location data was not yet available for the full 750 identified by FSDU and MOP. Population figures obtained from Uganda Bureau of Statistics. 2004. “Main Report, 2002 Census.”
Security and Accessibility: Tradeoffs and Opportunities for Linkages

An unfortunate tradeoff can be observed between institutions that offer the best proximity of service and those which are the most secure. Figure 4 is a stylized representation of this phenomenon, plotting security on one axis (as proxied by portfolio-at-risk rates) versus proximity, as reflected in presence in rural areas. The circle labeled “Target” shows the optimal point where Ugandan clients would have both security and proximity. The size of the “bubbles” reflects the total number of savers served by each category.

Post Bank has pioneered several such connections with MFIs, with mixed results. One partnership with a MFI yielded a UGS 300 million increase in deposits in several branches in northern Uganda, with Post Bank making several loans to the MFI for on-lending. A second MFI linkage involving deposit-taking vans met with less success. Customer confidence was limited by the fact that accounts could not be updated in real time, creating client concerns around the possibility of fraud. In addition, customers had concerns about the physical security of mobile vans. Post Bank believes more aggressive marketing might have yielded stronger consumer understanding of the service. DFID’s Financial Sector Deepening Project Uganda (FSDU) is currently negotiating projects with Post Bank and another commercial bank which will include mobile banking units and presumably take advantage of lessons learned from Post Bank’s previous experience. They are also looking to Equity Bank in Kenya, which has had considerable success with mobile banking vans.

VSLAs: Combining Security and Accessibility from the Bottom Up

While linkage projects attempt to increase the outreach of regulated institutions, CARE Uganda, FSDU and PLAN International are supporting an informal approach to providing financial services through Village Savings & Loan Associations (VSLAs). VSLAs are self-selected groups of 20 to 30 members who save every week. Loans are funded from member savings, typically at 10 percent monthly interest. Because interest returns to the VSLA coffers, members can earn an annual return of 50 percent or more on their savings. Most groups also establish a small insurance fund. Advocates say VSLAs are less susceptible to fraud than typical revolving funds. After one year, VSLAs conduct an “Action Audit” and distribute all group funds back to members, giving them a usefully large sum of money at a predictable time and creating a definite point in time for all outstanding loans to be settled. They also have a key advantage relative to SACCOs in that operating costs are very close to zero, since VSLAs have no physical offices and no staff. This low cost structure permits very small transaction sizes, typically savings of UGS 100 to 1000 (USD .05 to .50), and loans from UGS 5,000 to 50,000 (USD 3 to USD 28). VSLAs can therefore serve poorer people who are willing to put up with weekly meetings and a limited product range in exchange for the security, proximity and high return on savings that VSLAs purport to offer.
There is considerable “buzz” on the topic of institutional linkages, which decompose the financial services value chain to allow different players to concentrate on their strengths. For example, institutions working in close proximity to rural savers (e.g. SACCOs) could partner with institutions which have stronger management (banks, MDIs). By doing so, banks and MDIs would gain greater outreach, SACCOs might gain access to training and improved management, with rural clients gaining access to more accessible, more secure savings (and other) services.

A number of institutions are currently exploring linkages. The Rural SPEED project is working with 10 SACCOs which it hopes to link with regulated financial institutions later in 2006. Nile Bank has explored the possibility of linking with a large SACCO in northern Uganda, but has not yet concluded a partnership. CMFL has also held discussions with SACCOs in northwestern Uganda, and FINCA is reportedly analyzing several opportunities to link with SACCOs. Successful linkages may go beyond shared retail operations and include back office strengthening as well. Rural SPEED is in the planning phase for a study which will analyze the types of institutions that can be most feasibly linked on the basis of financial transaction types, shared MIS and shared training.

**Meso: Supporting Infrastructure for Deposit Mobilization**

- **Main Finding:** Excessive second-tier funding to Tier 4 institutions risks proliferating unsupervised, low-capacity deposit-taking institutions, while other meso-level mechanisms are in need of development.

Although there is currently a great deal of donor and government activity at the meso level, much of it takes the form of capacity building and wholesale lending to Tier 4 institutions. This approach may expand access but, given the weakness of existing SACCOs, also runs the risk of creating many institutions where poor people’s savings would not be safe. Excessive lending can serve as a disincentive to pursue additional deposits or, worse, threaten the very incentive structure holding SACCOs together.

In the meantime, meso-level structures that support small savings mobilization are in need of significant development. Consumer education is inadequate, as is reliable information about SACCO performance. SACCOs lack mechanisms to channel excess deposits into safe and profitable placements. Poor access to the payments system also inhibits institutions’ incentives and ability to mobilize small deposits. Given the considerable amount of funding in the pipeline (see box), this may be an opportune time for donors and the government to re-evaluate the types of investments that would best promote access to quality deposit services for poor Ugandans.

**Wholesale Funding and Liquidity Management Mechanisms**

In Uganda, major sources of wholesale financing to Tier 4 institutions include the EU’s Support to Feasible Financial Institutions and Capacity Building Efforts Project (SUFFICE), OikoCredit, Stromme Foundation, and the Microfinance Support Center Ltd. (MSCL). MSCL’s portfolio is several times larger than that of the others combined, and targets SACCOs for wholesale lending as well as MFIs. It is questionable whether lending to SACCOs is appropriate given (1) the potential to discourage deposit mobilization, (2) the negative impact of large chunks of external funds on management and governance, and (3) the fact that many SACCOs are already overliquid.

Easy access to inexpensive financing can serve as a disincentive to deposit mobilization. In one SACCO in Central Uganda recently evaluated by a donor, average savings of UGS 62,500 (USD 35) per member was paralleled by wholesale financing of UGS 41,000 (USD 23) per member. The exorbitant degree of external financing was judged by both SACCO management and donor staff to have discouraged the institution from mobilizing more savings. Wholesale funds are abundant and relatively easy to access in Uganda, suggesting that disincentives to deposit mobilization could
Stakeholders report that savings rates at SACCOs have decreased as lending to SACCOs increased. Equally troubling, stakeholders report that delinquency at SACCOs has increased at the same time. This should not be surprising, given that the negative effect of external funds on group cohesion has been repeatedly demonstrated in other countries. In addition, given the liquidity position of most SACCOs, the need for such wholesale lending is unclear (see Table 6).

Table 6: Excess Liquidity in 147 SACCOs (USD mil)

<table>
<thead>
<tr>
<th></th>
<th>USD mil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>1.91</td>
</tr>
<tr>
<td>Voluntary savings</td>
<td>6.66</td>
</tr>
<tr>
<td>Total savings on deposit</td>
<td>8.57</td>
</tr>
<tr>
<td>Total loan portfolio</td>
<td>6.35</td>
</tr>
<tr>
<td><strong>Excess liquidity</strong></td>
<td><strong>2.22</strong></td>
</tr>
</tbody>
</table>

Source: Data gathered by UCA and UCSCU

Donor support could instead focus on finding ways to channel these excess deposits out of shaky SACCOs and into safe, profitable placements. At present, most over-liquid SACCOs resort to depositing excess funds at banks, which typically pay interest rates of 2 to 3 percent—well below the annual inflation rate of 5.2 percent. Investing in higher-yield vehicles such as government treasury securities appears to be beyond the treasury management capacity of nearly all SACCOs.

Although reportedly under consideration by at least one donor project, no formal liquidity management mechanisms currently exist to allow over-liquid SACCOs to lend to others seeking additional funds. In a study by Rural SPEED, SACCO managers responded...
negatively to the idea of central funds management by a SACCO union, mainly because of concerns that liquidity sharing could drag successful institutions down when weaker ones fail.

Capacity-Building Resources on Deposit Mobilization

In 2004 CGAP’s Microfinance Sector Effectiveness Review found the supply of training and technical assistance resources inadequate for the demand in Uganda. However, this review finds that capacity-building resources knowledgeable about deposit mobilization are relatively plentiful compared to other markets (if perhaps still insufficient for the overall demand).

Overall, there are more than 30 sources of capacity building services in Uganda. Three universities – Nkozi, Makerere and Uganda Martyrs – offer capacity building on deposit mobilization, as does the Microfinance Competence Centre (MCC) at the Ugandan Institute of Bankers. A number of MicroSave and AFCAP-trained consultants are also active in providing training and technical assistance. Their numbers are limited, however, and over 90 percent are Kampala-based according to a recent analysis.43

Another source of management support services for Tier 4 institutions is membership-based umbrella institutions. The Uganda Cooperative Association (UCA) has a broad membership of more than 7,000 multi-service cooperatives, with 300 SACCOs among them. Membership of the Uganda Credit and Savings Cooperative Union (UCSCU) is limited to SACCOs, 31 of which report quarterly and an additional 210 with which it works periodically. The Association of Micro Finance Institutions of Uganda (AMFIU) is a network of 114 MFIs, of which only the four transformed MDIs are authorized to collect voluntary deposits. UCA, UCSCU, and AMFIU provide services including performance monitoring, on-site advice, and coordination of training from other sources. However, the high ratio of member institutions to staff (see Table 7) limits their capacity.


| Table 7: Staff Resources at Tier 4 Umbrella Institutions |
|-------------|----------------|---------|---------|
| Institution | Member Institutions | Staff | Members per Staff |
| AMFIU | 114 | 7 | 16 |
| UCA | 7000 | 80 | 87 |
| UCSCU | 241 | 8 | 30 |

Source: AMFIU, UCA, UCSCU

At present, the largest sources of technical assistance funding are the Matching Grant Program and Rural Financial Services Project, both under the MOP. MOP is a multi-year effort aimed at encouraging branch expansion and product diversification among Tier 4 institutions, strengthening apex institutions, and funding consumer education. Funding comes from the EU, DANIDA, and IFAD. In addition, several donor-financed entities, such as the Capacity Building Unit at SUFFICE and the Stromme Foundation provide capacity-building grants, training and other support.

Although investments have been significant, stakeholders report that a “vaccination” approach is typical, with funders exposing as many institutions as possible to training. This tends to spread resources evenly, but thinly. At least one MDI reports it would like to add three additional savings products but is unable given limited in-house capacity and locally-available training. Parceling out capacity building in small packets also begs the question of whether donors and government programs have the resources needed to build up many small institutions, or would be better advised to concentrate on developing fewer, stronger ones. Some stakeholders also noted the duplication of effort and sub-optimal usage of resources among capacity-building service providers.

An additional shortcoming in the current structure of capacity-building efforts is that they are targeted almost exclusively to managers. Several stakeholders pointed out that, in membership-based institutions, capacity building for managers without corresponding education for members serves to increase the “capacity distance” between the two. This makes it harder for members to monitor and hold managers accountable, increasing the possibilities for fraud and mismanagement.
Lack of Reliable Information for Consumers and Investors

Access to reliable information about the health of financial institutions is key for helping consumers decide where to bank. All clients want to know is that their money is safe, and donors want to make wise investments. Yet, in Uganda, such information is scarce, particularly for Tier 4 institutions.

Some stakeholders in Uganda are considering the merits of a “star” system to communicate information about financial institutions’ health. Dependable external monitoring and data collection would be a precondition, but unfortunately no entity is effectively supervising and/or collecting data on SACCOs. A number of efforts are underway which have potential to improve the situation:

- A comprehensive census of Tier 4 institutions (MOFPED/FSDU);
- A consumer education program (AMFIU/FSDU/EU);
- A publicity campaign with the message “save, but save prudently” (Rural SPEED);
- Financial Extension Workers (SUFFICE managing on behalf of MOP);
- Conversion of the industry-standard Performance Monitoring Tool into an internal monitoring tool for Tier 3 and 4 institutions, and consolidation of data into a centralized database of financial and outreach information (AMFIU, Rural SPEED, GTZ/Sida, SUFFICE);
- Development of a time-efficient due diligence tool for wholesale lenders (Rural SPEED);
- A Tier 4 rating service which will be operated by PlaNet Rating (SUFFICE/FSDU).

Payment Systems and the Promise of Technology

Well-functioning payment mechanisms make deposit products more attractive and accessible to low-income customers in multiple locations, potentially drawing previously unbanked clients and their liquidity into the formal sector. Technology-enabled delivery channels—such as mobile phones, ATMs, and point-of-sale (POS) card readers—have the capacity to multiply the number of financial service access points, unlocking rapid growth for institutions, and substantially increasing convenience for customers.

Uganda’s national payment system has seen major improvements since 1988. Several commercial banks have established a national switch, and Stanbic operates its own via the ATMs in its network of 68 branches. At the moment, however, MDIs are not permitted direct access to the national switch. Instead, they are forced to use commercial banks for this function, adding to their cost.

As a result, some donor agencies, MDIs and other stakeholders are exploring technology-enabled remote payment systems. Technology also holds the potential to reduce the cost of offering services in close proximity to clients by bypassing traditional (and expensive) branch-based expansion models.

Hewlett-Packard and three Ugandan institutions (UMU, Finca and FOCCAS) are piloting the Remote Transaction System (RTS). Through RTS, clients are issued smart cards which store data about their accounts on a computer chip. Clients access their account using the smart card via card-reading terminals at a network of shops and other retailers. By swiping the card through the terminal, customers can conduct balance inquiries, cash deposits and withdrawals, and electronic payment for goods. The terminals use cellular connections to communicate information about the transaction back to the financial institution.

Rural SPEED is also engaged in a partnership with Simba Telecom to develop a payments system using SMS text messaging over mobile phones. The project will initially use Simba’s company-owned stores as points for sending/receiving cash transfers, with a later roll-out to 1200 affiliated vendors and creation of a platform for mobile phone banking for Simba subscribers.

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44 The strongest institutions would be awarded the most stars (perhaps five out of five), and would be able to display the rating on their premises to inform current and potential clients.

Such approaches still have much to be worked out. A key challenge for making technology-enabled solutions relevant for low-income clients is encashment—allowing customers to convert electronic value into paper currency and vice versa. One common solution is to partner with merchants who exchange cash for the value on the smart card or mobile phone account, as in the case of gas stations with RTS or Simba Telecom’s stores.

However, retailers with adequate literacy or comfort with technology may be difficult to find in a low-income, rural environment. In addition, retailers must be able to handle the full volume of demand for cash-in and cash-out transactions. Chains of gas stations, airtime resellers and other retailers affiliated with a larger company may be better able to meet the liquidity challenge. Another area of uncertainty is regulatory authorization for non-bank entities to act as agents of a financial institution in accepting deposits. The RTS experience also shows how expensive it can be to get technology “right”. One institution engaged in the experiment estimates it has individually invested USD 200,000 to date, and the system has yet to be rolled out at scale. Hewlett-Packard and other international supporters have also invested a considerable amount.

Finally, customer adoption of new technology must also be considered. MTN tried its “Me2U” airtime uploading solution which previously met with success in South Africa, but found that Ugandan clients needed more training to become comfortable with the product.46 One encouraging sign is adoption of ATM cards as customers recognize the convenience and time saving over crowded bank halls: surveys show that 15 percent of clients in Kampala already use ATM cards. Moreover, 70 percent of respondents not currently using an ATM said they would use one if it were offered to them.47

MACRO: POLICY AND REGULATORY ENVIRONMENT

Main Finding: Regulated institutions benefit from capable oversight, albeit with heavy costs, slowing the expansion of MDIs. In contrast, Tier 4 institutions suffer from inadequate supervision.

MDI Act and Implications for Rural Outreach

The MDI Act marks a significant milestone in the development of Uganda’s financial sector. It paves the way for high-performing institutions to offer a wider range of services to clients, clarifies their ownership, and bolsters the security of poor people’s deposits. Much has been written about the positive qualities of the law, and the highly consultative process pursued in drafting it.48 Enacted in 2003, it provides a regulatory window for the strongest MFIs to come under BoU supervision and legally mobilize deposits. Four institutions have received MDI licenses, with a fifth (Faulu) moving through the process. As a matter of policy, MDIs are subjected to continuous off-site monitoring and an on-site visit at least once annually. On average, a team of four BoU staff devotes 25 person-days in preparation, time on-site and in follow-up with each MDI.

There is broad consensus that regulations governing MDI operations have, however, slowed the pace of branch openings and rural outreach, at least temporarily. BoU has established stringent physical requirements for new branches (including 24-hour guards, secure teller windows, and standards for the appearance of premises). BoU has also mandated that MDIs provide end-of-week statements by the following Monday. According to stakeholders interviewed, this requirement is more stringent


than that levied on Tier 1 and Tier 2 institutions, necessitating large investments in MIS and networking of branches to be able to comply. MDI managers estimate the cost of achieving compliance at approximately USD 1 million per institution to date. One institution stated the total cost of transformation at USD 4 million over three years.

These regulations have, thus far, caused MDIs to slow or completely halt planned branch openings while they bring existing branches up to the new standards. PRIDE, for example, has upgraded only 18 of its 29 branches, and halted savings mobilization in the remainder until they are brought up to BoU standards. In the medium-term, the investment in modern facilities and MIS capacity are likely to be a boon to MDIs. But for the short-term, it would appear that growth in MDI outreach may come more from intensification of market share in current markets, rather than via significant extension to unserved rural areas.

**Regulatory Vacuum for SACCOs**

Given that achieving rural outreach through the MDIs is likely to take time, SACCOs are receiving increased attention from donors and the Government of Uganda. The very substantial investments shaping up for Tier 4 institutions are fueled by hopes of significantly steepening the growth curve for rural access. But unless interventions are thoughtfully crafted, there is a substantial risk of pouring support into historically weak institutions that do not enjoy an adequate regulatory and supervisory framework.

In contrast to institutions in Tiers 1-3, SACCOs operate in what amounts to a supervisory vacuum. Ugandan SACCOs benefit from no legal status, regulation, or supervision system which recognizes their distinct nature from non-financial types of cooperatives. They fall under the Uganda Cooperatives Act, which governs all cooperatives and which charges the Ministry of Trade, Tourism and Industry (MTTI) with maintaining a registry of cooperatives and overseeing their functioning and stability.

In practice, limited staff resources and technical expertise do not permit MTTI to analyze the operations of SACCOs, conduct monitoring visits, or state which SACCOs are active, let alone healthy. As a result, deposits in SACCOs have little external protection. Many stakeholders are examining options for ameliorating this situation, from having BoU supervise SACCOs itself, to various forms of delegated supervision (member-owned apex or a third-party model).

Direct supervision seems unlikely in the short term, as BoU has taken to heart the axiom “Do not regulate what you cannot supervise.” It is understandably reluctant to take on the costly task of supervising up to 1400 small, scattered institutions with its current resources. Perhaps in the medium term BoU will be given sufficient resources to supervise a limited number of large SACCOs.

Until such time, some analysts have recommended delegating supervision to a membership-based body such as UCA or UCSCU. When published in 2005, the “Government Plan to Enhance Rural Financial Services in Uganda” assigned a supervisory function to UCSCU, though few details were provided about how this would be implemented. Self-supervision by cooperative apexes or federations has accumulated a dismal record around the world. In Uganda, the necessary conditions are not yet in place for delegating supervision to an entity like UCSCU. First, UCSCU is not empowered by law to perform prudential supervision for its members. Second, even if it were, it is doubtful that UCSCU would be able to discharge those duties without a substantial increase in its institutional resources and skill base. Currently, no umbrella organization has the ability to enforce even basic transparency standards for SACCOs, such as regular reporting requirements, disclosure of institutional performance, and a code of conduct for SACCO managers.

If some form of delegated supervision is inevitable given BoU’s resource constraints, experiences from other countries may offer useful lessons. First, a single apex body is often

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49 This view was expressed in multiple stakeholder interviews during the assessment.

more effective than multiple institutions in charge of evaluating institutions. In the Philippines, federations and TA projects have created multiple rating systems, which diminish the effectiveness of each one. In Mexico, the creation of multiple federations has opened the possibility for cooperatives to switch their memberships in order to avoid strict supervision or sanctions.

For this reason, membership in the apex must also be mandated, not voluntary. The threat of sanctions is much less effective if institutions can simply renounce their membership. If apexes are dependent on member dues, their ability to objectively analyze member institutions may also be compromised. Due to the possibility for conflicts of interest, a third-party model of delegated supervision may have some advantages over one that operates through a membership-based organization. The “third party” could be an offshoot of the membership-based apex, as long as it was wholly independent in its supervisory role.

In any delegated supervision approach, bestowing adequate enforcement power will be key to effectiveness. In Benin, the credit union apex FECECAM does not possess legal authority to make binding recommendations upon its members. As a result, recommendations go unheeded or only partially implemented.

Getting the Recipe Right for New Delivery Channels

As in many countries, regulatory clarity on new delivery mechanisms for deposit services such as mobile phone banking and POS devices is lacking in Uganda. BoU is currently firm on prohibiting deposit-taking at non-licensed points of service, although they may be satisfied if retailers load value on cards right away. BoU has indicated it would like to study the issue further. Insights might be drawn from what regulators have done in several countries where technology-enabled delivery channels have been launched, including South Africa, the Philippines and Brazil.

Some Ugandan institutions are piloting “low-tech”, but equally promising, delivery channels such as mobile vans, mini-branching (at least to originate and disburse loans), as well as linkages with SACCOs and MFIs. However, current banking regulations limit the scope of linkages by prohibiting co-branding of products between regulated and unregulated entities and banning unregulated institutions from collecting deposits on behalf of an MDI or bank. Mobile vans appear to be permitted, but BoU has limited mini-branching to credit operations. As these new delivery channels—both high and low-tech—are just beginning to feature on the Ugandan microfinance landscape, there is an opportunity to be proactive in defining what would constitute a mutually acceptable balance of systemic stability and expanded access for consumers.

Strategies to Improve Small-Balance Deposit Mobilization in Uganda

This section suggests potential strategies for increasing and improving the quality of small-balance deposit mobilization in Uganda. Rather than offer prescriptions, these suggestions raise key points that warrant further research and reflection among stakeholders. Many of the suggested actions drive towards increasing rural access to deposit services, part of a more general challenge facing the Ugandan financial services sector today.

1. Create smart consumers of financial services. Consumer education efforts should be launched to help small savers better understand the mechanics of financial savings (such as how to interpret and predict fees and charges on their accounts). But educational efforts should go one step further, equipping small savers to recognize healthy institutions, especially given the current lack of effective supervision for SACCOs. At a minimum, consumers should understand the meaning and implications of regulated vs. unregulated status.

Technical assistance to SACCOs should also include member education, as wide gaps between member and manager know-how tend to create openings for fraud and mismanagement. Design of consumer education messages and development of standardized curricula and campaigns would be a worthy object for donor funding, in consultation with other stakeholders.
A system for disclosure of pricing and performance information would be a desirable complement. BoU regularly publishes schedules of bank fees in urban newspapers, but avenues for making similar information available and understandable to rural savers should be explored. An easily communicated indicator of institutional health could be produced by an independent rating service for Tier 4 institutions or, in the longer term, by a supervisory body.

2. Size the market and clarify behavior to design competitive products. The business case for small deposit mobilization would be bolstered by information about the level of unbanked liquidity in the informal sector, in-depth analysis of clients’ risk, return and liquidity profiles, and how they align different kinds of savings instruments with various savings goals. Such information can help institutions understand where attractive pools of unserved demand lay which can be tapped by appropriately designed products. The upcoming Finscope Uganda study of financial service demand should yield data that could be analyzed along these lines.

3. Link institutions to combine outreach and stability. Encourage linkages that combine the strengths of different types of institutions and facilitate the flow of poor people’s savings into safer, regulated institutions. Such linkages would build on SACCOs’ front office strength of close proximity to rural savers, and the back office capacities of MDIs or banks.

Donors and government ministries active in supporting SACCOs have a role to play in brokering connections with interested banks and MDIs, though consummation of a partnership should rest solely on its commercial appeal to both SACCO and bank or MDI. There appear to be strong incentives on both sides. In exchange for depositing excess liquidity in regulated partners, SACCOs might receive training and technical assistance needed to improve their management. Deposit-hungry MDIs, CMFL and some smaller banks facing increasingly fierce competition might find linkages to be a cost-effective source of portfolio financing. Marketing has an important role to play in shaping customer trust in the linkage, though BoU’s prohibition against co-branding limits its scope.

Another potentially promising linkage could involve Tier 1 banks launching their own service companies to lend to and take deposits from low-income clients. Commercial banks have used this model in other countries with considerable success. Creating an independent entity permits the bank to open new lines of business with clients who otherwise lay outside the parent bank’s traditional target, while preserving the parent bank’s hard-won brand. Increasing competition may make this approach increasingly attractive to Ugandan commercial bankers. Clients would gain access and stability in a single entity.

4. Invest in developing new delivery channels for MDIs and Tier 1 and Tier 2 institutions with an interest in microfinance. Innovative solutions are needed to help institutions reach farther afield and serve rural areas where 75 percent of Ugandans reside. Both high- and low-tech solutions should be considered. Delivery channels using mobile phones or smart cards could be an area worthy of donor support, given the up-front investment required to get technology right, and potentially enormous impact on rural access. Even without external funding, institutions can roll out low-tech but potentially very effective solutions on their own, including the use of mobile vans or mini-branching to reach areas where a full-fledged branch may not be profitable.

Stakeholders in Uganda should also examine the lessons conveyed by the successes of Centenary and Stanbic. Both manage large rural branch networks serving a considerable volume of lower-income Ugandans, built in some measure with the aid of external inducements and support. Although direct subsidies may not be appropriate in replicating this type of outreach, the government might consider extending fiscal or other kinds of incentives to banks that agree to service under-banked regions and lower-income Ugandans.

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5. Explore innovative ways of managing SACCO liquidity. Beyond linking SACCOs with regulated institutions, another promising opportunity to manage SACCO liquidity could be to link them to Uganda’s Collective Investment Scheme. The mechanism pools individuals’ funds and invests in treasury securities, providing a low-risk instrument offering yields over 8 percent. The instrument could be employed not only by SACCOs, but also offered by MDIs and banks as an inducement for individuals to become (or remain) clients. If such an idea were pursued, Ugandan authorities should act to ensure that fund managers are thoroughly vetted, and low-income people’s deposits are placed only in secure investments, such as treasury securities.

6. Promote active dialogue with BoU on new methods of increasing outreach. BoU has a critical role to play in shaping a number of solutions contained in this report. BoU approval for linkage partnerships can help clarify movements of liquidity between tiers, and potentially carve out room for pilot tests of co-branding of products. To further the application of technology to building low-cost delivery channels, guidelines need to be worked out for encashment and the role of agents. Likewise, discussion should take place on the possibilities for mini-branching and mobile vans for mobilizing deposits.

There is a legitimate need to ensure against adding systemic risk though any of these delivery channels. But given the well-documented barriers to access for low-income Ugandans, deliberations should focus on finding the optimal balance of access and security. Industry actors at all levels should seek to engage BoU in active dialogue. Entities such as AMFIU, MDIs and donors can reprise the role they played in the highly consultative (and ultimately successful) deliberations surrounding the MDI Act. They can be joined by other actors which have a stake.

7. Focus support to SACCOs on better monitoring, regulation, and supervision, rather than on-lending. The very substantial funding planned for Tier 4 institutions risks investing in historically weak institutions that do not enjoy adequate regulation and supervision. Capacity building programs are unlikely to strengthen protection of poor people’s deposits in SACCOs if oversight is not also strengthened.

The first requirement is a legal framework that distinguishes SACCOs from other cooperatives. In light of limited resources at BoU and MofPED, delegating supervision to an independent body would be the most feasible solution. If this is the route chosen, a single supervisory body should be established to ensure consistent monitoring and eliminate openings for regulatory arbitrage. Requiring SACCOs to submit to supervision by this entity would also help avoid the conflicts of interest possible in apexes based on voluntary membership. The government should also make its backing of the entity clear; international experience strongly indicates that the supervisory body should have the legal authority to enforce its decisions. Finally, limited resources for a prudential supervision could be concentrated on the largest SACCOs that represent the majority of deposits in Tier 4 institutions. Detailed mapping of the SACCO landscape would be necessary to understand whether a small cohort of relatively large SACCOs exists to make this feasible.

Alternatively, a non-prudential system of regulation could be tried. Even this more limited monitoring would increase depositor protection by requiring regular reporting, disclosure of institutional performance, and possibly even a publicly posted notice informing clients of an institution’s unregulated status. Better performance monitoring would also help donors better target their support to SACCOs, by providing information enabling them to differentiate SACCOs according to priority criteria such as outreach, and track progress against performance-based funding contracts.

Regardless of design, the effectiveness of a regulatory and supervisory framework hinges on a realistic assessment of the resources available to implement it. In light of limited resources, authorities should not regulate what they cannot supervise. Conveying the impression of active supervision without the corresponding reality may actually increase risk to depositors.
## Annex I: Summary Matrix of Findings and Suggestions

<table>
<thead>
<tr>
<th>Level</th>
<th>Opportunities</th>
<th>Obstacles</th>
<th>Suggestions</th>
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| Clients | ➔ Documented evidence of demand for formal savings services among low-income savers  
         ➔ Awareness of client demand in financial sector | ➔ Client mistrust of financial institutions  
         ➔ Little data on level of unbanked liquidity  
         ➔ Lack of research on rural risk/return/liquidity preferences hamstrings advanced product design | (1) Create smart consumers of financial services  
(2) Size the market and clarify preferences to design competitive products |
| Micro | ➔ Diverse range of institutions mobilizing small deposits | ➔ Few branches of deposit-taking institutions relative to population  
         ➔ Limited geographic outreach of regulated institutions  
         ➔ Products not competitive with informal sector | (2) Clarify preferences to design competitive products  
(3) Link institutions to combine outreach and security  
(4) Invest in perfecting new delivery channels for MDIs and banks with interest in MF  
(5) Explore innovative ways of managing excess liquidity in SACCOs  
(6) Promote active dialogue with BoU on mitigating risks of new outreach methods |
| Meso | ➔ Abundant and knowledgeable sources of training and TA on deposit mobilization  
      ➔ Active coordination among donors, including agreement to lend at or near market rates | ➔ Consumer education is inadequate, as is reliable information about SACCO performance.  
      ➔ SACCOs lack mechanisms to channel excess deposits into safe and profitable placements  
      ➔ Accessible institutions not connected to payment system  
      ➔ Excessive second-tier funding risks undermining SACCOs | (1) Create smart consumers of financial services  
(4) Invest in perfecting new delivery channels for MDIs and banks with interest in MF  
(5) Explore innovative ways of managing excess liquidity in SACCOs  
(6) Promote active dialogue with BoU on mitigating risks of new outreach methods |
| Macro | ➔ MDI Law provides for regulation and supervision of deposit-taking institutions serving the poor | ➔ High cost for current MDIs to expand or new institutions to become MDIs  
      ➔ SACCOs lack proper regulatory framework and supervision  
      ➔ Government programs may encourage start-up of many weak SACCOs | (4) Invest in perfecting new delivery channels for MDIs and banks with interest in MF  
(6) Promote active dialogue with BoU on mitigating risks of new outreach methods  
(7) Focus support to SACCOs on better regulation and supervision rather than on-lending |
ANNEX II: SOURCES CONSULTED ON DEPOSIT MOBILIZATION IN UGANDA

INDIVIDUALS

Michael Atingi-Ego, Director, Research, Bank of Uganda (BoU)
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Henry Bagazonzya, World Bank
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Justine Bagyenda, Acting Exec. Director Supervision, Microfinance, Bank of Uganda (BoU)
Steven Bangonzya, Head, Microfinance Competence Center, Uganda Institute of Bankers
Lucy Businge-Kugonza, Operations Manager, MicroFinance Support Centre Ltd. (MSCL)
Charles Byanyima, MicroFinance Support Centre Ltd. (MSCL)
Andrew Iappini, Development Alternatives, Inc. (DAI)
Wilson Kabanda, General Secretary, Uganda Credit and Savings Cooperative Union (UCSCU)
Solomon Kagaba, Microfinance Advisor, SNV
Alex Kakuru, Faulu Uganda
Agnes Kamya, Bank of Uganda (BoU)
Saliya Kanathigoda, Programme Advisor, GTZ (German Technical Cooperation) / Sida (Swedish International Development Cooperation Agency)
James Karama, Post Bank
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Fabian Kasi, Executive Associate Director, Finca Uganda
Grace Kasisira, Bank of Uganda (BoU)
Mathias Katamba, Head of Business Development, PRIDE Uganda
Emmanuel Kawuki, Aitec International Ltd.
Lawrence Kiiza, Director, Economic Affairs, Ministry of Finance, Planning and Economic Development (MoFPED)
Gerald Kikambi, PRIDE Uganda
Terri Kristalsky, Chief of Party, Rural SPEED
Aomu Mackay, Bank of Uganda (BoU)
Dipankar Mahalanobis, Managing Director, MicroCare
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Leonard Msemakweli, General Secretary, Uganda Cooperatives Association (UCA)

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Elliot Mwebya, Bank of Uganda (BoU)

Robina Nakato, Bank of Uganda (BoU)

Josephine Nakkomo, Head of Business Development, Nile Bank

Isaac Nsereko, Head of Retail, DFCU

Paul Nyakairu, CEO, Commercial Microfinance Ltd. (CMFL)

Peter Okawulo, General Manager, Uganda Finance Trust

Henk Van Oosterhout, Programme Manager, SUFFICE

Anthony Opio, Director Non Bank Financial Institutions, Bank of Uganda (BoU)

Gunilla Ouku, Head of Retail Banking, Nile Bank

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Rodney Schuster, Uganda Microfinance Union (UMU)

William Sekabembe, Head of Retail Performance, Barclay’s Bank

Daniel Herbert Sentumbwe, Stromme Foundation

Priscilla Serukka, Regional Director, Stromme Foundation

Eldard Ssebbale, Rural SPEED

Albert Ssemukutu, MSE Specialist, United Nations Industrial Development Organization (UNIDO)

William Steel, World Bank

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Geoffrey Tusiime, Post Bank

Jackie Wakhweya, Cognizant Technical Officer, United States Agency for International Development (USAID)

Clare Wavamunno, Finca Uganda

Patrick Woyaga, CERUDEB

DOCUMENTS


ANNEX III: MAP OF POPULATION PER BRANCH OF DEPOSIT-TAKING INSTITUTIONS BY DISTRICT IN UGANDA