THE REPUBLIC OF UGANDA

Improving access to rural microfinance: What must be done?

OVERVIEW

The National Budget Framework paper for Increasing access to microfinance is vital in improving the incomes of the rural and urban population. This is a key priority for the Government of Uganda (GoU) as stated in the second National Development Plan.

Microfinance in Uganda has since the mid 1990s gained wide recognition for the role it plays in providing financial services to the low-income households and the rural poor in particular.

Improved access to microfinance is measured by the increased number of institutions providing affordable credit to the rural poor or low income earners in all product segments. Despite the recognition, the expected benefits have not trickled down to all the beneficiaries and access is still low due to the limited number of functional microfinance institutions.

This policy brief highlights the microfinance situation in Uganda, discusses key constraints and gives policy recommendations

KEY ISSUES

- The Tier IV institutions census (2015) indicated that 45% of the existing Savings and Credit Co-operatives (SACCOs) were either dormant or closed. The Northern and Eastern regions were most affected, yet they have the highest poverty levels.
- Microfinance Institutions (MFIs) have governance and management weaknesses due to lack of a regulatory and policy framework.
- MFIs have human resource capacity constraints that are worsened by high staff turn-over.
- The supervision and monitoring of SACCOs is inadequate thus creating room for ineffective operations.

INTRODUCTION

Microfinance is the provision of affordable financial services (deposits, loans, payment services, money transfers, insurance, and accepting a wider variety of assets as collateral) and microcredit to urban, rural poor, and low income households and their micro enterprises *(Microfinance Policy, 2005-2015, MFPED).*

Formal microfinance started in Uganda in the late 1980s through foreign funded Non-Governmental Organizations (NGOs). The Government actively participated in credit delivery through a number of programmes such as Entandikwa Credit Scheme (ECS). These programmes had an objective of; providing seed money to the beneficiaries for purposes of undertaking sustainable development activities. However, the funds had little or no impact on the intended objective.

The Ministry of Finance, Planning and Economic Development (MFPED) subsequently developed the Rural Financial Services Strategy (RFSS) as a guiding document to implement the 4th pillar of the Prosperity-for-All programme.

The strategy was to ensure the continued role of government in provision of a conducive environment for increasing access to affordable financial services in the underserved rural areas

The strategy emphasized the establishment of a SACCO at every sub-county as the most cost effective option for savings mobilization and credit/ loans as a source of capital to rural enterprises.

The Microfinance Sector

The sector comprises of three main projects that spearhead its activities to reduce rural poverty. These are; **Project 0997:** Support to Microfinance, Microfinance Support Centre **(MSCL)**, and **Project 1288:** Project for Financial Inclusion in Rural Areas (PROFIRA).

Microfinance Institutions adopt various legal forms and strategies ranging from Tier 1-4. They differ in their strategic goals which affect their mode of operation, target clients and financing sources.

Tier 1: Bank of Uganda (BoU) regulated institutions with a microfinance portfolio targeting the economically active poor. In Uganda so far, these include; Centenary Bank, Equity Bank, and Finance Trust Bank.

Tier 2: Credit Institutions - There are currently three institutions regulated by BoU that offer micro finance products in this category. These include; Post Bank, Opportunity Uganda, and Mercantile Bank.

Tier 3: Microfinance Deposit Taking Institutions - These are fully regulated MFIs that serve small and micro enterprises with a broad range of financial services targeting low income and economically active poor in the urban areas. Microfinance products offered are; savings and lending, money transfers and micro insurance. Currently these include; Pride Uganda, FINCA, UGAFODE, and Entrepreneurs Finance Centre (EFC).

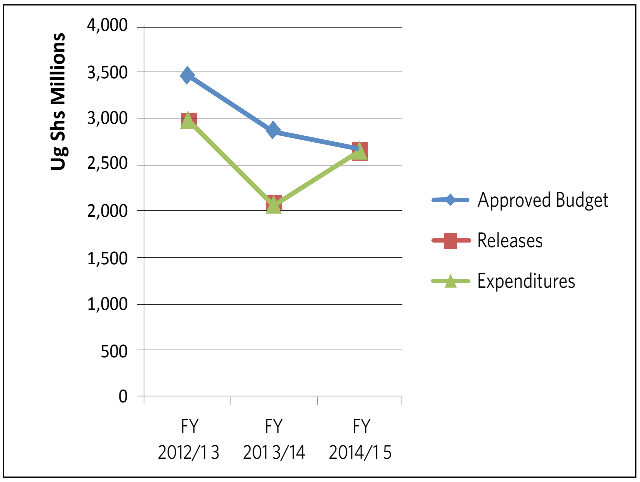
Tier 4: These are financial institutions and associations not regulated by the BoU. These include; SACCOs, Village Savings and Loan Associations (VSLAs), Community Based Organizations (CBOs), money lenders, and Non-Government Organizations (NGOs). These MFIs have predominantly targeted the rural poor.[1]

Financing Trends of the Microfinance Sector FY2012/13-2014/15)

The sector has been funded by GoU and development partners - International Fund for Agricultural Development (IFAD), and African Development Bank (ADB).

There has been a declining trend in the budget for the sector over the years; however, the expenditure performance remained excellent as all the released funds were expended (Figure 1).

Figure 1: Trends in GoU Budget Performance



Source: Ministerial Policy Statements 2012/13-2014/15

[1] *There are no current statistics available for the VSLAs, CBOs, Money Lenders and NGOs in the country.*

Functionality of Microfinance Institutions

Major emphasis in the provision of microfinance to the rural poor has been put in the SACCOs or Tier IV institutions. The most recent (2015) census carried out on Tier IV institutions (SACCOs) indicated that 45% of the existing SACCOs were either dormant or closed. This shows the reducing access by the rural poor to microfinance. The Eastern and Northern regions were most affected (Table 1). This occurrence is due to a number of challenges as discussed below.

Table 1: Functionality of SACCOs in 2015 Census

Category	Central	West	East	North	Total
Active with reliable data	156	318	154	79	**707**
Active with unreliable data	50	110	159	73	**392**
Dormant	48	38	102	68	**256**
Closed	41	112	253	236	**642**
Total	**295**	**578**	**668**	**456**	**1,997**

Source: PROFIRA 2015 MFI census

Challenges encountered in improving access to microfinance

- **Poor governance and management practices:** In many MFIs, the executive committees and management staff have in most instances deliberately misappropriated funds or colluded to defraud the institution.

- **Managers, cashiers and board members defrauded many of the SACCOs.** For instance in Naroo SACCO in Ngoloriet sub-county (Napak district) a loan of Ug shs 10 million from the MSCL was shared among the executives, leaving hardly anything for the community to borrow.

  Other instances were in; Mazinga SACCO (Kalangala district), and Kyagenyi SACCO (Mbarara district), where managers took off with people's savings and start-up loans of Ug Shs 10 million accessed from the MSCL.

- **Capacity training gaps in the SACCOs:** The workforce has limited knowledge, skills and abilities needed operate the SACCOs. There are no substantial capacity building programs to strengthen the internal controls and governance to comply with regulations.

- **High Staff turnover:** Most of the SACCOs are unable to retain quality staff because of low pay. This has caused serious operational and management challenges to the institutions. The continued loss of trained staff has rendered the institution dormant or led to closure. For instance, a manager in Bukongoro SACCO (Soroti District) left for another institution after being trained in bookkeeping, and auditing by MSCL.

- **Weak monitoring and supervisory role:** The Microfinance Department and member driven organisations like Association of Microfinance Institutions in Uganda

(AMFIU), and Uganda Cooperative Savings and Credit Union (UCSCU), have limited capacity to track progress on the activities of microfinance institutions.

Current Interventions

1) The sector has presented the Microfinance Institutions Bill to Parliament and would subsequently create a Microfinance Institutions Authority for regulation, licensing, and management.

2) A new Project for Financial Inclusion in Rural Areas (PROFIRA) as a successor to Rural Financial Services Project has been created to oversee the activities of SACCOs in Uganda.

3) The sector is planning a microfinance institutions census for all Tier IV categories to establish their current functionality.

4) The security requirement to access a loan greater than Ug shs 100million was uplifted as a measure to reduce the default rates of SACCOs.

Conclusion

The Government has geared its efforts towards developing and expanding the outreach of microfinance services to the low income earners especially those in rural areas. This has especially been through SACCOs as the most cost effective approach. However, this has been met with a lot of challenges that affect the functionality of these institutions and therefore limit access to microfinance.

Recommendations

- Parliament's Committee on Finance, Planning and Economic Development should approve the Microfinance Institutions Bill to enable effective regulation and licensing of especially Tier IV institutions.

- The Microfinance Department (MFD) in the MFPED, MSCL, and PROFIRA should continuously provide training to strengthen internal controls within the institutions.

- The MFPED should carryout routine needs assessments of the MFIs staff to address resources needed to improve productivity, and provide quality products and services.

- The MFD in MFPED should strengthen its monitoring of MFIs and collaboration with microfinance umbrella organizations like AMFIU, and UCSCU.

References

- Budget Monitoring Reports FY2009/10 - FY 2014/15

- MFPED, Ministerial Policy Statement FY2012/13 - FY2014/15

- The Tier 4 Microfinance Institutions Bill, 2015

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