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**Recognising the Role of Micro Finance Institutions in  
Uganda**

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# **B a n k o f U g a n d a**

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Research Department

**Recognising the Role of Micro Finance Institutions in Uganda**

By

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**Abstract**

This paper shows that micro finance is an important part of the growth strategy in Uganda and has in the recent years gained increasing recognition. This is evidenced by initiatives and strong commitment by government, donors and practitioners towards supporting micro finance activities in Uganda, and the rapid expansion of the micro finance industry. Integration of Micro Finance Institutions (MFIs) into the formal financial system has been established, while measures have been taken to build capacity and enhance coordination in the micro finance industry, as well as expand the outreach of sustainable micro finance.

The paper, however, identifies a number of challenges to the development of the micro finance industry: There is need to strengthen the capacity of MFIs to build their management information systems, and to rebuild infrastructure in underserved areas as well as strengthen capacity for identifying potential market structures, which could serve as the basis on which to build sustainable micro finance services. Other challenges include restoring peace in conflict areas and strengthening corporate governance especially for the Tier-4 MFIs. Moreover, for many of the programs aimed at supporting the micro finance industry to be effective, there is need for continued economic stability, government commitment to develop the industry, improvements in mechanisms to monitor the implementation of the programs, and further efforts to rebuild the capacity at local governments.

The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of BOU or BOU policy. Working Papers describe research in progress by the author(s) and are disseminated to elicit comments and to further debate.

Key words: Recognising, Role, Micro Finance Institutions, Uganda

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## ACRONYMS AND ABBREVIATIONS

ACORD	Agency for Cooperation and Research in Development.
AFCAP	African Pilot Capacity Building Programme
AMFIU	Association of Micro enterprise Finance Institutions of Uganda.
BOU	Bank of Uganda
CBOs	Community Based Organisations
CDW	Community Development Worker
CERUDEB	Centenary Rural Development Bank.
CGAP	Consultative Group to Assist the Poorest.
CMF	Centre for Micro Enterprise Finance.
DANIDA	Danish International Development Agency.
DFD	Development Finance Department, Bank of Uganda
DFID	Department for International Development.
ECS	Entandikwa Credit Scheme
FEW	Financial Extension Worker
GOU	Government of Uganda.
GTZ	German Technical Assistance
IFAD	International Fund for Agriculture Development
MCC	Micro Finance Competence Centre.
MDIs	Micro Deposit-taking Institutions
MFF	Micro Finance Forum.
MFIs	Micro Finance Institutions.
MPED	Ministry of Finance, Planning and Economic Development
MGLSD	Ministry of Gender, Labour and Social Development
MTCS	Medium Term Competitiveness Strategy for the Private Sector
NAADS	National Agricultural Advisory Services Programme
NGOs	Non Government Organisations
NPART	Non-Performing Assets Recovery Trust
NURP I	Northern Uganda Rehabilitation Project
OSS	Operational Self Sufficiency
PAP	Poverty Alleviation Project
PAPSCA	Programme for Poverty Alleviation and Social Costs of Structural Adjustment
PEAP	Poverty Eradication Action Plan
PMA	Plan for the Modernisation of Agriculture
PMA	Plan for Modernisation of Agriculture
PRESTO	Private Enterprise Support, Training and Development Programme.
PSDP	Private Sector Development Programme.
RMSP	Rural Micro Finance Support Project
SME	Small and Medium Sized Enterprise
SPEED	Support for Private Enterprise Expansion and Development.
SUFFICE Efforts.	Support to Feasible Financial Institutions and Capacity Building Efforts.
UBOS	Uganda Bureau of Statistics
UCA	Uganda Cooperative Alliance.
UCAP	Uganda Micro Finance Capacity-Building Framework

UIB	Uganda Institute of Bankers.
UNDP	United Nations Development Programme.
UNEX	Union Expert Services
UNHCR	United Nations High Commissioner for Refugees
USAID	United States Agency for International Development.
YES	Youth Entrepreneurs Scheme

## 1.0 INTRODUCTION

Micro Finance Institutions (MFIs) in Uganda have since the mid 1990s gained wide recognition for the role they play in providing financial services to the low-income households, and their contribution to poverty alleviation. This recognition is evidenced by rapid advances by the government, donors and practitioners in the development and implementation of programs that support micro finance initiatives in Uganda, as well as the dramatic expansion of the micro finance industry. The micro finance industry had for a long time operated under a number of constraints, among others: lack of legal recognition, weak institutional capacity and unsustainable sources of funding. The combination of these factors led to a small, uncompetitive and inefficient micro finance industry and to the failure of some MFIs. In addition, there were urban/rural and regional imbalances in the distribution of micro finance services, with the northern region receiving the least services, while most institutions were concentrated in urban areas.

However, beginning in 1997 the Government of Uganda (GOU) developed a Poverty Eradication Action Plan (PEAP)<sup>1</sup> within which strategies were drawn to increase growth of the economy by removing bottlenecks to private sector activities, and facilitating the expansion of the rural economy through modernisation of agriculture. Lack of financial services mainly at the micro/sectoral level was identified as a major factor inhibiting the private sector from playing its central role of promoting growth, under the poverty eradication strategy. Consequently, further development of micro finance services became an important policy intervention recommended in all these plans. It is in this context that over the last few years, the GOU in collaboration with donors and other stakeholders initiated a number of programs aimed at developing the micro finance industry.

The purpose of this paper is to document the initiatives undertaken in developing the micro finance industry and to assess their impact. The initiatives include, linking MFIs to the formal banking system and building their capacity to ensure quality service delivery and sustainability in the long-term. The paper is organised into four

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<sup>1</sup> The PEAP was revised in 2000. For a further discussion of the PEAP see MFPED (2001).

sections. Section 2, provides a background to the development of the micro finance activities in Uganda and the recent developments in the micro finance industry. Section 3 discusses the interventions made to support the sector as well as their successes and failures. Sections 4 concludes and draws recommendations.

The analysis will benefit all stakeholders, who wish to better understand the reasons for successes and failures in the development process of the micro finance industry and to rethink strategies as necessary. The resulting policy recommendations should over time be reflected in institutional structures, policies and practices of government, donors and practitioners. The lessons and recommendations from this analysis could also be useful to other industries/countries, which are in the process of reform.

## **2.0 BACKGROUND**

Uganda's financial system is characterised by the co-existence of formal and informal financial markets. The formal financial markets, which mainly comprise of commercial banks, development banks and credit institutions mainly exist in urban areas and offer a narrow range of financial services. They concentrate on providing working capital mainly to medium and large-scale enterprises. Furthermore, the formal financial institutions are inflexible in their operations, with respect to the needs of the small-scale enterprises and the poor people in the rural areas who may not have collateral or well-written feasibility studies to solicit for loans. As such, the rural areas, where the majority of poor people live, remain either under-banked or served by informal financial institutions. It is estimated that only 10% of the rural population and 5% of the rural poor have access to financing services in terms of saving and credit. This limits the rate of investment and employment creation particularly in rural areas, thus constraining overall economic growth (UBOS and MSEPU, 2003).

A wide range of Micro Finance Institutions (MFIs) have, however, existed in Uganda in many forms and for many years to respond to the resource gap in the market and are working to become more responsive to the real needs of their clients who constitute low income households, thereby contributing to economic growth. However, though Uganda has a long history of informal finance, a more organised micro-finance industry picked momentum in the early 1990s following the

liberalisation of the financial sector. The industry is therefore still young, but very vibrant. In the last eight years, the industry has grown as high as 70 percent per annum. Despite this growth, the rural financial sector in Uganda is largely underdeveloped, fragmented and not adequately integrated with the formal financial sector. The costs of operation of MFIs are also generally higher than those of the formal financial institutions since MFI clients are generally located a distance from the branches and require continuous monitoring. Interest rates are hence necessarily higher for loans obtained at MFIs than those on loans obtained from the formal financial institutions (Ledgerwood et al, 2002).<sup>2</sup> To reverse this trend, the government and key stakeholders have started initiating policies aimed at implementing market based rural financial services on a sustainable basis with the major objective of increasing access to and availability of micro finance services in rural areas where the poor people live and work. Therefore, the role played by MFIs is high in the growth strategy of Uganda.

In its original form, micro-finance business was considered as ‘charity.’ As a result, the performance of the schemes was adversely affected by very poor loan recovery, inefficiency and high management costs which consequently led to under-performance or collapse. The view that prevailed for many years was that micro borrowers were too poor to pay back their loans at commercial rates and therefore, any loans to them must be subsidised.

However, over the past decade the industry has transformed into a large, dynamic private sector catering for the financial needs of the low -income households and economically active poor. Over the years, the MFIs have demonstrated considerable comparative advantage in their service provision to rural and low -income urban clients. Furthermore, most institutions have embraced a more business oriented outlook and maintaining their target groups of economically active poor while focussing on achieving operational and financial sustainability.

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<sup>2</sup> While lending rates range between 11% - 80% for MFIs, they range between 5% and 30% for the formal financial institutions.

## 2.1 Size, Structure and Composition of the Micro Finance Industry

MFIs in Uganda consist of moneylenders, micro-finance agencies, Non Government Organisations (NGOs), rural farmers' schemes and savings societies that provide savings and/or credit facilities to micro and small-scale business people who have experienced difficulties obtaining such services from the formal financial institutions. Their range of activities include; deposit taking, savings schemes, small-scale enterprises, agriculture, real estate, group lending, retail financial services, giving advice on financial matters and training in business management. It is estimated that there are over 1400 MFIs with an active loan portfolio of over Shs 97 billion (or US\$ 53.3 million), over 340,000 borrowers and over 900,000 active savers (MSEPU, 2002). MFIs in Uganda can be broadly categorised according to their respective stages of development. Table 1 shows that the majority of the micro finance institutions (i.e category D) are small Community Based Organisations (CBOs), generally unaware of micro finance best practices, outside the micro finance information loop, focused on rural outreach but have minimum numbers of clients.

**Table 1: Structure of the Micro Finance Industry in Uganda**

Category	Number	Characteristics
A	5-8	At or nearing operational or financial self-sustainability. Well-documented operational procedures. Fairly good MIS, well-qualified management and staff. Applying Micro Finance best practices. Often registered as companies limited by guarantee. Active clients over 10,000.
B	10-15	Mainly NGOs. Also registered as companies limited by guarantee. Charge market interest rates, have adapted a business-oriented approach to poverty alleviation, and are moving towards Operational Self-Sufficiency (OSS). Fair documentation of procedures and MIS. Good management, OSS at levels between 50% and 85%. Active clients range from 5,000 to 10,000.
C	40+	Mainly small local NGOs with limited resources and clientele. Fairly familiar with "Best Practices" and are within the industry's information loop. However, most have modestly qualified management and are still far from reaching OSS (35% to 49%). Active clients ranging from 500 to 3,000.
D	Numerous	Small community based organisations, generally not well known in the sector. Largely outside the national micro finance information loop. Most are generally little aware of micro finance best practices. Focused on rural outreach but have minimal numbers of clients.

**Source:** Ledgerwood et al (2002).

## 2.2 Geographical distribution

The database on MFIs in Uganda is scanty and sometimes contradictory. The paper uses several data sources including Bank of Uganda MFIs Rating System Project, AMFIU, Micro and Small Enterprises (MSE) Policy Unit of the Ministry of Finance, the National MFI Technical Coordination Committee and statements from some institutions are used to assess the state of MFIs in Uganda. Table 1 below summarises the geographical distribution of the MFIs in Uganda, based on a national survey of MFIs, which was conducted in 2002 to assess the performance of the micro-finance industry in Uganda. The survey was carried out in all the 56 districts in Uganda and covered approximately 1,426 micro-finance institutions/organisations subdivided into geographical regions of Uganda and classified according to their focus as rural, rural-urban, and urban.

**Table2: Geographical Distribution of the MFIs 1/**

Region	No. of MFIs	% Rural	% Rural-Urban	% Urban
Central	291	37	15	48
Eastern	281	60	15	25
Western	494	59	17	24
Northern	360	65	15	20

Source: MSEPU and MFPED (2002)

1/ Rural refers to where focus is on the communities in the villages, rural-urban refers to where focus is on trading centres, and urban is where focus is on town councils, municipalities and city councils.

According to regional analysis, majority of the MFIs are located in the western region followed by the central, eastern and lastly northern region. The limited number of MFIs in the northern region could probably be attributed to the ongoing insurgency in that region of the country. In terms of urban-rural distribution, most MFIs are rural based according to survey findings. Most MFIs with large loan portfolios are, however, urban based. The implication of this finding is that while MFIs have increased their outreach to the rural areas, the average loan sizes in the rural based institutions are still very small.

## **2.4 Legal Status of MFIs**

The survey findings indicate that the legal status of MFIs in Uganda is categorised as follows: member based MFIs, local social NGOs, international social NGOs, companies limited by guarantee, church owned MFIs, government credit programs and companies limited by shares. However, the legal status of some MFIs was not clear and others could not state their legal status. This could be attributed to the poor organisational structure of those institutions.

## **2.5 Registration of MFIs**

A majority of the MFIs had some form of registration, either at the NGO board, ministry trade and cooperatives, of trade registrar of companies, registrar of cooperatives, apex body, district or sub-county levels. The eastern region had the largest number of registered MFIs, whereas the northern reported the least number of registered MFIs. Overall, over 77% of the MFIs covered in the survey were registered, hence, signifying some level of organization.

## **2.6 Human Resource and Management**

Survey findings indicate that the management teams of most MFIs in both urban and rural areas have all obtained university and tertiary levels of education, respectively. However, the majority of the member based MFIs lacked business management skills. Further, the experience of management teams reduces proportionately to loan portfolio, while most MFIs engage more females than males in their routine activities. One strong implication is that these institutions are not only providing financial services to those without access to them in the formal financial sector, but they also provide employment.

## **2.7 Capital and Funding Sources**

Available data on MFIs establishes the following sources of financing:

- Donor funds
- Retained earning
- Own secured physical assets

- Compulsory savings
- Voluntary savings
- Loans from commercial sources and paid-in-equity
- Local donations and contributions

The government is another source of capital, particularly loan capital for MFIs in the form of revolving funds and rural farmers support schemes. Funds from government and donors are obtained at concessional terms. However, the underlying danger with donor funds is that these funds may dry up in future and the MFIs may find it difficult to mobilise funds from other sources. Therefore, most MFIs are considering possible strategies to ensure their sustainability.

## **2.8 Products/Services Offered and Delivery Methodology**

The majority of the MFIs provide two main categories of financial products; credit and savings. These services are categorised further by terms and size of loans and type of deposits. The survey established an estimated loan portfolio of UShs 97 billion (or US\$ 53.3 million) with an average loan size of UShs 283, 266 (or US\$ 161). Of this active loan portfolio, 91 percent is shared among 17 districts that were classified as high borrowers and the remaining 9 percent among the medium and low borrowing districts. It is worthwhile noting that most districts are net borrowers in that their savings cannot entirely meet their demand for loans. In addition, liquidity risk is high in deposit taking MFIs as they do not have appropriate liquidity management techniques in place (Ledgerwood et al, 2002). Loan terms range from one month to twelve months. There is little similarity in the loan sizes and terms offered by the different MFIs. However, the majority of loans are of three months duration. Most MFIs report a fairly high recovery rate of about 85 percent on their loan portfolio. This could be attributed to the importance attached to the recovery of money lent out for sustainability reasons. Most MFIs mainly employ two methods of delivering their products to their clients; the group and individual lending methodologies. Usually, the first thing a potential borrower is required to do is to become a member of a group. The borrower must also save a percentage of the expected loan directly with the MFI or with a link bank or any other formal banking institution.

With regard to the volume of savings, the survey established the existence of 909,272 active savers in MFIs countrywide with a total savings volume of UShs 107 billion (or US\$ 61 million). These figures have almost doubled in a period of five years. Women account for 65 percent of the active savers. One of the traditional saving mechanisms popular among communities in Uganda is the rotating savings and credit system whereby members contribute a fixed amount into a pool and the total amount is distributed to each member at fixed intervals on a rotating basis. Under this mechanism, money is saved on a daily, weekly or monthly basis and the distribution takes place at the end of the month or the year. The other system of savings mobilisation is the accumulated savings and credit where sums collected are on lent or invested against interest during the cycle. Some MFIs use village banking approach where people within communities form a group or groups and mobilise own savings and extend credit amongst themselves.

### **2.8.1 New Product and Service Innovations**

Recently, some MFIs have begun to diversity the products and services offered to fit the increasing needs of their customers. The recent product innovations include:

- ***Safety and Money Transfer*** – some MFIs provide additional services to their clients such as safe custody of valuable items e.g. land titles, wills etc. They also assist their clients to transfer their money safely from one point to another especially in rural areas.
- ***Price Protection for Coffee Farmers*** –A pilot price protection scheme has been set up by Uganda Cooperative Alliance (UCA) and Union Expert Services (UNEX) Limited to enable farmers to purchase a price insurance that will enable them to reap a guaranteed price for their coffee products. The total product of farmers will then be insured at a minimum fixed price through an international broker trading at the London market.
- ***Health Care Schemes*** – MicroCare Limited has introduced a health-financing scheme for clients of MFIs and their immediate family to access better health care at affordable prices through agreements with hospitals and

MFIs. Under this scheme, the clients will form groups and pay up a minimal up-front quarterly premium to MicroCare Limited.

- ***Salary Based Loan Products*** - where the employer is required to deduct the repayments from the monthly salary cheques of his employees and transfer them to the participating MFIs.
- While a majority of the MFIs mainly employ the group lending methodology approach especially for small loans usually repayable over 4 - 6 months, a good number of MFIs have introduced individual loan products to cater for clients who need larger loans for growing businesses.
- Some MFIs are testing products specifically suited to agricultural borrowers, particularly the smallholder farmers where repayment schedules are designed to compliment the seasonal cash flow.
- ***Annual Business Exhibitions:*** - For the MFIs to exhibit and market their products and services to potential customers and business partners.

## **2.9 Gender distribution of Micro Finance Services**

Survey findings indicated that women access most of the services offered in the MFIs. Among the various micro-enterprises financed by credit, trade and commerce run by women receive the most credit. About 70 percent of the active borrowers in the surveyed institutions are women, while women constitute 65 percent of the active savers. Women also account for 51 percent of the management staff and credit officers in the MFIs. However, it is worthwhile noting that even if women are more served by the MFIs industry, it does not necessarily mean that the objectives of poverty reduction in relation to gender equality have been met. This is largely because the average loan size is quite small for engagement in large income generating activities and saving is still limited. The average loan size in all categories of groups and institutions is UShs 283,266 (or US\$ 161) and the average saving volume is UShs 160,713 (or US\$ 92) per person. In addition, most of the biggest MFIs are located in

urban centres with good infrastructure, which implies that the majority of the women living in rural areas are not served.

### **3.0 INTERVENTIONS TO SUPPORT THE MICRO FINANCE INDUSTRY**

Over the past decade, a number of steps have been taken by Government, donor and practitioners to support sustainable growth of the micro finance industry. These include:

- Maintenance of macroeconomic stability and providing a conducive environment for private sector activity;
- Development of a regulatory framework for the MFIs;
- Promotion of national coordination and linkages through the Micro Finance Forum (MFF);
- Capacity building of the MFIs;
- Divestiture from direct delivery of credit and transfer of credit schemes into credit lines and capacity building support channeled through autonomously managed institutions;
- Strengthening of the framework for effective and decentralised government structures; and
- Commitment to the provision of incentive grants to MFIs willing and able to reach out into under-served areas.

#### **3.1 Maintenance of Macroeconomic Stability and Provision of a Conducive Environment for Private Sector Activity**

Over the past decade, the government has successfully implemented sweeping economic reforms to remove structural distortions in the economy. The reforms included stabilisation and rehabilitation of the economy removal of structural distortions. These reforms have been successful and the economy has reaped significant gains as a result. Inflation was reduced from 27% in 1990 to a low and stable rate of less than 5%, and the economy has been growing at average rate of 6% per year over the last decade. In addition, the implementation of prudent fiscal, monetary and exchange rate policies have restored investor confidence in the economy as well as public confidence in the currency resulting into financial stability.

In 1997, the government of Uganda developed the PEAP framework for eradicating poverty. Within this framework, measures have been put in place to facilitate the private sector fulfil its role of promoting economic growth, under the Medium Term Competitive Strategy for the Private Sector (MTCS)<sup>3</sup> and Plan for Modernisation of Agriculture (PMA).<sup>4</sup> Important reforms under MTCS included divestiture of state enterprises, reduction of import duties and the removal of quantitative restrictions on imports as well as revision of regulatory and legal framework to facilitate private sector participation. The objectives of the PMA are: to increase incomes and improve the quality of life of poor subsistence farmers, improve household food security, provide gainful employment, and promote sustainable use and management of natural resources. Both the MTCS and PMA frameworks identify the need to increase financial services to the poor. To this end, the micro finance industry has developed very fast to bridge the gap left by formal financial institutions, especially in the rural areas.

### **3.2 Regulation and Supervision of Micro Finance Institutions**

In order for MFIs to effectively fulfil their role of intermediation and to grow in a sustainable manner, these institutions must operate in a financially sound and safe manner. Prudential regulation and bank supervision of the MFIs, hence, became necessary. In this regard, the Micro Finance Deposit-Taking Institutions (MDI) Act (2003) was enacted. The MDI Act (2003) which is embedded within an overall regulatory and supervisory 4-tier framework, clearly establishes the responsibility of Bank of Uganda (BOU) to license, regulate, supervise and discipline all deposit taking MFIs, under Tier 3.<sup>5</sup> A number of regulatory and prudential guidelines have been set under the MDI Act (2003) to ensure that MDIs operate in a sound and manner and do not expose themselves to excessive risk taking. These include the following:<sup>6</sup>

(1) Establishment of minimum capital and liquidity sufficient for deposit taking and intermediation, (2) the requirement that banks make appropriate provisions for loan

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<sup>3</sup> For a further discussion of the MTCS see MFPED (July 2000).

<sup>4</sup> For a further discussion of the PMA see MFPED (2000).

<sup>5</sup> Tier 1 and Tier 2 consisting of commercial banks and credit institutions, respectively, are regulated under the existing Financial Institutions Statute (1993).

<sup>6</sup> For a further discussion of the regulatory and prudential guidelines, see Bank of Uganda/GTZ (1998) The Republic of Uganda (2003), and Bank of Uganda (2000).

losses, (3) stipulation of lending limits to individual borrowers, shareholders and insiders to reduce the risk of bad loans, (4) provision for a MDI deposit protection fund, which protects depositors against the risk of losing their savings in the event of an institution's failure, and (4) stipulation of a number of provisions aimed at ensuring good corporate governance of MDIs.

All other micro finance providers, including non-deposit taking institutions and very small member-based organisations mobilising deposits from their members, will be categorised under Tier 4. These institutions will neither be regulated nor supervised by BOU under the proposed law. Consequently, they will not be allowed to take deposits from the public. These MFIs will be overseen by an umbrella body, the Association of the Micro Finance Institutions of Uganda (AMFIU). An important role played by the AMFIU in supporting growth of the MFI industry was to develop uniform performance indicators and reporting format that constitutes a performance monitoring system<sup>7</sup> for the non-regulated MFIs. The performance monitoring system, has established consistent standards, which will contribute to risk control, adherence to minimum requirements and best practices within the micro finance industry.

The performance monitoring system has been developed in consultation with all stakeholders and is expected to contribute to growth of the industry in a number of ways: (1) It will enhance planning of MFIs through clearer targets and benchmarks for their expected development, (2) it will improve financial management, (3) it will increase the awareness and ability of MFIs to report on their performance, for internal management purposes as well as external reporting purposes, and (4) through uniform reporting, the MFIs will save time that they spend in applying for funds and reporting to different funding agencies, and time that funding agencies take in assessing applications and reports from MFIs. (5) Transparency and accountability will also be increased in the micro industry. This will not only safeguard against mismanagement of funds and fraud but it will contribute to protecting clients, thus increasing public confidence in the industry. (6) Reliable and up-to-date information on the performance of the industry will be useful to different stakeholders including policy makers and funding agencies. (7) Coordination will be enhanced within the sector and

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<sup>7</sup> For a further discussion of the performance monitoring system for Tier 4 MFIs see AMFIU (2002).

lobbying and advocacy on important issues affecting the sector will be facilitated. (8) Acceptability of the MFIs as borrowers of private capital from the formal financial institutions will be increased, thus stronger linkages will be created within the Ugandan financial sector as a whole.

Two major challenges face the AMFIU in monitoring the performance of the tier 4 MFIs: First, the majority of these institutions have not yet developed a Management Information System (MIS), capacity to track loans and accounting systems which are able to generate accurate and timely financial information. This underscores the need to build capacity of MFIs to enable them develop/access relevant MISs. Second, there is need to ensure good corporate governance within these institutions in order to build public confidence in these institutions and ensure that they grow in a sustainable way.

### **3.3 Enhanced Coordination in the Micro finance Industry**

Coordination in the Ugandan micro finance industry has been enhanced under the guidance of the Micro Finance Forum, which is comprised of government agencies, donor agencies and other practitioners who support development of the industry. The Micro finance Forum meets regularly under the chairmanship of the Ministry of Finance, Planning and Economic Development, to discuss new developments and constraints in the micro finance industry. Uganda also exhibits a high level of donor coordination and was, hence, selected as one of two countries to be studied at field level as part of the Consultative Group for assistance to the Poor CGAP-led Donor Peer Review process to pilot ways of improving aid effectiveness in the micro finance industry.

In close collaboration with other coordination fora, like the Donor Sub Groups on Agriculture and Private Sector Development, the Micro finance Forum monitors developments and provides guidelines for practitioners and donor funded support initiatives. In particular, several Forum Sub Committees are mandated to provide recommendations for action on strategic issues of further policy development and other matters affecting the industry. It is in this context that the Apex Sub Committee of the Forum was given the mandate to formulate a plan for the operationalisation of the Presidential Directive of extending financial services to the parish level, and to

work on effectively alleviating the constraints in rural finance. Under this plan the following initiatives will be put in place:

Community Development Workers (CDWs) and Financial Extension Workers (FEWs) will be contracted to support all development efforts at community level within the sub-county and parishes. In particular, the CDWs and FEWs will be responsible for mobilising and training of potential clients within the sub-county for Good Practice micro finance, and linking them to well-managed MFIs operating in the area. They could also assist in the selection of clients for MFIs based on their local knowledge of character and business environment, in the monitoring by MFIs of the client's usage of credit facilities and repayments, and in the initial and follow-up data gathering and dissemination in under served areas.

Under the framework for decentralised government in Uganda, the FEWs will be contracted and monitored by the sub-county authorities. However, there is still lack of administrative capacity and facilities to efficiently manage a system of timely receipt and disbursement of funds at this level, which could cause delays for the recruitment of FEWs, and hamper implementation and effectiveness of the interventions.

Further, while MFIs to a large extent contribute to outreach in rural areas, they alone may not be enough to close the gaps in rural finance markets that relate to scarce provisions of medium and long-term finance. This underscores the need to develop a comprehensive market based policy to ensure provision of medium and long-term finance.

### **3.4 Capacity Building in the MFI Industry**

A number of donor projects and programmes have been supplying capacity building services to the micro finance sector over the last nine years: among others, the Centre for Micro enterprise Finance (CMF, 1996) a USAID project under PRESTO, MicroSave Africa project co-funded by UNDP and DFID, the Development Finance Department of BOU, which has piloted basic MFI training courses using the services of the Uganda Cooperative Alliance (UCA), ACCORD, ACIDI/VOCA, SPEED and URDT; and PAP (now RMSP) and UNDP/PSDP which provide basic training

services to their partner organisations. To a limited extent, a few national and international training/consultancy firms have also been involved in capacity building in the sector e.g. UIB, IPC-CERUDEB for the Centenary and some non-Centenary bank staff, PRIDE Africa's Training Institute (REDI) for PRIDE senior staff, Aclaim Africa, and the CGAP-funded AFCAP, which is training African micro finance consultants.

However, it was found that many capacity building programmes worked in isolation, with little or no coordination and synergies. This did not only limit the overall effect of their endeavors but led to wastage of resources due to duplication of efforts. The demand and supply communities are also not adequately interlinked and the national supply community is not yet fully developed. Further, it is recognised that MFIs in Uganda differ considerably in terms of skill, outreach and access to funds and training. In particular the smaller and less mature MFIs in tier 4 lack access to quality services, have less capacity to accurately articulate their demand and fewer resources to attract quality providers. Many MFIs also complained that the training offered to them was not very relevant, as it did not target specific entrepreneurial problems.

To increase access to information on capacity building services and the market for them, it became necessary to establish a more systematic approach to capacity building encompassing training at all tiers of the micro finance industry, and involving private sector suppliers of capacity building services. Initial efforts at improving access to services for MFIs and to facilitate the development of a capacity building market in Uganda included the establishment of the Micro Finance Competence Centre (MCC), and consequently the co-location of five of the key service providers to physically sit in the same building. This will create synergies and avoid duplication of work.

Further, a proposal for a capacity-building framework for the micro finance industry, titled the Uganda Micro Finance Capacity Building Framework (UCAP)<sup>8</sup> has been developed by the Apex Sub Committee of the Micro Finance Forum (MFF) for consideration of Government and donors. The framework aims at increasing access to

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<sup>8</sup> For a further discussion of the UCAP see The Apex Sub Committee of the Uganda Micro finance Forum, (2001).

high-quality capacity building services to all MFIs through the development of standardised training packages; the training and certification of private sector suppliers of training, consultation and technical assistance; and the linking of the demand and supply communities.

Upon approval the framework will be overseen by a co-ordination committee consisting of representatives from the key programmes, projects and other interested agencies. In particular, a framework coordinator and administrator will be responsible for compiling information and coordinating the demand and supply of capacity building services. The final design of the capacity building framework, as well as all training packages will be carried out in a consultative manner, involving stakeholders in the micro finance industry and the supply community, GOU, BOU and donors through the Micro Finance Forum.

A more coordinated approach to capacity building would benefit different stakeholders in the micro finance industry in a number of ways: The suppliers of services would get access to quality-enhancing training and upgrading of current services, as well as more accurate information on the size, characteristics, demands and needs of their market. Provision of capacity building services would also become more viable, with a more visible MFI market. The MFIs will benefit from easier access to more and better quality services, while the micro finance industry as a whole will benefit from increased consultation on content and delivery mechanisms for capacity building, which will ensure that more of the real needs of the industry are met and that high quality capacity building is attained and maintained.

A coherent approach to capacity building may attract support from several donors and sponsors, hence, furthering minimum standards, and reducing duplication of efforts and sub-standard interventions. Finally the UCAP would facilitate transfer of expertise and technology from donor-funded programmes currently providing capacity building services to existing Ugandan private sector institutions. This would ensure the sustainability of high quality capacity building in the long-term.

### **3.5 Divestiture from Direct Micro Credit Delivery**

Over the past decade, the Government of Uganda via the Ministry of Gender, Labour and Social Development (MGLSD)<sup>9</sup> has implemented and/or supported various micro credit schemes aimed at fighting poverty in the country. Most of these schemes focused on the provision of revolving funds for micro credit to households at the grass root level. Examples include the Poverty Alleviation Project (PAP), Entandikwa Credit Scheme (ECS), Rural Farmers Scheme, Cooperative Credit Scheme, and the Youth Entrepreneurs Scheme (YES). In addition, the Government has supported credit activities within the framework of other multi-purpose projects, including the Micro projects Programme, Danida Credit scheme in Rakai District, NURP I, SWARP and PAPSCA.

However, implementation of many Government programmes lacked the effective methodologies and the adequate management and coordination capacity necessary for their success. As a result, the performance of the schemes was adversely affected by very poor loan recovery, inefficiency and high management costs which consequently led to under-performance and/or collapse. In view of this, there was need to restructure the surviving schemes with the aim of instituting measures to recover outstanding loans, and divesting or writing off non-performing loans, government withdrawal from the provision of credit and transferring the recovered resources to credible MFIs capable of delivering sustainable services under a new Implementation Plan to expand the outreach of sustainable micro finance.

In the new framework for the support to expanded outreach of sustainable micro finance arising from the above mentioned policy shift, the MGLSD is envisaged, in partnership with the Micro finance Forum, to play the following roles:

- Active participation in policy formulation, direction and guidelines.

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<sup>9</sup> The roles of the MGLSD were: to formulate policy, supervise the implementing agencies, monitor and evaluate performance of projects and ensure overall coordination.

- Restructuring and transformation of the Entandikwa Credit Scheme and the Youth Entrepreneur Scheme to conform to the new Implementation Plan for expanded outreach.
- Participation in the monitoring and evaluation of the performance of the micro finance industry, and
- Preparation and monitoring of grant-based support initiatives for the poorest of the poor.

### **3.6 Strengthening of the Framework for Decentralised Government Structures**

Decentralised government structures are central to Uganda's mode of governance as spelt out in the 1995 Constitution and the 1997 Local Government Act. Moreover, the decentralisation process is at the heart of the Poverty Eradication Action Plan, which sets out the strategy through which the GOU aims to eradicate poverty. The GOU has over the years strengthened the decentralised structures through increasing their autonomy, and widening their participation in decision making in order to enhance the efficiency and effectiveness in allocation of resources towards the achievement of the PEAP objectives in line with local priorities.

The government also recognises that effective monitoring and evaluation is essential for ensuring that budgetary allocations are fully translated into outputs and outcomes. To this effect, the GOU has put in place a monitoring network comprising representatives from the central government, line ministries, donors and the civil society. In addition, efforts have been made to improve transparency and accountability by stepping up public information through the media and use of notice boards in public places such as schools and places of worship. Strong decentralised structures will facilitate the work of CDWs and FEWs through better coordination and wider participation.

### **3.7 Incentives to MFIs for Expanding Financial Services to the Underserved Areas**

It is also recognised that there are some areas in the country, which are under-served by MFIs. In particular, in the northern part of the country delivery of micro finance services is difficult due to insecurity which has led to a large number of people living

in displaced peoples' camps, disruption of economic activity, and destruction or deterioration of infrastructure such as roads, trading centres and marketing societies.

Though current efforts to improve the security situation<sup>10</sup> in these areas will diminish some of this risk, further motivation is needed to allow MFIs to venture into such areas without taking on the full risk. Under the UCAP it has been proposed that the GOU provides for a "Remote Rural Outreach Fund" to be established to avail operational grants to good practice MFIs willing to expand their services to areas of the country that do not currently offer conducive markets for micro finance.

In addition, a mechanism is being developed by stakeholders in the micro finance industry for providing grant support to enable MFIs access to affordable capacity building. While this will facilitate MFIs access to affordable capacity building, the databases managed under the UCAP framework will be enlarged to include suppliers of capacity building services and appropriate training materials for rural clients, in preparation for response to demands identified by the FEWs from the under-served sub-counties.

#### **4.0 CONCLUSIONS AND RECOMMENDATIONS**

The paper argues the case that micro-finance is an important part of the growth strategy in Uganda and has in the recent years gained increasing recognition. This is evidenced by initiatives and strong commitment by government, donors and practitioners towards supporting micro finance activities in Uganda. Integration of MFIs into the formal financial system has been established by BOU to ensure growth of the MFIs while maintaining the stability of the micro finance sector as well as protecting interests of small savers. Measures have been taken to build capacity and enhance coordination in the micro finance industry, as well as expand the outreach of sustainable micro finance. Further, the micro finance industry is expanding rapidly to facilitate development of the private and agricultural sectors. Growth of the micro finance industry is not without challenges though. This paper identified immediate challenges as follows:

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<sup>10</sup> Initiatives undertaken by government, international community and civil society towards attaining peace in the North as well other parts of the country that are equally affected include military operations and campaigns, peace talks with rebel groups, community mobilization, political education, disarmament and amnesty.

There is need to strengthen the capacity of MFIs to build their management systems. This will be critical to the regulation and monitoring the performance of MFIs. It is further appreciated that the under-served are underserved because of market deficiencies, infrastructure constraints or lack of information about actual community based activities. This underscores the need to rebuild infrastructure such as roads, safe water, telecommunications and electricity, as well as strengthen capacity for identifying potential market structures, which could serve as the basis on which to build sustainable micro finance services.

It is further established that insecurity, is the most important factor in explaining low economic activity and destruction or deterioration of infrastructure particularly in the northern parts of the country. Though initiatives have been undertaken by government, international community and civil society towards ending armed conflict and attaining peace in the affected parts of the country, there is need to intensify these measures to bring about a faster end to the conflict and a revival of economic activity in such areas.

With regard to the unsuccessful GOU Entandikwa scheme, there is need for efforts to recover the outstanding loans as writing them off will not only have negative effects on the entire private sector micro finance industry, but will also result in increased and willful defaulting. One option for the GOU is to hand over the portfolio to court bailiffs, lawyers and/or the Non Performing Assets Recovery Trust (NPART)<sup>11</sup>, which will continue recovery of the loans. Another option is to sale the loan portfolio to financial institutions, which will provide additional financial services to the clients subsequent to full recovery of the outstanding Entandikwa loans.

Other challenges facing the micro finance industry in Uganda include building good corporate governance especially for the Tier-4 MFIs and providing medium and long-term finance for small and medium enterprises. With regard to corporate governance, a code of conduct could be put place by the AMFIU for the Tier 4 MFIs. With regard to medium and long term finance it is important to establish other financial products

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<sup>11</sup> NPART was set up by government to recover the loans of Uganda Commercial Bank in 1997.

like equity facilities, venture capital, long-term bonds, higher purchase schemes and leasing facilities. In this regard, it is noted that plans are underway to review the legal and institutional arrangements for the development of equity funds to pave the way for the provision of long-term investment finance for the small and medium scale enterprises. And recently government introduced a three-year bond.

Moreover, for many of the programs aimed at supporting the micro finance industry to be effective, there is need for continued economic stability, government commitment to develop the industry, improvements in mechanisms to monitor the implementation of the programs and further efforts to rebuild the capacity at local governments.

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