Bank of Uganda - German Technical Co-operation
Financial System Development (FSD) Project

MICROFINANCE IN UGANDA - LESSONS FROM FINCA

FSD Series No. 4

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Publisher:
Bank of Uganda – German Technical Co-operation
Financial System Development (FSD) Project
37/43 Kampala Road
P.O. Box 27650
Kampala, Uganda

Printer:
Graphics Systems (U) Ltd.
8, Buvuma Road, Luzira, Port Bell
P.O. Box 22631, Kampala

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Abbreviations

CGAP	Consultative Group to Assist the Poorest
CMF	Center for Microfinance
DISH	USAID Delivery of Improved Services for Health Project
FINCA	Foundation for International Community Assistance
FY	Financial Year
FSD	Financial System Development Project
GTZ	German Technical Co-operation (Deutsche Gesellschaft für Technische Zusammenarbeit)
MDI	Microfinance Deposit-taking Institution
MFI	Microfinance Institution
NGO	Non-Governmental Organisation
p.a.	Per Annum
PRESTO	USAID Private Enterprise Support, Training and Organizational Development Project
ROSCA	Rotating Savings and Credit Association
USAID	United States Agency for International Development
USh	Ugandan Shillings (Exchange rate as of January 2000: US$=USh1,550)

1 Introduction

Microfinance is a fast-growing and dynamic part of the Ugandan financial sector, but it is not yet very transparent as regards approaches and performance. Various institutions have carried out several surveys in order to provide an overview. But these do not usually provide in-depth information on and analysis of specific microfinance institutions and their performance, and are at times even contradictory. In this case study, the Bank of Uganda/GTZ Financial System Development Project (FSD) wants to contribute to closing this information gap and enhance Bank of Uganda's understanding of microfinance practices in the country.

Bank of Uganda has recently taken the lead in the discussion on regulation and supervision of microfinance by formulating a policy statement and designing a legal framework to provide a regulatory environment in which the provision of financial services for the lower income strata can grow soundly in Uganda. In this report, we specifically concentrate on some regulatory and supervisory lessons that can be drawn from the experiences of microfinance institutions in the field.

FINCA Uganda was selected for the outlined endeavour. It is, at least in terms of the number of loans, one of the biggest microfinance institutions in Uganda with more than 20,000 clients and a loan portfolio of more than USh1.9 billion (US$1.3 million). It is affiliated with the network of FINCA International and has operated in Uganda since 1992. From 27 May to 18 June 1999, a Bank of Uganda/GTZ team (Luke Okumu and Michael Muliisa, Bank of Uganda; Michael Fiebig, GTZ; and Gabriele Benning, trainee) visited FINCA Uganda. The observations form the basis for this report.

Michael Fiebig, GTZ, wrote the first draft. Guy Winship from FINCA Uganda, Clare Wavamunno and Jaime Arguello from FINCA International and Stefan Staschen from FSD developed it further. Dr. Alfred Hannig, Teamleader FSD, guided and supervised the entire study. We wish to thank FINCA International and FINCA Uganda not only for the willingness to subject themselves to such an extensive study, but also for having been friendly, open and helpful.

The paper begins with the analysis of institutional aspects of FINCA. After reviewing the performance indicators, we turn to the organisational structure and FINCA's strategies. Subsequently, we take a look at the control mechanisms in place. This section forms the basis for reflections on lessons for the regulation and supervision of microfinance institutions later on. Thereafter, we analyse FINCA's staff structure and policy before turning to an overview of the financial technology applied. Risk, cost and liquidity management issues follow. In a change of perspective, chapter 3 gives impressions and evaluations from the clients. While this provides fewer lessons for the discussion of regulatory and supervisory issues, it sheds light on the impact of FINCA's work. In chapter 4 we summarise the lessons learned before giving recommendations for FINCA. These recommendations for the regulation and supervision of microfinance through Bank of Uganda follow in the last chapter.

2 Institutional Analysis

2.1 Performance

We measure the performance of a microfinance institution by two sets of categories. "Sustainability" refers to indicators of financial health. "Outreach" refers to the degree to which the microfinance institution serves a wide range of lower income strata people; proxied by indicators of portfolio size and characteristics of the products offered, as for example interest rates and average loan amount.

Table 1: FINCA Sustainability Indicators as of January 2000[1]

Portfolio Quality	
Historical loan loss rate	0%
On-time repayment rate	93%
Portfolio at risk (balance in arrears over 30 days/loan portfolio)	0.6%
Sufficiency of loan loss reserve (reserves/portfolio at risk)	477%
Productivity	
Avg. no. of clients per credit officer	396
Loan portfolio outstanding per credit officer (in US$)	24,000
Loan portfolio outstanding per employee (in US$)	13,000
Efficiency	
Financial costs per avg. portfolio outstanding (annualised)	1.13%
Operating costs (excludes loan loss reserve and financial expenses) per avg. loan portfolio outstanding (annualised)	71.5%
Financial spread (financial margin per avg. loan portfolio, annualised)	105%
Financial self-sufficiency	127%
Operating self-sufficiency	146%
Profitability (FY 1998/99)	
Return on assets	17.3%
Return on assets before operating grant income	-2.3%
Return on "equity"[2]	20.5%
Return on "equity" before operating grant income	-2.7%

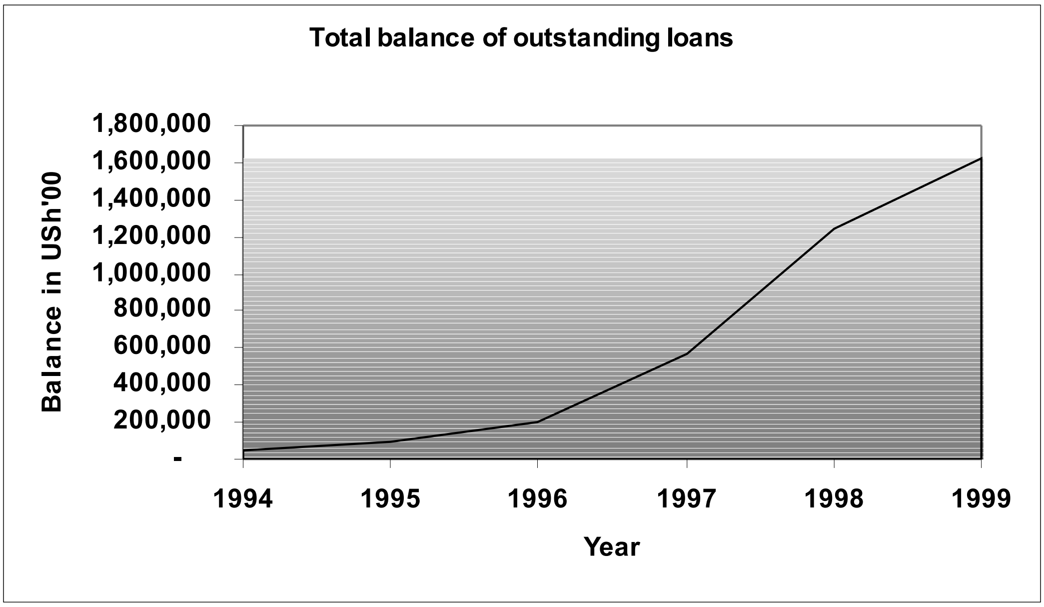
Table 2: FINCA Outreach Indicators as of January 2000

No. of clients	20,587
Female clients per total clientele	99.99%
Total balance of outstanding loans (in USh'000)	1,965,049
Minimum loan size (in USh'000)	50
Maximum loan size (in USh'000)	1,500
Avg. disbursed loan size (in USh'000)	200
Effective annual interest rate	87%
Total savings balance (in USh'000)	2,022,190
Savings ratio (savings balance per loan portfolio, end balance)	103%
Client drop-out rate (clients withdrawn per avg. no. of clients 1999)	53%

[1] Annex 1 contains more detailed information on FINCA's performance over the last five-year period.

[2] "Equity" refers to grants and retained earnings. FINCA, as an NGO, does not have equity that carries voting rights.

The sustainability indicators show a good repayment performance of FINCA's loan clients. Only 0.6% of the total outstanding loan portfolio was at risk in January 2000.[3] Over the past five years, total loans outstanding have shown a very dynamic development. 1997 and 1998 in particular have been extensive growth periods for FINCA Uganda. In 1999, however, portfolio growth had almost come to a halt due to the failure of Co-operative Bank. After periods of rapid expansion, FINCA is currently in a period of consolidation.



As regards productivity and efficiency, FINCA benefits from the group lending methodology as a cost-reducing measure. Every credit officer has on average 14 groups with 29 members each, amounting to an average of 396 clients per credit officer. Although this efficiency ratio has improved over the years, it is still at the lower end of international best practices and performance standards (see Gibbons/Meehan, 1999). An average loan portfolio of US$13,000 per employee and expenses for salaries and benefits standing at 37% of the average portfolio outstanding in 1999 leave room for further improvement in overall staff productivity. Accordingly, the staff productivity is targeted to increase from 371 for 1999 to 486 borrowers per credit officer by 2004 in the financial projections.

Operating costs per average outstanding loan portfolio remain relatively high at 71.5% p.a. in 1999. The largest part of operating costs in 1999 consisted of salaries and benefits. The relatively high ratio can be explained by limited portfolio outstanding per credit officer due to very low average balances of clients reflecting that FINCA is reaching a lower level of clients than most others are. As FINCA operates in urban and peri-urban, but also in rural settings, travelling takes up significant time and decreases the potential number of groups per officer. Out of a total of 94 staff members, 55% or 52 persons are credit officers.

Recent developments after April 1999 have shown decreasing profitability. As of August 1999, return on assets reached 17.3%, and, adjusted return for the grant income, fell to –2.3%. Return on equity was 20.5%, with the adjusted return on equity (before operating grant income) at –2.7%. This is partly due to effects of the Co-operative Bank collapse and the following increase in refinancing costs.[4]

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3 Portfolio in arrears for more than 30 days.

4 For more detailed data see Annex 1.

2.2 Organisational Structure

FINCA Uganda, headquartered in Kampala, currently has a network of five branches operating in Kampala, Jinja, Masaka, Masindi and Lira that serve a total of 12 districts.[5] The geographic dispersion is managed with a high degree of centralisation of key functions in the Kampala headquarters. Senior management comprises a Credit Director, in charge of the branch operations, a Finance Director, who leads the accountancy department, and a Personnel/Training Officer in charge of staff development. An Internal Auditing Department reports directly to the Kampala-based Regional Director of FINCA International.[6]

Headed by the Country Director, FINCA Uganda is governed by a Board of Directors, currently comprising seven members. These are employees of FINCA International, FINCA Regional Office, UNDP, The Uganda Project, World Bank, National Association of Women's Organisations in Uganda and the Parliament of Uganda. Several of these board members, however, do not act as representatives of their respective organisations. The Regional Director of FINCA International heads the Board.

On 30 April 1999, the Country Director resigned at short notice and a transition team, consisting of the Regional Director for Africa, a Regional Office staff member as well as Finance Director and Credit Director of FINCA Uganda, was put together to steer the organisation until the new Country Director was appointed. This appears to have been a prudent approach to dealing with the resignation. The collective leadership of the Regional Director (former Country Director), Regional Office staff member (who is a former Bank of Uganda Supervision staff member) and the two current "insiders" of FINCA Uganda ensured the smooth continuation of FINCA's work until a new Country Director took office on 1 December 1999.

2.3 Strategies and Planning Procedures

The mission statement of the company is: "*To provide empowering microfinance services and monetised savings services to women under positive social interaction, through highly motivated staff.*" FINCA Uganda is striving to fulfil this mission applying the FINCA Village Banking methodology developed by FINCA International. This technology has been adapted to the Ugandan situation, but basically remains the same as in the other affiliates. By the time FINCA International set up FINCA Uganda in December 1992, this international network had achieved considerable experience with microfinance institutions operating in ten Latin American countries. In January 2000, FINCA International was operating in 19 countries in Latin America, Africa and the Newly Independent States.

FINCA Uganda is targeting women microentrepreneurs who are active mainly in the trading sector. It is currently operating on the basis of the three-year business plan from September 1997 to August 2000. Prior to 1997, FINCA Uganda prepared an annual operating plan and budget against which actual performance was measured. This plan included operational and financial performance measures as well as balance sheets and income statements.

Today, FINCA has a rolling-over strategic planning process. The requirements reinforced FINCA's strategic planning. In order to apply for funds at the USAID PRESTO[7] project, it has compiled its first three-year plan in 1997. In addition, a business plan for the financial year 2000/2001 is now available. Currently, the business plan is adjusted on a yearly basis. For this purpose, FINCA uses the business-planning model *Microfin* developed by CGAP (see

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5 The branches also cover the districts of Kamuli, Iganga, Mukono, Mpigi, Luwero, Rakai and Bugiri.

6 Also see organisational chart in Annex 2.

7 The USAID PRESTO project created a Center for Microfinance (CMF) in Uganda, which provides technical assistance to Ugandan MFIs, but also gives access to grants for selected institutions.

CGAP, 1998a). The Country Director carries out the strategic planning in close co-ordination with the Regional Director.

FINCA planned to open one additional branch in February 2000 in Arua. USAID and Austria supported the opening of Arua and Lira branches with nearly US$1.4 million, out of which US$500,000 was loan capital. After the opening of the Arua branch, a halt in geographical expansion and a focus on vertical rather than horizontal growth in the served markets was planned. Initially, the three-year strategic plan of 1997 had included opening another branch in Pallisa. As several competitors also intended to enter Pallisa, which is considered a very small market unable to sustain even two competitors, this plan was given up. In addition, the plan for new branches had relied upon the use of branches of the Co-operative Bank for depositing mobilised savings and loan repayments. With the closure of Co-operative Bank, FINCA had to look for other commercial banks to co-operate with. In the case of the Arua branch, this will be Centenary Bank.

2.4 Control Mechanisms

2.4.1 Ownership Structure

FINCA Uganda is registered as a Company Limited by Guarantee and as an NGO and is governed by a Board of Directors. As an NGO, it does not have shareholding owners with their own capital at stake. While accumulated profits and grants contributed to institutional capital, this capital does not carry voting rights. The Board of Directors is appointed and discharged by FINCA International. This is stated in FINCA Uganda's Articles and Memorandum of Association.

The Board of Directors' current role is more that of an advisory board than of an effective and hands-on control mechanism. Instead, FINCA International has entrusted most of the supervisory powers to the Regional Director Africa, who therefore acts as overseer of FINCA Uganda's activities. During the interim team leadership, the Regional Director was also directly involved in day-to-day senior management issues.

In 1998, the Board of Directors only met once, reflecting its rather limited hands-on control. In addition, board members have limited experience with the operations of an MFI as well as with the specific approach of FINCA Uganda. In 1999, however, five meetings had taken place, three of which were regular meetings, and one extraordinary meeting each due to the resignation of the Country Director and the closure of Co-operative Bank respectively. In the beginning of 1999, the Board temporarily stopped lending to new groups in face of an insufficient information base on portfolio performance.

There are discussions on converting FINCA Uganda into a shareholding company, with FINCA International as major shareholder, or at least with a "golden share" in the Board of Directors to ensure its veto rights. This will also have implications for the proposed regulatory framework for so-called microfinance deposit-taking institutions.

2.4.2 Internal Control Systems and Auditing

This section looks at control mechanisms, the management information system as well as the role of the internal auditing department.

2.4.2.1 Control Mechanisms

The credit officers visit the village group meetings on a weekly basis, which results in their work being largely concentrated outside the FINCA branches. While they do not carry any money as the groups deposit their savings as well as loan repayments themselves at a local commercial bank branch, they have considerable responsibility in acting as the monitoring agents of FINCA group performance.

Credit officers prepare short summary reports on the group performance to be checked by supervisors, who also monitor and compare the performance of the credit officers' groups. In the weekly report of the supervisors to the branch manager, for example, repayment rate, late clients, average attendance of group members and average loan outstanding are monitored. This, as well as spot checks on group level, provide supervisors with tools for control. The branch managers, in turn, prepare weekly reports on the credit activities, which aggregate the data provided by credit officers and supervisors on branch level. These reports are submitted to the Credit Director.

Credit officers and supervisors do not handle any cash anymore. As of June 1999, the sale of T-shirts and other promotional products was terminated as a reaction to wrongdoings on the credit officer level. These measures are expected to effectively reduce the potential for fraud.

2.4.2.2 Management Information System

FINCA Uganda monitors overall operational and financial performance on a monthly basis. This includes a full monthly income statement and balance sheet, a set of indicators and a cash-flow statement. These reports are prepared on a monthly basis by the Finance Department using Excel spreadsheets, and the data is compared to planned targets. The manual preparation of the reports takes considerable time and is vulnerable to mistakes. After the strong growth in the years from 1996 to 1998, the shortcomings of such a system have become obvious. In the meantime, FINCA has implemented a computerised loan tracking system and intends to supplement it with a fully integrated management information system within the next three months.

The new management information system will be provided through the Regional Office for Africa. The decision for software that integrates management information system, loan tracking and asset/liability analysis has been made by FINCA International, which underlines the considerable direct involvement of FINCA International.

2.4.2.3 Internal Auditing Function

Internal audits were introduced in 1996. Today, FINCA Uganda has an Internal Audit Department that reports directly to the Regional Director and it recently became organisationally independent from the other departments within FINCA headquarters. The department has three staff members, and an additional auditor is to be recruited. It audits on the level of branches as well as on the level of village groups. Auditing the groups forms part of assessing the assets of FINCA Uganda, as approximately 80% of them are invested as loan capital to these groups.

The department follows a detailed audit plan, which outlines the work and the staff assigned to it over the period of the fiscal year. 75% of all groups should be audited within a cycle. Every three months, an audit of the accounting system is done. Currently, internal auditing covers 34 groups a week, i.e. 136 groups a month.

The village group audit covers aspects such as accuracy of books, problems within group administration as well as dropout rates, but mostly concentrates on the financial performance of the group. The audit is submitted to the head of the Internal Audit Department. It is shared with the responsible credit officer as well as the head of the Credit Department at FINCA headquarters. Reactions to the problems encountered are required within two weeks in order to ensure timely follow-up and adjustment.

The head of the Internal Audit Department holds weekly briefings with the Credit Director, and for the future, direct monthly reports to FINCA International are scheduled. This reporting procedure is intended to ensure information flows to the quasi-owners of the institution (FINCA International), and to provide an effective control system to discover internal problems in a timely manner. The role of the new Country Director is currently being strengthened through a strict separation of responsibilities with operational tasks being assigned to the Country Director and the supervisory role is to be assumed by the Board of Directors.

2.4.3 External Auditing

PriceWaterhouseCoopers Ltd. carries out external auditing as required by FINCA International to ensure high quality audits. Over time, PriceWaterhouseCoopers has developed a certain capacity in auditing a microfinance institution. Yet it has to comply with internationally agreed upon standards for external auditing that do not particularly cater for the specific characteristics of microfinance. As a measure to increase familiarity with microfinance operations, they were provided with the recently published CGAP manual on external audits.[8] So far no specific adjustments of the auditing procedures as outlined in this manual have been made for FINCA Uganda. While adjustments of the manual for one MFI may prove too costly, it could well be an endeavour for Ugandan MFIs to undertake jointly. If the microfinance law is introduced, however, the Bank of Uganda presumably will define basic requirements of external audits as well as stipulate specific requirements for MDIs.

FINCA sees the relation with the external auditor as mutually beneficial. FINCA auditors and accountants have participated in workshops organised by PriceWaterhouseCoopers and have thereby gained and shared experience. In addition, FINCA headquarters in Washington DC carries out a yearly audit through an independent "internal auditor" team of FINCA International that comes in to monitor the overall performance of the institution. This forms part of a strong intra-network control system.

2.4.4 External Regulation

FINCA is not regulated as a formal financial institution under the Financial Institutions Statute but subject to Company Law as a company limited by guarantee. The requirements of Company Law are minimal and do not set prudential standards for FINCA's business. As compared to other regulatory powers, external regulation so far plays only a very minor role.

FINCA Uganda has considered converting into a regulated financial entity, and has shown interest in the future regulatory framework for microfinance institutions in Uganda. However, FINCA Uganda explained that they leave it open to future investigation whether FINCA would rather opt for this legal form or become a credit institution or bank.

2.4.5 Regulation by Funding Sources

Apart from the above-mentioned sources of regulation, funders significantly influence financial institutions' actions. Looking at FINCA's sources of funds, it is clear that FINCA used to be almost fully donor-funded. In the FY 1999, however, it has achieved over 90% operational self-sufficiency. By January 2000, it was 146% operationally and 127% financially self-sufficient. After seven years of operations, FINCA Uganda has developed into a profit-making financial institution with six agencies. Here below, we analyse the different funding sources and identify the consequences of FINCA's specific funding portfolio composition.

FINCA received the following funding:

- In 1995, FINCA received a three-year US$1.8 million grant from USAID to provide financial services in the districts covered by the USAID Delivery of Improved Services for Health (DISH) project;
- The European Development Fund provides a USh223,400,000 loan at concessionary terms (formerly interest rate tied to inflation, after December 1999 at 16%) for loan capital use. This loan has recently been rolled over for another three-year period until 2002.

[8]See CGAP (1998b), External Audits of Microfinance Institutions – A Handbook. Technical Tool Series No. 3, Washington DC, December 1998.

- In addition, Rotary International and the Belgian NGO Coopibo provide loan capital of US$33,000 and US$20,000.
- A US$800,000 grant from the Austrian Bureau for Development Co-operation, yet to be approved, is another major source of potential funds.

It has to be noted that FINCA International – especially through its Regional Office – makes considerable non-monetary contributions through oversight, auditing and technical assistance services. FINCA Uganda is charged for a portion of these services via the affiliation and technical assistance fees that it has to pay as a member of the FINCA network on a regular basis. The affiliation contract provides a very strong link and an effective means of control for FINCA International.

Being the major monetary funding source, USAID has had significant impact on FINCA's business conduct. It has provided funds for geographic expansion to the DISH districts. Even though no financial data were available for individual branches, senior management confirmed that some of the branches in more distant and rural areas had problems covering their costs. The decision of this branch expansion was attributed to the USAID project plans rather than to an institutional expansion strategy of FINCA. Management confirmed, however, that in most cases these openings were in line with the overall strategy of opening branches in locations with few financial intermediaries.

Different funding sources have different reporting requirements and formats. This translates into largely fixed administrative costs that are disproportionately higher for smaller amounts of funds. FINCA, however, has not yet priced its different funding sources in this context.

So far, most funding sources of FINCA are grants denominated in US dollars. The loans are denominated in Ugandan Shillings and thus do not pose substantial devaluation risks to the institution, as it lends in Ugandan Shillings only. The recent rise in inflation provides an incentive to reduce foreign currency denominated funding in favour of local funding. In the section on liquidity management, the current move towards locally intermediated loans backed by US$ guarantees is described. With this overall tendency towards commercialisation, the control mechanisms exerted by funding sources will change to more market-based assessments as compared to donor assessments. Frequent repayments to commercial banks as well as the requirements of managing future credit line arrangements will be an incentive towards professionalisation for FINCA.

2.5 Staff

In January 2000, FINCA had a total of 94 staff members, of which 52 were credit officers. FINCA staff is very young with staff members' age averaging 25 to 30 years. Most of the staff holds a diploma in fields such as accounting and economics, but few have significant prior experience. Only recently, a financial background became more important in recruitment. Credit officers are trained on the job by FINCA, undergoing a two-month introductory period before fully assuming their new position.

Supervisors are recruited mainly out of the pool of credit officers. On the one hand, this creates a career path for well-performing credit officers. On the other hand, it ensures familiarity and promotes the dedication of the supervisors. Diploma- or other degree-holders can be promoted to supervisors. Until recently, supervisors operated as credit officers simultaneously, but FINCA has decided to avoid combining the possibility of conflicting roles. At top management level, FINCA has found a new County Director, who has considerable experience in the financial sector with three years in microfinance, 12 years in microenterprise development and five years in development finance.

Every position has a detailed job description, which outlines the supervisor, primary responsibilities, and functions, reporting requirements as well as abilities and personal qualities required. Thus, responsibilities are clearly defined within the organisation, which provides a good basis for the staff evaluations organised by the Personnel/Training Officer on a semi-annual basis. Superiors answer the detailed questionnaires, and the persons in question have open access to all the information and the right to comment. This personnel evaluation system provides an important tool of personnel management.

FINCA has introduced its first staff incentive scheme for field staff in 1996. This incentive scheme is based on three criteria: repayment rate, gross loan portfolio (adjusted for arrears) and quick loan portfolio turnover ("week-17-recapitalisation" incentive). Field staff, however, is only eligible for this incentive scheme once they achieve an average of 30 clients per village group. With an average of 29 clients per group, many of the credit officers do not participate in the scheme. Therefore FINCA is currently seeking to simplify the incentive scheme by introducing a remuneration system that is based on the loan portfolio size. The incentive payment will be a yet undetermined additional income for FINCA credit officers.

Staff training is included in the strategic plans and funding is sought for it. FINCA follows a rotating principle so that all staff members have the possibility to participate. FINCA also gives employees the opportunity to improve their personal qualifications by supporting, for example, attendance of academic courses by allowing staff to leave during work time.

2.6 Financial Technology

2.6.1 Lending Technology

FINCA is using a group-based lending technology, the so-called village banking methodology, working with women groups with an average of 29 members that meet weekly at a self-selected place. The FINCA credit officer attends these meetings in order to monitor the proceedings. FINCA currently offers two loan products, the "internal loan" and the "external loan". It has, however, been decided to phase out internal lending in the near future as even after nine loan cycles no graduation of the client group to a financial intermediary has taken place.

FINCA operates its lending business on the basis of "loan cycles" of four months, i.e. after having repaid the loan with 16 weekly instalments; a client can obtain the next loan. In order to access the external loan product,[9] a minimum of 20% of the loan amount (10% for the first cycle) has to be saved. Within the loan cycle of 16 weeks, programmed savings build up the savings mandatory for accessing a higher loan in the subsequent cycles. Loans are repaid on a weekly basis at the meetings, and subsequent loans given one week after the last repayment of the previous loan. Up to 31 May 1999, the interest rate was set at 3% flat per month. In addition to this interest, a 1-% premium for life insurance and a 1-% FINCA International affiliation fee is charged per cycle based on the principal borrowed. Repayments are 1/16 of principal and interest paid per week.

The maximum loan amount is USh600,000, the minimum USh50,000. While the fieldwork for this study was carried out, FINCA adjusted the upper limit to USh800,000. The initial loan ("base loan") amount depends on the location of the group. In rural areas, it is USh50,000; in peri-urban settings USh75,000 and in urban areas USh100,000. The maximum limit of the subsequent loan is the client's base loan plus the total of all savings at the end of a loan cycle.

From June 1999, FINCA has changed the interest rate structure of this loan product: the interest rate is now a 4% flat rate, per month, and all other fees including affiliation fee and a previously voluntary 1% life insurance fee, are abolished.

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9 External referring to FINCA being the funding source from outside the group, as opposed to the internal loan from members' funds.

From the second loan cycle onwards, FINCA clients can choose whether they want to apply for a loan as large as their entitlement, or whether they want to opt for a lower amount. As a consequence, the self-evaluation of repayment capacity becomes part of the lending technology. Groups may also influence the amounts borrowed by group members. As they co-guarantee the loans of their fellow group members, it is in their interest to restrict the amounts guaranteed to an acceptable level. Therefore groups in a specific loan cycle can have divergent loan amounts outstanding.

For clients, one of the most important incentives to repay is FINCA's progressive lending approach. Once a client has shown good repayment performance, she can graduate to a higher loan amount.

Internal loans can be given on the basis of the savings mobilised by the village group. Loan amounts follow a certain formula and depend on the amount of savings mobilised. The group determines the interest rate, with many charging a 3% flat rate as with the external loan. However, higher rates of up to 10% for two weeks have been observed as well. The maximum loan amount available used to be USh800.000, but since January 2000, it can be increased up to USh1.5 million based on the individual grading of the client and the compliance with additional criteria. FINCA Uganda is phasing out this loan product, as it has shown consistently low repayment performance and has been identified as a potential threat to the repayment performance of the external loans provided by FINCA. The elimination of this product is in line with the development of FINCA International's credit methodology.

2.6.2 Savings Technology

FINCA Uganda itself does not take deposits, but, as part of its lending technology, establishes a link between the village groups and commercial banks where the groups' savings are deposited. The savings product basically forms part of FINCA's lending technology. Depending on regional availability, FINCA Uganda works mainly with one of four commercial banks: Centenary Bank, Bank of Baroda, Uganda Commercial Bank and, since the closure of Co-operative Bank, Standard Chartered. As the co-operation with Co-operative Bank was very close, the closure of the bank led to serious disruptions, as will be explained in more detail in the section on liquidity management.

Two different savings mechanism can be distinguished. With every loan cycle, clients make programmed savings, amounting to 20% of the loan borrowed (10% for the first cycle) and paid with the loan instalments each week. The amount saved can be accessed at the end of a loan cycle. Because total programmed and voluntary savings are added to the base loan amount to determine the maximum loan available for the next cycle, most clients do not withdraw these savings. Voluntary savings are offered in addition. Every group member can save additionally at group meetings. These savings can also be freely withdrawn on a weekly basis.

Non-member savings are also offered, but these are not heavily marketed. FINCA does not count savers-only as group-members, which reflects its emphasis on the loan products, although some of the dropped-out ex-borrowers remain in the groups' books with their savings. They could re-join the group and start borrowing again.

Interest rates on savings deposits are set by the commercial banks with which FINCA and the groups are working. The interest obtained, even though data is not collected systematically, can be estimated as negligible, ranging from 2% to 3%, as bank account and money transfer fees generally reduce the profitability significantly.

2.6.3 Other Financial Products

FINCA is offering a life insurance policy provided by the licensed American Insurance Group. In the case of death by illness, it covers loan principal and interest balance. In case of death by accident, the insurance company pays USh1.2 million plus loan principal and interest balance. For temporary disability, it covers loan principle and interest during the period of disability. In case of hospitalisation, up to USh100,000 of the expenses are covered. To date, the cost of this insurance product is 0.5% of the principal borrowed.

All groups are automatically included in the arrangement. As of October 1999, a new health care programme was initiated with Nsambya Hospital and has been expanded to Kitovu Hospital in Masaka. At Nsambya, the premium, paid directly to the health provider, is USh23,350 per three months for one client and three dependants.

2.6.4 Non-Financial Products

FINCA offers some basic training for group formation. Apart from this, no business development training or other technical assistance is offered on a systematic basis. FINCA's credit technology thus can be characterised as a "credit only" approach. However, group members are allowed to conduct peer training. It is also allowed for other NGOs to use group meetings for their purposes. They have included AIDS sensitisation as well as other topics. The number of training sessions, however, has been very limited.

2.7 Risk Management

FINCA lends a total amount to the entire group, which is then broken down into the loan amounts for each group member. These loans have a standardised term of four months with one single disbursement and monthly repayments for 60% of the groups, as well as 40% paying weekly. The performance of weekly repayments on the group level is not monitored directly, and field visits seem to indicate that substantial parts of these payments come in late on the group level. To control this risk, a new grading system on village group level was introduced in June 1999 to monitor the repayment histories of the members of the cycle and to reward good clients. From the institutional perspective, late weekly repayment on group level does not pose a problem, as long as portfolio performance remains as good as it currently is. However, this mechanism may hide potentially substantial performance problems until the group loan becomes due. While credit officers review the group's weekly repayment performance, these are not directly reflected in the loan portfolio datasheets at FINCA Uganda headquarters, which are used as a basis for strategic decision-making. From the supervisory perspective, the correct risk weighting of the portfolio is delayed until the payment of the overall amount becomes due.[10]

FINCA credit officers manage loan default risk through the intense monitoring of and reporting on group performance and accuracy of bookkeeping on a weekly basis through the monitoring form. During every group meeting, credit officers also record late clients, fines collected, the length of the meeting and repayment rates. Supervisors at branch level, in turn, monitor credit officer reports to ensure hands-on the health of the loan portfolio.

Strong control systems have to be in place to manage portfolio quality and more especially the default risk. FINCA has discovered weaknesses in its monitoring capacity of portfolio risk in early 1999. This was followed by a temporary halt of lending to new groups due to a lack of information to the Board of Directors. In May, this stipulation was lifted again. While the study was carried out, FINCA changed from a manual to a computerised loan tracking and default risk management system. This change was completed at the end of August 1999 and has improved the situation significantly by easing workloads and providing more

[10] An example may illustrate this point: Suppose that two thirds of group members fail to repay the scheduled amount due at the first group meeting after disbursement. On the second meeting, again e.g. half of the group members fail to repay. The group members who have repaid so far may sense an overall deterioration of repayment discipline and decide to stop repaying as well, as they fear being held responsible for all payments at the end of the four-month loan cycle. While it is likely that the FINCA credit officer would react quickly and try to re-establish discipline, the reporting mechanism to signal to problems to FINCA headquarters management does not provide information on individual client performance. In an extreme situation with quickly deteriorating repayment performance on the group level, a delay may occur until the situation is reflected in the portfolio reports. The widespread change of group repayment from a monthly to a weekly basis improves this situation.

accurate information for management. It is planned to integrate this system into a comprehensive management information system that also covers accounting and the preparation of regular management reports by May 2000.

Regional diversification is one of the common risk management strategies of financial institutions. At FINCA, some branches in rural areas have been opened in connection with the DISH project of USAID. While a link-up to regions with above average technical assistance levels, and thus a better repayment capacity seems prudent, some of the branches are not yet cost covering due to the low scale of their operations. Sectoral diversification is another typical risk management strategy, but its use remains very limited, as FINCA's portfolio is concentrated in financing trade activities.

2.8 Cost Management

FINCA Uganda monitors its cost efficiency with a system of indicators applied to the overall data collected from all branches.[11] These data sheets are compiled and compared on a monthly basis and provide a good basis for management's monitoring of performance and opportunities for improvement. However, FINCA does not analyse branch income and expenditure data, which makes specific monitoring of branch costs difficult. In addition, specific data on officers and clusters would be necessary to improve cost control and monitoring of credit officers.

Working with village groups is one of FINCA's most important techniques to reduce the high costs of short-term lending and in small amounts to women of the low-income strata. Instead of having the credit officer administering 30 loans, only one loan has to be managed by the institution. Much of the paper work and monitoring process is delegated to group officials. A credit officer, however, participates in the group meetings and assists with administration.

In order to reduce costs, client groups are put together in geographic clusters, which then are assigned to one credit officer. This is part of FINCA's means to optimise travel time, as group meetings are co-ordinated and the residence of the credit officer is included in planning.

A strong donor influence often has implications for the costs, as branches may be set up in locations that would not be approved of under merely financial considerations. By deciding against the Pallisa branch, FINCA demonstrated, however, that cost-benefit considerations form the basis for their expansion strategy. As noted previously, no branch-by-branch data are currently available, which renders it difficult to determine which stages of cost coverage individual branches have reached.[12]

Plans exist for cost pricing of the non-financial and the financial products. For the group training and management, a separate and cost-covering fee could then be introduced. This would allow the inclusion of clients who only save in covering the costs of group formation and maintenance. It would also allow for a more accurate pricing of loan and savings products.

2.9 Liquidity Management

FINCA projects the organisation's cash-flow development as part of the three three-year planning and of yearly projections. Weekly cash-flow projections are used and actual figures compared to these, to be able to fine-tune the liquidity requirements.

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[11] See Annex 4.

[12] For the evaluation of branch profitability it has to be considered that new branches always go through a period of investment before profits can be earned. From the regulator's point of view, too rapid and uncontrolled growth is one of the major risks for microfinance institutions, as the Colombian FinanSol case has clearly shown. It may thus be advisable to require some form of branch-by-branch projections of operations and performance, which then can be monitored as the new branches mature.

In the past, FINCA was a largely donor-funded institution. There are thus some difficulties in projecting financial flows. Especially in 1998, the disruption of inflows due to external, but to a large extent also due to internal management complexities has had a significant impact on loan portfolio growth. Later in the year, the expansion process continued when donor money was disbursed. As a reaction, FINCA now focuses on commercial refinance and contracted lines of credit. Furthermore, the new Country Director developed a fund mobilisation strategy. It has to be emphasised that FINCA has come a long way from being completely donor funded to being a microfinance institution whose current funding stems from retained earnings earned on donor grants.

In May 1999, the closure of Co-operative Bank had a severe impact on FINCA's liquidity: Village groups' deposits were frozen and FINCA itself had to rapidly find other sources of liquidity as long as access to Co-operative Bank deposits was denied. FINCA managed to obtain a guarantee by Bank of Uganda, facilitating a USh100 million loan from Centenary Rural Development Bank on the basis of a 1:1 match to the guarantee. At the same time, affiliation to FINCA International has proven extremely helpful, as a guarantee of US$200,000 for the same purpose was relatively quickly granted. FINCA's credibility, built up throughout several years of operation, made it possible to access commercial loans to bridge the liquidity gap.

Further, it needs to be emphasised that proper liquidity management is essential to microfinance operations as liquidity problems may quickly spill over into risk management problems. One major repayment incentive for FINCA borrowers is the guaranteed access to subsequent higher loan amounts, also referred to as the graduation principle. If liquidity gaps that limit access to these loans occur, loan portfolio performance may deteriorate rapidly. During the Co-operative Bank crisis, repayment performance was difficult to maintain for FINCA, as trust and confidence in the banking system had been damaged. However, in order to protect itself against potential problems in the commercial banking system, FINCA had already diversified the deposits, so that the problematic 60% of its deposits did not lead to an interruption of service provision.

Strong efforts had been made to deal with the crisis, using existing and new contacts to FINCA International, Bank of Uganda and Centenary Bank. Loans and even savings balances kept growing throughout the crisis, albeit at a slower pace. Up to mid-1999, repayment performance suffered significantly, but since then FINCA has managed to contain it. This reflects substantial risk and liquidity management capacities, especially on the part of the Regional Office of FINCA, which was mainly in charge of handling the crisis.

3 Client-Level Analysis

Apart from studying the institutional characteristics of FINCA Uganda, the clients' perspective can shed light on the achievements made. This part of the report outlines our visits to FINCA in Jinja, the oldest of FINCA's branches, and some of its village groups.[13]

A total of 11 groups were visited, out of which 29 FINCA clients were randomly chosen for in-depth individual interviews.[14] In addition, six ex-clients and seven non-clients were also interviewed with a similar questionnaire. Out of the 11 groups, three are situated in Jinja, i.e. in urban or peri-urban areas, while the rest were located in rural areas in Iganga, Kamuli and Bugiri. We are fully aware of the very limited sample of groups and clients visited. We believe, however, that even this small sample allows drawing helpful conclusions on FINCA's microfinance approach.

3.1 Clientele Served

Socio-economic Characteristics. FINCA works exclusively with women. Of the clients, non- and ex-clients interviewed, a good 50% have attained secondary education, with a fifth of them having completed secondary education. In contrast, among the clients interviewed two thirds had a completed secondary level education and almost a third finished at S4. The level of education thus appears to be slightly higher than that of the overall sample. A majority of the interviewees have families with at least seven members. The number of children belonging to the household ranged between two and eight. The family size and number of children for the clients as compared to all interviewees is insignificantly higher.

Sources of Income. The most common economic activities of the persons interviewed were agricultural production and trade. Most of the interviewees had more than one economic activity, with the combination of crop production and trading dominating. Only very few exclusively produced crops. Agricultural utilisation of FINCA's short-term loans with its weekly payments seems unlikely. Accordingly, trade was found to be the predominant economic activity the loan was used for.

Assets. Most of the clients interviewed had assets worth less than USh500,000. Surprisingly, a number of the clients interviewed claimed to possess assets worth more than USh5,000,000, which in light of the terms and loan sizes available from FINCA seems surprising. One of the possible explanations may be social benefit perceived especially from being a group's representative. In addition, the participation of even slightly better off-women may indicate a strong demand for liquidity. Fixed assets may be used as a savings option, and FINCA loans as supplementary liquidity source, in case urgent need arises.

3.2 Use of Financial Services

3.2.1 Evaluation of Lending Technology

FINCA implements a group lending approach. These client groups are, preferably, self-selected. In our sample, more than half of the groups interviewed existed before they joined FINCA (e.g. as another village group, ROSCAs, savings and loan clubs or social groupings of other type). One group had split from a fast growing group. In some cases, the credit officers themselves had mobilised and formed the group. Often family members, friends or neighbours joined an existing group. FINCA sets a maximum amount for the first loan in a group, which, depending on the area, may vary between USh50,000 and USh100,000 per individual. As soon as a loan has been repaid without problems, the borrower can obtain a

[13] The field visit took place 14 – 17 June 1999.

[14] See Annex 3 for the questionnaire.

subsequent higher loan. Among the groups interviewed, the highest loans approved amounted to USh600.000 at the third loan cycle.

In the small sample of interviewed groups, the average loan amount has a tendency to grow from the first loan cycle on. However, there appeared to be no strict relation between average loan amount and loan cycle. Interviews with credit officers and headquarters staff underlined that no stringent graduation to higher loan amounts occurs throughout loan cycles. In contrast, some other microfinance institutions have strict graduation principles.

Originally, FINCA's lending technology foresaw the growth of the loan amount up to a certain ceiling until village groups became independent financial intermediaries. However, neither did this happen in Uganda nor in any other country where FINCA operates. Instead, clients seem to see FINCA as a steady and reliable source of short-term loans, which do not necessarily lead to the economic growth of clients' business, but rather provide an instrument for smoothening income and expenditure cash flows over time. A connected explanation may be that repayment capacity of the client does not always increase, and that group executives want to limit the risks of too diversified groups as regards loan sizes. The higher the discrepancies from the average in a group, the higher becomes the probability of a "hit and run" behaviour of large borrowers. The probability of small borrowers to stand in for others also decreases.

FINCA does not require physical collateral; instead clients save 10% of the loan amount before, and an additional 20% of the loan amount after they receive a loan. At group level, however, we found that most of the clients and ex-clients had to pledge some form of collateral to the group, e.g. a plot of land, sewing machines or household items. Some groups required co-signing of guarantors. Half of the clients interviewed possessed a plantation of up to five acres; another third of the clients held plots of more than five acres. Potentially, these clients could also be offered individual lending products against non-traditional collateral.

If total savings with any financial institution, i.e. including savings outside FINCA, of the clients interviewed is compared to the last amount borrowed from FINCA, a surprising fifth had a simultaneous savings of more than the last amount borrowed.[15]

Several clients showed worries about the increase of the interest rate from 3% to 4%, which had been announced by FINCA in June 1999. In practice, this increase of the monthly interest is partly offset by abolishing the 1-% affiliation fee and the 1-% insurance fee and had to be paid once at the beginning of the cycle, as well as payments for passbooks and other supplies. The clients had never calculated these fees into the interest rate, which therefore effectively rose from 14.5% to 16% instead of 12% to 16%.

Many clients lobbied for the introduction of a grace period at the beginning of each cycle and of fortnightly or even monthly instalments. The predominant reason given for this request was their businesses' turnover during one week was too low to immediately serve the loan. Up to now, FINCA's reaction to this frequently stated request has been denial of any relaxation, as trade activities in on-going business are targeted, which should provide the necessary weekly turn-over. In addition, a major part of its risk management are the regular payments from week one of a loan cycle in order to make it easier for client to withstand the diversion of loan funds to non-productive uses. However, a new flexibility regarding the frequency of instalments is planned for the better clients, after having introduced a client grading system.

[15] Due to the fact that FINCA groups use commercial banks for their savings, several of the visited groups mentioned problems with their money being withheld in the other recently closed commercial banks.

3.2.2 Repayment Capacity

In order to estimate the repayment capacity of the clients, the interviewees were asked about income and expenditures of their business and household. Capturing both household and entrepreneurial spheres reflects the absence of a strict separation of both spheres of most microentrepreneurs. Specifically for women, managing liquidity and economic activities means balancing family and business needs as well as the short and long-term perspectives of both spheres.

In conducting the field interviews, we found the interviewees had major difficulties in estimating correctly their income and expenditures. Nearly half of them claimed to have less income than expenditures per month and at the same time showed good repayment performance over their FINCA client history. In addition, most women did not know how much their husbands earned. Some of them received money from their husbands erratically, some as need arose and in some cases, the husband fully covered the household needs. Thus, a more detailed study would be required to validate the impressions and indications given here.

The average of the interviewed clients estimated a positive net cash flow (overall household income minus overall household expenses) of USh220,000 per month. At the same time, the average loan amount of all interviewed clients was USh220,000, demonstrating repayment capacity and excess liquidity. About half of the interviewees lent money to family members, friends or customers. Most of these informal loans were given for an unspecific period of time and without interest. They appear to provide a significant and sought-after liquidity service and may reflect a strong pressure on liquidity from social environments.

This informal lending represents a potential threat to repayment capacity. In one of the groups, onlending in the form of consumption credit for customers was the major reason for non-payments. Another danger lies in clients passing on of the loan to the husband who is not committed to repayment. Other reasons for non-payments are poor business performance or because clients paid school fees or built a house with the credit and then were unable to repay. Illness or loss of relatives also may cause non-payments. Further research could shed more light on these informal security nets.[16] [17]

If a client failed to repay, it was stated, the group usually pays for her. One group visited used the fine income, which had been accumulated from late arrival fines in the internal account, for outstanding savings. In another group, individual savings were used to cover the defaulting member. Sometimes guarantors were held responsible for the defaulter. Group and guarantors usually seized the collateral of the non-payer, sometimes with the help of local council members. The non-payers either paid when they were threatened with the seizure of collateral, or the collateral was sold. A number of defaulters were excluded from the groups. In these different ways, the group mechanism has ensured the payment of the group to FINCA.[18]

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[16] One customer had to leave FINCA because her parents died and she had to spend some time at the place where her parents lived. She involved in charcoal trade with her own money and used the FINCA loan she received to trade rice. Currently she has no income at all and is supported by friends and neighbours. Her brother, for instance, pays the school fees for her children and does not expect the money back.

[17] One client saved 142% of the last loan amount and on-lends the loan amount taken from FINCA to her sister. She said that her own FINCA group knew and accepted this, while her sister's group did not know. This illustrates a form of financial arbitrage, as this client makes money from applying a spread to the on-lent loan amount.

[18] An example may underline this: In one group a treasurer misused her position and used the money in illegal foreign exchange operations instead of bringing the weekly payments to the bank. At the Ugandan-Kenyan boarder the money was confiscated. The treasurer was tracked down by group members and pressurised to repay the money in small instalments. To date, she has repaid half of the amount.

3.2.3 Use of Other Financial Institutions

Two thirds of the clients interviewed claimed to access only FINCA for credit. The remaining women admitted using three other institutions, including a fifth of them accessing other microfinance institutions. As FINCA policies stipulate that clients must not borrow elsewhere if they have FINCA loans, the figures of our sample may have to be adjusted upward.

Generally, multiple indebtedness without the knowledge of FINCA may pose a potential threat to the portfolio performance. While it remains unclear whether clients are borrowing from other microfinance institutions or credit programs to a significant extent, FINCA has become aware of these cases. Some informal co-ordination with other institutions has taken place for example in Jinja. A systematic handling of this potential threat, however, remains difficult in the absence of a well-functioning personal identification system. A well-functioning credit information bureau could provide substantial benefits in assessing individual clients' default risk, but would above all require a clear national identification system.

3.2.4 Evaluation of Services Offered

The interviewees stressed that while obtaining loans was their prime motivation to join FINCA, it is as important for them to save with FINCA[19] as it is to get a loan. Most interviewed clients stress that the main reason for saving is to have a safe and convenient place for their money. The savings are collected on a weekly basis at group meetings, with only one person travelling to the next bank branch to deposit the group's entire loan repayments and savings.

Clients also save with FINCA: The very stringent requirement of FINCA that 20% of the taken loan amount has to be saved throughout the loan cycle has led to the impressive savings-to-loan ratio of approximately 1:1. While these savings can be withdrawn once needed, and can provide a liquidity cushion for times of need, money is withdrawn in front of the whole group. This may imply strong social pressures not to use the option, while providing an effective control mechanism over the treasurer.

Overall, a strong demand for savings services seems to prevail. The FINCA lending technology may, from a different angle, be seen as a savings scheme, with the incentive of loan access to stick to the savings plan. Using other incentives, such as lotteries, and one-time interest payments instead of higher interest rates[20] may be applied by formal financial institutions allowed to take deposits.[21]

[19]Clients stressed that they learned how to save with FINCA. Potential access to FINCA loans, and the regular meetings of the FINCA groups induce a continuous savings activity with the partner commercial banks of FINCA. FINCA, this has to be stressed again, does not touch clients' savings at all.

[20] Interest rates do not seem to be the prime criterion for clients' savings decision.

[21]One of the interviewees proudly stressed that she had been able to build a new house after being with FINCA for years. For purchasing the required material, she used her accumulated savings, plus a USh200,000 loan from FINCA. She thereby pooled different funding sources, own savings and the external loan. Seen from the result, the FINCA lending technology acted as a housing savings scheme. A closer look at this case would need to calculate the overall costs, or net interest, that the client had to afford over the years to accumulate the savings she needed to finance the largest part of the housing investment.

3.3 Assessment of FINCA by its Clients and Non-Clients

The interviewees gave a diverse array of reasons why they were FINCA clients. The most important personal benefit from being with FINCA was access to savings.[22] More than a third of the interviewees emphasised that FINCA services had given them the chance to expand their business. This may indicate in turn that some of the loans are not used for business expansion, but rather provide a liquidity management tool for the clients. A number of interviewed clients also stressed that they used part of the loans for paying school fees due or using it for consumption purposes. Quite rightly however, FINCA does not see such "non-productive utilisation" as a problem. They acknowledge that in a household unit, cash in-flows (loans) cannot be attributed to specific cash out-flows, such as economic activities or consumptive uses as school fees, housing or medication. Instead, repayment performance is emphasised and social pressure is exerted on group members to evaluate the repayment capacity of the overall unit. Although interviewed clients had to submit the concrete business uses of FINCA to the group, peer evaluation of repayment capacity appeared to rely more on an assessment of the character and the overall economic situation of the respective client.

A third of the clients interviewed stated that they had improved business management and that FINCA taught them to work harder. Borrowing requires planning, as the loan will have to be repaid in a regular and timely manner. Following a set savings plan has, in their view, improved their economic management capabilities. Apart from monetary outcomes, this indicates that the clients profit in the form of acquired skills.

As outlined in the second chapter of this study, FINCA has a high rate of dropouts. Amongst the clients interviewed, reasons given for leaving FINCA were sickness or death of relatives, and non-ability to repay due to low business performance. In the next cycle, not enough savings were accumulated to borrow again, either because the business did not generate enough profit or because customers did not fulfil their obligations. Another ex-client interviewed left because she found FINCA's services were not suitable for her requirements. Her business was not profitable enough to meet the repayment obligations starting with the first week. This gives an example of the "trial and error" process through which FINCA clients go when investing the loan. Dropouts reflect this process rather than inadequate services. Closer monitoring of the dropout reasons, as recently included in the monthly reports, is a worthwhile mechanism to include client evaluation in future credit technology development for FINCA. The two most important reasons for dropouts seem to be persistent poor business performance and default on external loans.

All non-clients interviewed learned about FINCA from other village members or neighbours who were with FINCA. They were aware of the services offered by FINCA: Some underlined that FINCA offers training and helps in women empowerment. The reasons given for not joining FINCA ranged from lack of the initial savings required to husbands opposing FINCA involvement. Some of the husbands fear that they will be held responsible for their wives not fulfilling their repayment obligations. Another non-client who applied for membership was told that the group was already complete. This may be a mechanism of excluding people whom group members do not judge appropriate. As a tool for group-internal risk management, it may reflect the efforts of the groups to maintain coherent structures that allow for a joint liability of group members.

[22] One non-client interviewed said she herself does not join FINCA because she thinks she cannot repay the loan on a weekly basis and because her husband does not allow her joining FINCA. She observed that clients of FINCA have built houses, are dressing well and can afford to send their children to school, thus are comparably better off than non-clients.

3.4 Evaluation of Results

Most clients used the loan to finance trade activities. This may be due to the relatively low entry barriers since trade requires low capital and little skills. FINCA found that a diversification of business activities often takes place after the first loan cycle, when the women venture into e.g. catering and accommodation. Trade's fast turnover is very compatible with FINCA's lending technology. Agricultural production, in contrast, has a turnover of about six months, and would thus not allow for weekly repayment instalments. Even though approximately 70% of the overall portfolio of FINCA is used for trade finance, diversification of economic activities amongst clients makes a strict assessment impossible. With pooled resources, a trader with agricultural activities may use part of the loan obtained to purchase seeds for her own agricultural production. Generally, FINCA loans tend to be used for working capital requirements as well as short-term consumption needs.

FINCA works with existing groups, but also promotes the establishment of new groups. Previously existing groups' common bond and resulting peer monitoring potential are likely to be stronger. It has to be taken into account, however, that although FINCA does not require physical collateral or individual guarantors, a substantial part of the clients had to provide collateral on the group level.[23]

We observed that a significant number of clients fail to repay on time at their weekly meetings. However, once the time has come for the whole group to repay to FINCA, the repayment rate is close to 100%. Groups obviously make up for the repayment failures of individual group members, indicating a high repayment discipline vis-à-vis FINCA.

FINCA clients explicitly appreciated the opportunity to save. While no separate data are being kept on a continuous basis, mandatory savings are estimated as 60% of the total savings balance of FINCA groups.[24] These are formed as a rule while repaying a loan. Accordingly, around 40% of the savings portfolio is voluntary savings of the clients, reflecting a high demand for deposit facilities, once a low-cost access to deposit accounts is given. Clients acknowledge that FINCA taught them how to save as the scheduled weekly savings instilled discipline.

The FINCA Village Banking methodology initially foresaw that the village groups would evolve into local financial intermediaries. This did not happen, and the internal lending of mobilised savings is being phased out. Furthermore, there is little interest from the commercial banks to serve customers who want to graduate from the maximum USh600,000 loan available from FINCA. Clients, in turn, appear to clearly acknowledge the rapid access to savings and loans available from FINCA. In order to give the older groups an opportunity to develop further, FINCA now elaborates a concept for introducing individual loans and lower repayment frequencies through group and individual lending products. This is in line with the expressed wish of a number of FINCA clients.

The visited FINCA clients underlined that benefits of working with FINCA includes the possibility to accumulate enough money to extend and build houses and specifically increased opportunities to send children to school. Apart from these monetary outcomes, they also appreciated that the discipline instilled also improved their business management skills. In addition, many clients mentioned increased self-esteem as a major non-economic benefit.

[23]On a national level, FINCA Regional Office estimates that 20% of groups require collateral.

[24]In July 1999, FINCA conducted a one-off review that forms the basis for these estimations.

4 Lessons Learned

4.1 Assessment of Performance and Trade-Offs

1. *FINCA shows good results in outreach and sustainability. It however needs to adjust internal systems and procedures to cater for the challenges of substantial growth.*

FINCA Uganda has shown that microfinance institutions in Uganda can balance outreach and sustainability criteria in their institutional growth. FINCA has maintained very good portfolio quality while keeping its average loan size at a low level, thus reaching clientele from the lower income strata. Few, if any, of the commercial banks in Uganda reach a similarly high quality of their loan portfolio. However, the challenges of quick growth have also become very obvious within FINCA: The loan portfolio grew at a very fast pace so that systems and procedures became increasingly inadequate. This necessitated an adjustment of the management information and accounting system, which is currently taking place. Continuous adjustment to institutional growth has proven to be a prerequisite for sustained success in microfinance service provision.

2. *FINCA's success depended heavily on individuals. It must be ensured that staff changes will not affect performance and institutional stability in the future.*

FINCA has proven to be a strong microfinance institution over time. The former FINCA Regional Director, who left at the end of 1999, had led FINCA Uganda for an extensive period until 1998 and remained very involved with the institution. Thus the Regional Director played a major role in ensuring FINCA's good performance and continued to provide case-by-case consultancy. While this has contributed considerably to FINCA's success, it also indicated a potential danger. It was unclear whether FINCA could substitute for this strong "quasi-owner" of the institution. Indeed it was difficult to find a candidate who fulfilled the criteria of being fit and proper, i.e. experienced and reliable. As of December 1999, a new Country Director had been signed up. Only two months later, the Regional Director resigned as well, but fortunately, there was some overlap with his successor for the latter to be trained on the job. The effects of these substantial changes in leadership are yet to be evaluated.

3. *Through its Regional Office, FINCA International has played a key role in providing hands-on assistance for achieving the current results.*

With the Regional office of FINCA International for Africa, FINCA Uganda has a "quasi-owner" who assumes a leading role in strategic decision-making, internal control and guidance. The issue of a single actor with strong responsibility for the continued well being of an institution should be considered in the context of regulation and supervision of microfinance institutions. On the one hand, this person could ensure a well-run microfinance institution. On the other hand, there is the danger of monopolising power in a few hands and abusing it. In the transitional period before the new Country Director took office, supervisory and managerial responsibilities had been blurred. Now a clearer segregation of duties between FINCA Regional Office and the Country Director is envisaged with a stronger role of the Country Director in everyday management and the supervisory responsibilities vested in the Regional Director and the Board of Directors.

4. *The Co-operative Bank crisis has proven FINCA's capability for ad-hoc crisis management. Liquidity management, however, remains a key challenge for FINCA moving towards more commercial sources of funds.*

Funding from donor sources has proven to pose some problems for the liquidity management of FINCA. While donor funding was indispensable for the rapid growth of FINCA, the reorientation towards commercial sources of funds is a positive development in a medium to long-term perspective. While the liquidity crunch following the Co-operative Bank failure may have been a transitory problem in the context of financial sector restructuring, it demonstrated FINCA's capacity to handle even such challenging situations. Liquidity planning and active asset/liability management are, however, still at an early stage and need to be improved if commercialisation is pursued. The recently installed, fully integrated computerised loan tracking system will be of great help.

4.2 Potentials and Limits of FINCA's Efforts

Currently, the demand for financial services in Uganda remains largely unsatisfied, leaving a lot of potential market volume for FINCA and other microfinance institutions. There are, however, signs of FINCA clients simultaneously accessing other MFIs, which could potentially pose a challenge to its risk management techniques. As Uganda does not yet have a national identification system, a credit information bureau seems unfeasible in the short term, but could provide competing microfinance institutions with an information basis for loan decisions in the medium term. In our opinion, the fact that clients use several MFIs indicates less a saturation of these urban markets in Kampala and Jinja, but more a transitory problem of a young microfinance industry targeting the same population with similar products.

FINCA's view of its clients has changed over time. The concept of graduating borrowers has been given up and efforts are made to bind good clients to the institution, as e.g. the development of an individual loan product. Adjustments to the group lending methodology are currently also being tested. FINCA's standardised Village Banking product has produced good results in the past, but recent activities show an eagerness to diversify products in order to keep clients.

Savings facilities are widely acknowledged as an important factor. In our small survey, more women emphasised access to savings as prime benefit gained from being with FINCA as compared to access to loans. In fact, FINCA developed this savings technology targeted at poorer segments of the population for commercial banks without being contracted nor rewarded for this by the banks. However, FINCA uses this relationship to negotiate with commercial banks about better services for clients and overdraft facilities. There is evidence of a large untapped demand for savings services. As deposit taking has extensive consequences for the overall management of a financial institution, and as FINCA does not operate under a license from Bank of Uganda, it has so far refrained from touching clients' deposit.

In this context, it also has to be noted that a fifth of the clients interviewed had paid their children's school fees with the loan obtained from FINCA, obviously covering liquidity problems and consumption needs within the client household. FINCA has not prescribed the use of the funds and is well aware that funds are not only used directly for productive uses. Instead, repayment performance is emphasised, so that the final decision of fund utilisation is left to the individual clients, restricted only by the self-screening mechanisms of the groups.

As long as FINCA is not an externally supervised financial institution authorised to mobilise savings, however, it has little incentive to venture into the development of more sophisticated savings products. In addition, the current organisational culture, staff qualification and the overall management systems are geared exclusively at the provision of credit. The introduction of savings services would require a substantial institutional transformation process.

4.3 Potential Role of an External Supervisor in FINCA

As FINCA is not a formalised financial institution and does not take deposits, it does not fall under the supervision of Bank of Uganda. The FINCA clients collect savings in their weekly group meetings and, together with loan repayments, deposit these funds in commercial bank accounts held in their name. FINCA does not have access to the groups' deposits. Thus, financial intermediation in the narrow sense does not take place. The whole loan portfolio is funded from donor sources, commercial bank loans as well as retained earnings.

There are several reasons why FINCA should consider converting into a formal financial entity and venturing into deposit mobilisation. It would widen the range and amount of funding sources available. The necessary transformation into a shareholding company would give access to more stable funding sources such as inter-bank loans, institutional investors, investment funds, private investment, and secondary financial markets. Finally, it would also solve previous problems in working together with several commercial banks specifically, as experienced during the Co-operative Bank failure.

Summarising the results of this study, FINCA is clearly a potential candidate for transforming into a microfinance deposit-taking institution (MDI), as proposed under the tiered approach of the Bank of Uganda Microfinance Policy Paper. A decision to transform into an MDI from the side of FINCA Uganda should take into account the fact that this can open up the possibility to mobilise deposits. Being a formalised financial institution also means improved access to other funding sources. While affiliation with FINCA International has strengthened access to commercial sources of liquidity, as the Co-operative Bank crisis in mid-1999 has shown, formalisation can further improve this situation.

5 Recommendations

5.1 Recommendations for FINCA Uganda

FINCA Uganda has made impressive progress in improving efficiency and financial sustainability in the past years. It is one of the market leaders in microfinance in Uganda, with a substantial outreach and market coverage in and around Kampala and Jinja. FINCA Uganda is now a fully financially sustainable microfinance institution.[25] In the following discussion, we will highlight a number of recommendations for FINCA Uganda to remain sustainable, stressing that the authors believe FINCA Uganda is one of the prime candidates for transformation into the tier three microfinance deposit-taking institutions as outlined in Bank of Uganda's policy statement.

1. *Converting FINCA Uganda into a shareholding company may provide stronger and more motivated owners in addition to FINCA International.*

The conversion from a non-profit organisation into a for-profit shareholding company may provide incentives for further and sustainable growth. Plans already exist to convert FINCA into a shareholding company. In order to achieve this, a computerised management information system has to be installed and new products have to be introduced. Furthermore, this would require shareholders to participate with their own capital, which would give them an incentive for stricter monitoring and control through the Board of Directors. In any case, according to its Regional Director, FINCA International intends to remain the prime leader of FINCA Uganda. This would either mean holding a majority of board chairs and/or company shares or reserve the right to overrule other shareholders.

Bringing in additional shareholders may further strengthen the balance between social and commercial objectives and, specifically, open up new funding sources. As a consequence of higher equity and more diversified ownership, FINCA would have improved access to commercial financial resources. In Latin America, several donor fund facilities, socially motivated investment funds and private capital sources are interested in investing in microfinance institutions. In sub-Saharan Africa, neither purely profit-oriented equity investors nor social investors have shown much interest. In addition, donors generally tend to be unable to exert strong ownership, as responsibility often shifts from one person to another, and hands-on control of the institution is rather unlikely. FINCA Uganda should use its international affiliation to attract institutional and private investors to provide the required strength, oversight and control through the Board of Directors.

2. *The Board of Directors should be trained in policy and owner control issues of microfinance activities.*

As already indicated in the previous recommendation, higher qualification and specialisation of the Board of Directors can provide a substantial strengthening of FINCA Uganda's strategy development and (quasi-) owner control mechanisms in the current situation as well as in a future share-holding company. The board members' role in providing a strategic vision and controlling business conduct of senior management can be strengthened by sensitisation and training in policy and owner control issues. Currently, however, there is no policy training available in Uganda in this area, which should be addressed by the relevant institutions, for example as part of the microfinance courses to be established in the Uganda Institute of Bankers.

3. *The external auditor's work should be adapted to microfinance operations on the basis of the CGAP manual.*

[25] Full financial sustainability is calculated excluding grants. Formerly received grants are accounted as equity.

FINCA recently introduced the CGAP manual on external auditing to its external auditor. As it contains no specific country recommendations, it is therefore necessary to adapt these general rules to the specific context of Ugandan microfinance institutions. Part of this work could also be carried out by one of the current or future technical assistance providers in the microfinance sector, as for example the Uganda Institute of Bankers. As long as FINCA remains a non-regulated financial institution, the quality of auditing in the end depends on the terms of reference applied by the institution itself. In the case of FINCA Uganda, the qualitative requirements have been generally set at a high level. Additional specifications, however, appear to be needed for future audits.

4. *FINCA's internal auditing should focus more on structural issues and procedures in place.*

The workload for the internal auditing function of FINCA is very high. While an overall internal auditing of structural issues was carried out after the former Country Director had left the organisation, daily auditing still concentrates on the village banking level. Coverage, however, is not yet sufficient in order to ensure sustained functioning of the internal systems.

5. *FINCA should continue its efforts to develop an individual loan product.*

FINCA is in the process of developing an individual loan product. This will have far-reaching organisational implications: The evolution from a single-product to a multi-product microfinance institution will necessitate a substantial reorientation of organisational culture, systems, procedures and internal control mechanisms. Moreover, individual lending generally requires more systematic and comprehensive information on the individual clients as it focuses on individual repayment capacity and willingness. This can substantially increase FINCA's risk management capacity in the long term. It will also help to diversify the loan portfolio, thereby reducing default and liquidity risks.

In the short term, however, introducing an individual loan product may result in difficulties both for loan clients and for the institution. Standardised loan products allowed FINCA to substantially reduce administrative costs and apply a uniform risk management with simple and stringent reporting systems from credit officers up to the credit director at FINCA Uganda headquarters. With the introduction of individual loans, FINCA will incur additional costs and will have to improve credit officers' capacity to evaluate individual repayment capacity and willingness of potential individual loan clients. The challenge of developing an appropriate individual lending technology also has to define effective collateral substitutes.

6. *In the medium term, FINCA should accompany the transformation into a formalised financial institution with a focus on developing savings products.*

FINCA currently offers access to deposit facilities at commercial banks through the collection of voluntary deposits at the group level that are then deposited with commercial banks. Once formalised, FINCA may consider venturing into mobilising deposits itself, using them as a highly valued financial service to customers and, as the figures show, a stable additional funding source. Savings mobilisation, however, far more than introducing a new lending technology, has far-reaching consequences and requirements for a financial institution (see Hannig/Wisniwski, 1999). Currently, as an example, credit officers are not at all involved in collecting repayments or deposits. This is part of FINCA's efforts to limit opportunities for fraud within the organisation.

Deposit mobilisation requires a high degree of formalisation, different branch office structures, a very clear distinction between savings and credit departments, sophisticated management information systems, automated accounting and loan tracking, risk and liquidity management tools and last, but not least, a license from Bank of Uganda. With its proven track record, however, FINCA appears to be a suitable candidate for a gradual transformation into a microfinance deposit-taking institution. More specifically, this study recommends that FINCA explore the opportunities of introducing a school fee savings product as well as other specialised programmed savings products.

5.2 Recommendations for Bank of Uganda

From the observations made, a few lessons for the regulation and supervision of microfinance institutions can be drawn that are generally applicable to all types of microfinance institutions. These can provide valuable input for Bank of Uganda's future role in the supervision of these institutions. We have structured our recommendations according to the risk categories used in Hannig/Braun (1999) to highlight the specific risks of microfinance institutions taking deposits.

We do not imply that FINCA Uganda will or should be supervised by Bank of Uganda. As FINCA does not yet operate savings services, neither do we recommend that Bank of Uganda supervise the institution at this point of time. Once a specific regulatory framework has been put in place, and once FINCA decides to enter the deposit-taking business, however, these issues need to be taken into account.

5.2.1 Governance Risk Evaluation (Ownership)

FINCA Uganda as an NGO does not have an owner who holds equity shares in the institution. Instead, FINCA International acts as a "quasi-owner" through affiliation contract and hands-on technical assistance and control through the Regional Office of FINCA International based in Kampala, Board of Directors participation and yearly diagnostic from FINCA International headquarters. The major funding source for the on-going loan portfolio of FINCA Uganda consists of donor funds transferred to the ownership of FINCA Uganda. In the recommendations for FINCA Uganda above, we have outlined how the wider variety of owners of a company limited by shares may provide additional control and cross-checking potential, but also enhance access to non-donor sources of funds.

In the new regulatory framework for microfinance deposit-taking institutions (MDIs), the requirements for the ownership composition of these institutions remain an open issue. For reasons that cannot be discussed in detail here, the institutional/legal form of a company limited by shares is taken as a given requirement. Some countries have additional requirements for owners. Bolivia, for instance, requires a diverse set of owners that needs to include natural persons as owners to a certain extent. In Kenya, shareholders of formal financial institutions are not allowed to own more than a fourth of the total shares of the company.

Strong owners bring in a substantial equity share, allow for leverage as they risk their own funds and reputation, and their "deep pockets" help to overcome crises. In the light of the FINCA Uganda experience, there are clear indications that an international network such as FINCA International can act as a strong owner. In order to ensure local participation and to restrict predominance of one equity shareholder in a transformed FINCA Uganda, we recommend a subset of national and regional, private and institutional owners.[26]

[26]The experience of the crisis of FinanSol Columbia has often been cited to underline the need for private investors who provide hands-on control over a microfinance institution. While this is valid and should be considered in the Ugandan context, it needs to be acknowledged that ACCION International, another international NGO network, provided the rescue means for FinanSol. In addition to their shareholding, this can be mainly traced back to the substantial reputation at stake.

5.2.2 Management Risk

Strong Internal and External Auditing. FINCA has assigned a strong and independent position to its internal auditing departments. Occasional problems with the independent position of the internal auditors within FINCA have been recognised by the Board of Directors, leading to reassurance of independence from senior management. In addition, FINCA works closely with PriceWaterhouseCoopers, a renowned external auditing firm. A mutual learning process has been initiated, and the division of labour between the internal and external auditors has been clarified in order to cover the control of village bank, branch and headquarter level evaluations.

Generally, internal and external auditing should go hand in hand and apply the same basic principles and standards. This requires customised terms of reference for both. In addition, as highlighted by the case of FINCA Uganda, well-qualified internal and external auditors are needed. Both parties should have a similar frame of reference, i.e. the persons involved should have compatible experiences and backgrounds. For MFIs, accounting and preferably also auditing experience in an auditing firm could form a basic requirement for the position as an internal auditor. For the external auditing firm, a certain degree of familiarity with microfinance operations is necessary. In sum, specialisation as well as continuity in the relation between MFI and auditing firm should be ensured.

It is, however, important to clearly distinguish roles of internal and external auditor, as we summarise in the table below:

Table 3: Differences between Internal vs. External Auditors

Internal Auditor	External Auditor
• Is an employee of the audited organisation • Serves the needs of the organisation • Focuses on future events by evaluating controls that ensure the achievement of the organisation's objectives • Is directly concerned with preventing fraud	• Is an independent contractor • Also serves third parties who need reliable financial information • Focuses on whether financial statements reflect historical events clearly and accurately • Is incidentally concerned with fraud controls in general, but is directly concerned only when financial statements may be materially affected

Source: CGAP, 1998a, p. 12

It should be noted that an internal auditor – although employee of the audited organisation – should be independent from day-to-day management. FINCA implements this by attaching the Internal Auditing Department to the Regional Director and disconnecting it organisationally from the rest of FINCA Uganda. For an external supervisor, it will be important to ensure such independence in the statute as well as in practice. It will also be important to ensure that internal auditing goes beyond checking the accuracy of quantitative information. An independent internal auditor should specifically take a major role in preventing fraud and ensure that there is an immediate follow-up to problems discovered in audits. Many small MFIs do not have a separate internal auditing function. FINCA Uganda provides a good example of defining clearly the objectives and scope of work and providing independence. Likewise, an external supervisor should require the following from internal auditing departments:

- organisational independence;
- clearly defined objectives and scope of work (including a detailed work plan);

- good qualification;
- reporting to the Board only;
- minimum quality standards for auditing reports; and
- clear follow-up procedures for problems encountered.

Qualitative auditing should also be emphasised by external auditors. For a supervisor, the reliability of the financial data provided is the key for effective supervision. If the supervisor cannot trust the figures provided, on-site examinations have to be carried out. Especially for small microfinance institutions, this would be extremely time- and resource consuming and would require specific knowledge. This cannot be the role of Bank of Uganda. When designing the future supervision of microfinance institutions, it is thus advisable to develop a manual for external auditors adjusted to the specific Ugandan situation and approved by Bank of Uganda. This manual or guideline could give auditing firms not yet familiar with the characteristics of microfinance a clear outline of their task.

Management Information Systems. It is imperative for an external supervisor to acknowledge that owners and management of a financial institution are in a privileged position to monitor its actions as compared to external supervisors. They do, however, require accurate, timely and relevant data. This is the role of management information systems. Taking into account the high number of loans within a microfinance portfolio, computerisation is an effective means to lower the costs of obtaining this information. For an external supervisor, it is important to ensure the functioning of the management information system. The supervisor should, however, not prescribe the format of this system, but define and evaluate the scope and effectiveness of the system and monitor the action taken when management reports indicate significant tendencies in portfolio development.

The case of FINCA Uganda has shown that growth of an institution requires substantial adjustments in the area of management information systems and specifically in loan tracking systems. With a manual accounting system and loan tracking formerly based on Excel spreadsheets, FINCA Uganda had not been properly prepared for the substantial growth in loan portfolio it experienced in 1998. This lead to a temporary halt in lending in the beginning of 1999, and the introduction of a new loan accounting system in mid-1999. There are plans to install a comprehensive management information system as part of a fully integrated and computerised banking system already tested in Latin America. In sum, for the regulatory and supervisory framework of MDIs in the future in Uganda, it appears imperative to require a comprehensive and computerised management information system.

5.2.3 Credit Risk

Neutrality of Regulation and Supervision towards the Lending Technology. Generally, group lending technology and individual lending technologies should not be risk weighted differently per se. FINCA's village banking methodology varies from other group lending approaches. Many of these approaches work with individual payments to the microfinance institution, while FINCA allows the groups to collect weekly payments themselves to repay FINCA with bulk payment monthly or weekly repayments. Within FINCA Uganda, this repayment period is not uniform. Therefore, as we have stressed, the FINCA methodology leaves some room for late payments on the individual level within the loan cycles, while closely monitoring and strictly enforcing group payments. Supervision of microfinance should consider evaluating the risk consequences of these technology differences, but should not favour individual as opposed to group lending approaches or vice versa.

However, group lending may pose some additional risks to a financial institution as compared to individual lending. Specifically, some of the risks may be more difficult to assess for an external supervisor. If loans are granted to a relatively homogeneous clientele, default risks may be highly correlated. Risk correlation can, in the case of group lending, be especially high if small and homogeneous groups are formed in order to ensure appropriate peer member screening and monitoring. In addition, small and homogeneous groups limit the potential for risk diversification of an MFI. This implies that supervisory assessment methods should consider, especially in the case of group lending approaches, a qualitative assessment of lending technologies and specifically credit risk management techniques in order to assess the overall credit risk of an MFI's loan portfolio.

Quantitative and Qualitative Loan Portfolio Assessment. Several proposals for the assessment of microfinance loan portfolio have extensively concentrated on the days of arrears as major basis for loan loss provisioning.[27] While this is a most valuable proxy for the default risk of a microfinance portfolio, supervision of a microfinance portfolio should also qualitatively evaluate the capacity to manage risks associated with the loan portfolio, including policies, technologies and practices within an institution. Such an assessment would take into account not only the current data of repayment performance, but would also widen the perspective to a prospective evaluation of the loan portfolio.

Portfolio at Risk and Provisioning. FINCA Uganda applies strict provisioning requirements with the limit for provisioning at 30 days of delinquency. It should be highlighted that the actual loan loss reserve with 477% of the required reserves for the given arrears seems to be more than sufficient. Portfolio at risk is shown on the basis of categories of 1-30, 31-60, 61-90, 91-180 and 180 and more days of delinquency. This reflects international practice in the area of microfinance. Bank of Uganda should require the same format for information disclosure. It remains to be discussed whether this substantial input to off-site surveillance should be disclosed on a weekly or monthly basis. As regards tiering of provisioning, we would opt for a general provisioning, which could be determined by supervisors according to a regular qualitative overall evaluation of default risk management capabilities and experience of an MDI. In addition, loan-by-loan provisioning should be based on days of arrears and on the number of times the loan had been rescheduled.[28]

5.2.4 Liquidity Risk

Quantitative Liquidity Ratios. Against the background of FINCA Uganda's experiences, a few recommendations can be made on liquidity ratios for an MDI. A substantial liquidity risks arises with the beginning of deposit taking as a potentially more volatile funding source. The liquidity crisis in mid-1999 following the Co-operative Bank failure, however, was an extraordinary problem that is not likely to trouble formalised MDIs in the future. FINCA's vulnerability derived from the heavy reliance on one commercial bank not only as business partner for itself, but also to deposit the groups' savings. Generally, however, FINCA's efforts ensure groups' access to subsequent loans as one of the major repayment incentives highlights the necessity to maintain higher liquidity levels in MFIs in order to cushion against short-term liquidity shortfalls.[29] Useful liquidity indicators are the quick ratio (liquid assets per current liabilities), the total deposit ratio (total customer deposits per total assets) and the core deposit ratio (taking only the stable base of deposits into account).

Liquidity Management Requirements. FINCA Uganda has shown that it can handle severe liquidity shocks on a short-term, ad-hoc basis. However, its limitations in strategic liquidity planning and asset/liability management highlight the necessity to introduce qualitative criteria into the supervisory process of MDIs in the future. The rating of an MDI on the financial markets (e.g. local commercial banks) as well the capability to mobilise additional

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[27]See e.g. van Greuning/Gallardo/Randhawa, 1999.

[28]Under the Bolivian regulation of Private Financial Funds, loans that have been rescheduled once directly need to be provisioned. While FINCA Uganda does not reschedule loans, prospective regulation should take into account that particularly in agricultural lending, rescheduling may be needed in case of outstanding harvests (see Fiebig, 2000).

[29]FINCA has reported a liquidity level (cash and equivalents to total liabilities and equity) of 19% for the second half of 1999, which the Country Director considers more than sufficient.

funds from owners, "quasi-owners", donors and institutional investors on a short-term basis should be included as well.

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ANNEX 1: FINCA UGANDA PERFORMANCE INDICATORS (1994-1999)

ANNEX 2: FINCA ORGANISATIONAL CHART

ANNEX 3: QUESTIONNAIRE FOR FIELD INTERVIEWS

Microfinance Practice in Uganda – Lessons from FINCA Uganda

Questionnaire for Client/Ex-client/Non-client-Survey

Background

The survey will include current and former clients of FINCA as well as people who have never borrowed from FINCA. It is expected that the comparison of data derived from these groupings will shed some light on the outreach of FINCA Uganda, potential demand for financial services and an assessment of FINCA services' quality.

Name of interviewer: ___________________

Date of interview: ___/___/99

Language in which interview was conducted: ______________________

Introduction

With this interview we want to learn about your personal economic situation and the way in which you use loans and savings. This is part of our work to look at FINCA Uganda and see what it has accomplished! We would like to ask you some questions and assure you that we will not pass personal information on to the people at FINCA.

1. General Data

Personal data

1.1 Please provide the following information about you and your fellow household members:

	Interviewed person	Household member No.1	No.2	No.3	No.4	No.5	No.6
Name							
Sex (m/f)							
Age							
Marital status/relation to interviewee							
Level of education: None/Primary/Secondary/ High school, diploma/ University							

1.2 Location of your household: ____________________________

1.3 How far away is your household from…

	Kilometres/miles	Minutes/time to travel	Cost of transport (one way)
FINCA office?			
Place where group meetings take place?			

Please indicate the economic activities you and other household members carry out;
Please write down exact activity (e.g. crop cultivated such as coffee, cassava etc).

	Interviewed person	Household member #1	#2	#3	#4	#5	#6
Crop production (traditional crops)							
Crop production (non-traditional)							
Crop processing (non-traditional)							
Crop marketing (non-traditional)							
Other trade activities							
Salaried work							
Service provision							
Other (please indicate)							

<u>Properties</u>

1.5 Do you own land or have you rented land? Please tick:
a) owned
b) rented
c) neither owned nor rented

1.6 What is the size of the land you own/use: ________ acres

1.7 How far is this land from your household? _______ kilometres

1.8 For what purpose do you use the land?
a) traditional crop production
b) non-traditional crop production
c) production for household consumption
d) none
e) other: __________________________

1.9 What form of ownership do you have of the land?

a) land title
b) customary property
c) 'mailo' –land
d) rented
e) no-ownership

1.10 What type of house do you live in? ___________________

1.11 What other assets do you own?

	Type	Quantity of assets	Used in household (no.)	Used in business activity (no.)	Value of assets (approximately)
Vehicles/motorcycles					
Bicycles					
Mattresses					
Cows					
Goats					
Other animals					
Radio and/or TV					
Plantation					(no value needed)
Machines					
Fridge					
Other valuable assets					

Space for comments on general data/background:

2 Sources of Income and Expenditures

2.1a Please indicate your AVERAGE income and expenditures from/for the different economic activities you have. Either provide annualised or monthly information.

	Income		Expenditure	
	Monthly	Annual	Monthly	Annual
Crop production (traditional crops)			See below 2.1b	See below 2.1b
Crop production (non-traditional)			See below 2.1b	See below 2.1b
Crop processing (traditional)				
Crop marketing (traditional)				
Crop marketing (non-traditional)				
Other trade activities			See below 2.1c	See below 2.1c
Salaried Work				
Service provision tailoring				
Transfer payments from other family members (e.g. from the city)				
Other (please indicate)				

2.1b Expenditure for agricultural income sources?

Agricultural Product	Seeds (in USh)	Fertiliser and other chemicals (in USh)	Harvest workers or others outside household (in Us)	Total amount

2.1c Please indicate average monthly expenses for trading, if you are in this business:

	Per unit price	Quantities	Total amount
Input goods (goods for trading)			
Salaries		(here no. of employees)	
Tools, machines			
Other			

2.2 Please indicate your average household's expenses either on weekly or on monthly basis:

	Weekly	Monthly
Food		
Electricity, Water		
Education		
Clothing		
Health/Medication		
Transport		
Other regular expenses		

2.5 Does somebody currently owe you money?

a) yes
b) no

2.6 Who owes you what amount of money?

	Relation to interviewee	Amount	Does he/she have to pay interest, and if so, what amount	When does he/she have to repay from now?
Person #1				
Person #2				
Person #3				

Space for additional comments:

3 Use of financial services

3.1 Did you get a loan or deposit money with of the following institutions in the last year?

	LOANS						SAVINGS	
	Y/N	Total #	Last loan taken when?	Size	Term	Interest paid	Savings type, e.g. fixed term	Savings: total amount currently deposited
Commercial banks								
FINCA								
Other MFI								
Savings and credit co-ops								
Money lender								
Savings club/savings and credit association								
Friends and relatives								

3.2 From whom did you receive the most important loan in the last 12 months?

a) commercial bank
b) FINCA
c) other microfinance institution
d) savings and credit coop
e) money lender
f) RoSCA/savings club
g) friends and relatives
h) other - please indicate: __________________

For clients of FINCA, please ask the following question relating to FINCA, for others relating to institution given in 3.2

3.3 Why did you access this institution, not others

a) low interest
b) sanctioning of late repayment not very severe
c) guarantee/collateral requirements are low
d) timely access possible, when loan is needed
e) because I can get loans repeatedly
f) did not fulfil requirements of others
g) don't know others
h) safe savings facilities
i) other: __________________

3.4 For what purpose did you borrow?
- a) education
- b) health expenses
- c) agricultural production
- d) agricultural processing
- e) trade activities
- f) service provision
- g) consumption
- h) to pay back other loan
- i) other: _______________

3.4 Did you need to provide collateral?
- a) yes, I had to pledge: _____________
- b) no

Space for comments:

4 Evaluation of FINCA services

For current clients please ask questions 4.1-4.15
For ex-clients please ask 4.15-4.19
For non-clients please ask 4.20-4.23

4.1 What has been your personal benefit from being with FINCA?
- a) access to loans
- b) access to savings
- c) I could start a new business
- d) I could expand with my present economic activities
- e) little change
- f) no change
- g) other: __________________

4.2 What do you think of FINCA's training?

a) helped me understand how to get a loan
b) helped me understand how to save
c) helped me my day- to-day economic decisions
d) was too lengthy
e) did not understand everything
f) other: ________________

4.3 How many loans have you received from FINCA? ____________

4.4 What loan amounts were these and what did you ask for/wanted to get?

4.5

	Loan amount	Wanted
Loan 1		
Loan 2		
Loan3		
Loan 4		
Loan 5		
Last Loan		

4.7 How much interest do you pay on the last loan? __________ USh, or ___% p.a.

4.8 How much time does it take to get a loan approved? __________ days

4.9 How often do you have to go to group meetings to get the loan amount? ___times

4.10 For what purpose have you actually used the last loan (more than one possible)
a) education
b) health expenses
c) agricultural production
d) agricultural processing
e) trade
f) service provision
g) consumption
h) to pay back other loan
i) other: _____________

4.11 For what purpose had you applied?
a) education
b) health expenses
c) agricultural production
d) agricultural processing
e) trade
f) service provision
g) consumption
h) to pay back other loan
i) other: _____________

4.12 Why do you save with FINCA?
a) to get a loan
b) to have a safe place to store my money
c) because I can easily get money out if needed
d) because I get interest on the savings

e) other reason: ___________________

4.13 How much time does it take to withdraw savings? ___________ minutes

4.14 If you have savings in other institutions, why do you save there and not more with FINCA?
a) better services
b) safer place for my money
c) I can access money quickly
d) I can get more interest
e) I can get a loan there
f) other: __________________

For former and current clients of FINCA:

4.15 What could FINCA do to improve their services?
a) quicker access to loans
b) higher loan amounts
c) better savings facilities
d) individuals loans
e) other: ____________________

4.15b How did your group form itself?
a) neighbours
b) group existed before for other reason
c) family members and good friends
d) loan officer suggested group members
e) other: ____________________

4.15c Has somebody in your group failed to repay on time?
a) yes; reason: ___________________
b) no

4.15d What was your group's reaction
a) excluded person
b) paid for her
c) put pressure on her, then she paid
d) other: _________________

4.15e Did you ever fail to repay in time?
a) yes; reason: ________________
b) no

4.15f If yes, what was the group's reaction?
a) excluded me
b) paid for me
c) put pressure on me, then I paid
d) other: ___________________

For current clients of FINCA: End.

4.16 Why did you stop accessing financial services from FINCA?

a) services were inadequate for my requirements
b) could not repay loan
c) others in my group failed
d) FINCA denied access to me
e) don't need loan now
f) other: ______________________

4.17 If answer in 4.16 is a): why are services inadequate?
a) requirements too hard
b) too high interest
c) too difficult to get loans
d) do not need loan

4.18 If answer was b) then why did you fail to repay?
a) had economic problems: project failure
b) robbery/loss
c) higher household/consumption expenditures than expected
d) other: ______________________

4.19 If answer was c): then why did the others fail?
a) had economic problems: project failure
b) robbery/loss
c) higher household/consumption expenditures than expected
d) other: _____________

4.19b What was your reaction after stopping access to FINCA?
a) tried to get a loan from somewhere else
b) tried to form new group
c) no reaction
d) complained to FINCA, but without success
e) other: ________________

End of questions for ex-clients

4.20 Do you know FINCA?
a) Yes
b) No

4.21 Where do you know FINCA from?
a) other village members/neighbours talked about it
b) other village members/neighbours were with FINCA
c) info meeting of FINCA informed me
d) other: __________________

4.22 What services does FINCA offer?
a) loans
b) savings facilities
c) training
d) women empowerment
e) other: ______________________

4.23 Why have you not yet accessed FINCA services?
a) can't afford it
b) do not need a loan or savings account at FINCA
c) have enough other sources of finance
d) I don't know
e) it is too far away for me
f) other: ________________

End of questionnaire - Thank you for your time!

Comments from interviewer: