Munich Personal RePEc Archive

# Promoting Financial Inclusion in Africa: The Two Ambiguities

Ayoki, Milton

Institute of Policy Research and Analysis

January 2009

Online at https://mpra.ub.uni-muenchen.de/82882/
MPRA Paper No. 82882, posted 23 Nov 2017 10:46 UTC

# Promoting Financial Inclusion in Africa: The Two Ambiguities

Milton Ayoki

IPRA Working Paper 25

Institute of Policy Research and Analysis, Kampala

January 2009

# Promoting Financial Inclusion in Africa: The Two Ambiguities

## Abstract

This paper reviews the African experience in fostering financial inclusion. It examines two aspects of financial inclusion—access by enterprises and households to affordable and appropriate formal financial services and the actual usage of financial services and products, how this has been helped with financial deepening. Empirical evidence does not point to a clear, definite relationship between financial deepening and access to affordable financial services or usage of financial services. This underscores the importance of paying attention to all dimensions of financial inclusions and innovations that meet the firms and households' needs. Financial inclusion is part of the solution to the serious problem of financial access/usage gaps that exist in many African countries, but not of itself a panacea.

*JEL Classification*: D14, G2, G3, D53, N27, O55.

*Key words*: Financial Markets, Financial Inclusion, Informal Financial Systems, Sub-Saharan Africa, Mobile Money.

---

© 2008 by Milton Ayoki. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

IPRA Working Papers contain preliminary material and research results, and are circulated prior to a full peer review in order to stimulate discussion and critical comment. Any opinions (the views) expressed (herein) are those of the authors and not necessarily those of the Institute of Policy Research and Analysis.
Contact email: milton.ayoki@ipraa.org

.

# Contents

**Abstract** **ii**

1 Introduction 1

2 Financial inclusion in Africa: review of experience 4

**2.1 The context 4**

**2.2 Account penetration 4**

**2.3 Mobile money 8**

**2.4 Savings 9**

3 Financial systems in Uganda 13

**3.1 Supply of financial services 13**

**3.2 Financial outreach and exclusion 14**

**3.3 Informal financial system in Uganda: Dataset 19**

4 Demand for and access to financial services 20

**4.1 Demand for financial services 20**

4.1.1 Sources of income 21

**4.2 Access to credit 26**

5 Conclusions and Recommendations 44

5.1 Conclusions 44

5.2 Recommendations 45

# 1 Introduction

Financial inclusion has become a central part of development discourse. This paper focuses on two dimensions of this discourse—access by enterprises and households to affordable and appropriate formal financial services that meet the needs of enterprises and households and the actual usage of financial services and products, and financial depth. It unveils the ambiguities that surround the discussions of financial inclusion, which have often focused on financial depth, or expansion of the financial system, driven by policy reforms and financial innovation, and the dilemmas that have been encountered in fostering financial inclusion in Africa. Can the new generation of African finance—micro deposit taking institutions (MDIs), Airtel Money, MTN Mobile Money, M-PESA and others deliver financial inclusion through access to poor people? How can this be achieved in a business model that all these actors actually are? Is there linkage between service expansion and service usage especially by the poor?

While African financial services (banks, capital markets, microfinance, corporate finance, risk sharing and insurance, etc) have expanded both in quantity and depth over the years, evidence suggests that finance has not been inclusive. For instance, in 2011, only 25 percent of adults in Sub-Saharan Africans had an account with a formal financial institution (Allen et al 2014), which is a half the world's average of about 50% (Demirgüç-Kunt and Klapper, 2012), and only 5 percent received a loan from a formal financial institution (Allen et al 2014).

Development agencies – inter alia, African Development Bank, UK Department for International Development (DFID) and the World Bank – have devoted substantial resources to promote financial inclusion in Africa, but severe gaps in financial inclusion remain in several African countries (Otchere, 2016). In 2011, 54 percent of the South African population had accounts at formal financial institutions, compared to 42 percent in Kenya, 30 percent in Nigeria, 10 percent in Egypt and 4 percent in the Democratic Republic of the Congo (DRC).

A firm-level data from the World Bank Enterprise Survey also shows a wide disparity across countries in terms of the percentage of firms with access to credit (Dabla-Norris et al 2015). Even in countries where credit penetration is high, large amount of credit do not

always reflect broad use of financial services as credit is always concentrated among the largest firms (Dabla-Norris et al 2015). Financial institutions have long been considered as conservative when it comes to financial outreach. The natural tendency of financial institutions, including those supposed to serve the unbanked, to adopt a risk-adverse attitude, with some notable exceptions, simply add to the common belief that most financial innovations are not there to deliver financial inclusion.

Moreover, the view that financial deepening spurs financial service usage lacks firm empirical support (Demirgüç-Kunt and Klapper 2012; and World Bank, 2012). There is also evidence that aggregate financial depth is positively associated with poverty reduction and income inequality (Beck et al., 2007; Clark et al., 2006). Empirical ambiguity thus mirrors policy ambiguity. Financial service providers and policy makers are often unaware of the financial models that can serve the poor. Policies that target financial depth (relaxing borrowing constraints) are likely to benefit the wealthy at the expense of the very poor.

The collective role of banks and informal financial providers in achieving solutions at the different levels of the financial system has been recognised in recent years. However, insufficient innovation in business models, inadequate use of existing and potential channels for reaching the poor, and lack of data available to describe the scope of the problem continue to undermine attempts to build inclusive financial systems in Africa.

While use of mobile money appears to hold out a promise of bridging the gaps in financial inclusion in Africa, there is growing debate about the ambiguity surrounding the actual impact that mobile money transfer service and other financial innovations have had on households, firms and societies especially the poor.

In 2009, Nobel Laureate Paul Krugman writes, "it is hard to think of any major recent financial innovations that actually aided society" (The New York Times, 2009 cited by Mention and Torkkeli, 2014). Critics argue that recent financial innovations were not aiming at the "enhancement of the ability of the financial sector to perform its social function" (Joseph Stiglitz, cited by The Economist, February 2012), but rather embraced "opaque pricing including billing tricks and traps … that encourages unsafe lending practices" (Pew Charitable Trusts, 2009, cited by Lerner and Tufano, 2011). They had hardly any visible effect on the productivity of the economy according to Volcker (New

York Post, December 13, 2009). Volcker also stated that ATM was the only financial innovation he can think of that has improved society.

Evidence suggest that it is not simply holding an account at a financial institution or expanding credit that matters, or availability of mobile money services, but also what you do with that account, and in the case of credit, financial innovation in risk sharing mechanisms and payments systems that fosters insurability and bankability of the poor and small actors such as smallholder farmers. After all, can introducing a new savings product, be really considered innovative? Or, what is truly inclusive about diverting people away from their less costly traditional system of holding savings in assets e.g. cattle, which earn them higher return to a non-interest or low return yielding, more costly savings account in financial institution? Drawing lessons from the informal financial system in Uganda, this paper underscores the importance of knowing and understanding firms and households' needs in designing and delivering innovations. Beneficial financial innovation in this sense, is the type that are modelled to fit the local context, not the other way round; the type that serves the interests of firms and households, thus positively affecting the functioning of society as a whole.

The notion of building inclusive financial systems as Otchere (2016) rightly puts it, "recognizes not only the goal of incorporating as many poor and previously excluded people as possible into the formal financial system, but it also assigns to mainstream financial institutions the role of reaching out to the unbanked (UN Capital Development Fund (2006)). However, such goal would be self defeating if the focus is simply to extract savings from the masses without investing on them in return, to improve their lots. In what follows, Section 2 reviews the progress in fostering financial inclusion in Africa. Section 3 and 4 explore the opportunities and challenges relating to the provision of and access to finance, for the majority of people who operate in the informal economy in Uganda, and Section 5 concludes with recommendations.

# 2 Financial inclusion in Africa: review of experience

## 2.1 The context

The number of countries that committed to Maya Declaration and the G-20 Financial Inclusion Action Plan, as well as strategies and targets set by individual governments[1], attest to the renewed interest in promoting financial inclusion in recent years.

The Centre for Financial Inclusion at Accion (CFI) defines full financial inclusion as a state in which all people who can use financial services have access to a full suite of quality services, provided at affordable prices, in a convenient manner, and with dignity for the clients. Financial inclusion refers to all initiatives that make formal financial services *available*, *accessible and affordable to all segments of the population* (Triki and Faye, 2013). These include technology-induced and enabled innovations, such as (i) mobile banking, i.e. access to basic payment services through mobile phones, even without having to have a bank account, (ii) ATMs, (iii) and e-banking as well as (iv) agricultural insurance based on objective rainfall data, and (v) new players in the financial systems, such as micro-deposit taking institutions (MDI), and cooperation between formal and informal financial institutions. Other examples include agency agreements between banks and non-financial corporations (supermarkets, post offices, etc.) to deliver financial services to remote and low-income areas, joint platforms for banks to provide factoring services to small enterprises, and private–public partnerships for infrastructure, often supported by international risk mitigation mechanisms.

They include provision of appropriate and quality financing that is both accessible and affordable to low-income and other vulnerable households. Notably they target groups traditionally excluded from the formal financial sector (Triki and Faye, 2013).

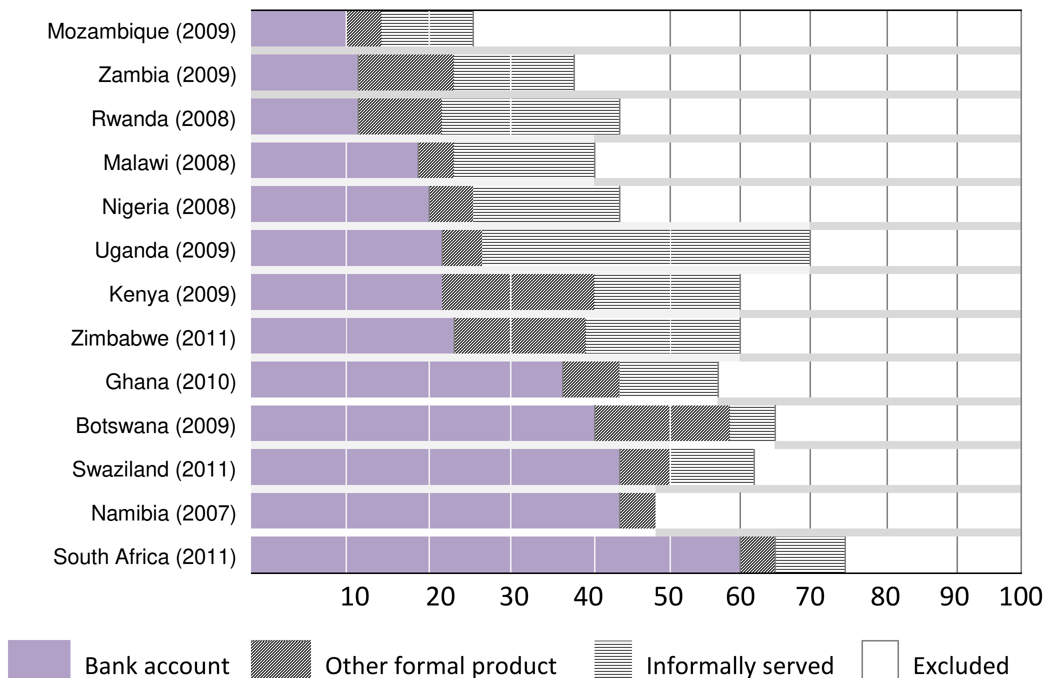
## 2.2 Account penetration

An estimated 4 per cent of the population in Africa have access to bank accounts, and the number of bank deposits per person is far below other regions. In addition, only 1 per

[1] The Maya Declaration is the set of commitments to financial inclusion made by AFI members. More information is available at: http://www.afi-global.org/gpf/maya-declaration. Also see the Global Partnership for Financial Inclusion action plan developed by G-20 countries, available at http://www.gpfi.org/our-work/work-plans/g20-financialinclusion-action-plan.

cent of Africans have obtained a loan or other forms of credit from a formal financial institution, and again the number of loans per person is well below the number in other areas (UNDP, 2006). Although recent surveys (e.g. by FinScope – see Figure 1) suggest some improvement access by enterprises and households to reasonably priced and appropriate formal financial services are still limited. Indicators describing the use of different financial services are available in the 2012 Global Findex database, for 148 economies that include 42 from Africa (Demirgüç-Kunt and Klapper, 2012).[2] Figure 1 shows that even with new innovations such as mobile money, a significant portion of the African population remain excluded from formal financial systems. These are mainly disadvantaged groups such as the poor, women, and youth— who lack access to savings and payment products. Figure 2 compares account penetration between Africa and other developing regions.

**Figure 1. FinScope Access Strands in Africa**




Source: AFI (2013) based on FinScope findings available at http://www.finscope.co.za .

Note: the FinScope surveys define inclusion based on the access dimension and use the Access Strand to measure financial inclusion. "The Access Strand is a powerful measurement framework particularly in countries with a significant informal sector. The Access Strand distinguishes between people who have bank accounts, people who have other regulated financial products (such as mobile money accounts, accounts at MFIs and other financial products), those who use informal financial products (such as savings groups and informal

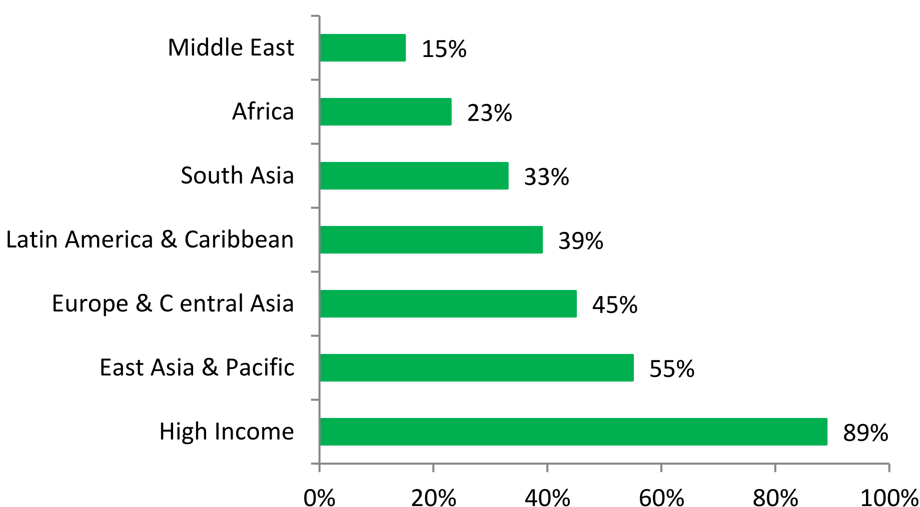
[2] The complete database and related reports are available at: www.worldbank.org/globalfindex (accessed in May 2013). The 2012 Global Findex database provides indicators, measuring how people save, borrow, make payments, and manage risk. These new indicators are constructed with survey data from interviews with more than 150,000 nationally representative and randomly selected adults aged 15 and above. The survey was carried out over the 2011 calendar year by Gallup, Inc. as part of its Gallup World Poll Survey and includes more than 40,000 interviews across 42 economies in Africa (Demirgüç-Kunt and Klapper 2012).

borrowing), and those who are excluded and use no financial products " (Triki and Faye, 2013).

Evidence from the 2012 Global Findex database shows that less than a quarter of adults in Africa have an account with a formal financial institution (Figure 2). Instead, many adults in Africa use informal institutions to save such as Rotating Savings and Credit Associations (ROSCAs), tontines, chit funds, burial societies and borrow from friends, family members, and informal private lenders (Demirgüç-Kunt and Klapper 2014). Within Africa itself, there are wide variations; number of individuals who own bank account vary from 42% in Southern Africa to 7% in Central Africa (Figure 3).

Within the region, some countries have fared badly; for example, in the Democratic Republic of Congo and Central African Republic, more than 95% of adults are "unbanked" *i.e.,* do not have an account at a formal financial institution (Demirgüç-Kunt and Klapper 2012).

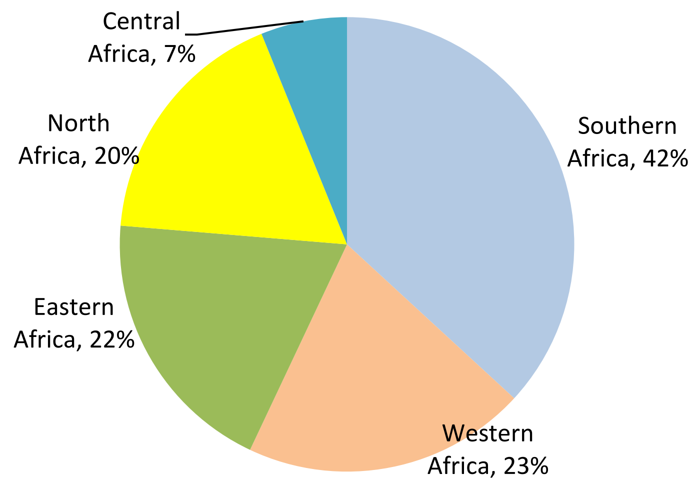
Figure 2. Account Penetration (% Adults)




Source: Source: Demirgüç-Kunt and Klapper (2012)

In North Africa, account ownership at a formal financial institution ranged from 39% in Morocco to 10% in Arab Republic of Egypt. Similarly, firms in African countries, compared to other developing economies, lack proper access to bank credit regardless of their size group (Demirgüç-Kunt and Klapper 2014) although the financing constraint is more acute for SMEs.

Figure 3. Account Penetration in Africa (% Adults)




Source: Source: Demirgüç-Kunt and Klapper (2012)

In recent years, technological advances such as mobile money and innovation are helping to improve access to financial services. How much this is changing lives remains a debated question. Similar advances include the creation of new delivery channels such as "mobile branches" or banking services through third-party agents e.g. supermarkets. Even then, the picture is still gloomy as only 14% of adults interviewed in 2012 reported having used mobile money in the past 12 months (Demirgüç-Kunt and Klapper 2014).

Lack of enough revenue to use is the most cited reason for not having a formal account in Africa (by 80% of adults without formal accounts surveyed) (Demirgüç-Kunt and Klapper 2012). Cost, distance, and documentation are among the other reasons cited for not having an account in formal financial institutions (cited by more than 25% of non-account-holders in Africa). Cost is the second most frequently cited reason in East Africa at 46% and distance is the third. Documentation is also a very important barrier to formal account ownership with 36% of adults in East and West Africa giving this as a reason. High costs of maintaining accounts (bank management fees/charges) seem to be hindering account ownership in Eastern and Southern Africa. Demirgüç-Kunt and Klapper (2014) find that maintaining a checking account in Uganda costs the equivalent of 25% of GDP per capita annually.

The use of bank account

Global Findex indicators show that the majority of adults with a formal account in Africa make deposits or withdrawals only once to twice a month (Demirgüç-Kunt and Klapper

2012). About 40 percent of adults in North Africa would a month without depositing into their accounts and 29% would take a whole month without withdrawing any money from their accounts. The indicators single out ATMs as the main mode of withdrawal for the majority of account holders in East and Southern Africa (even when we exclude South Africa). Only 14% of adults (and 63% of account holders) in Africa have a debit card. Up to 41 percent of account holders and 10 percent of adults in Africa use their account to receive remittances (with the highest remittances reported in Southern Africa). This far exceeds the global average of 14% of account holders (and 7% of adults) who use their account to receive remittances. Demirgüç-Kunt and Klapper (2012) find the use of accounts to receive money from family members living elsewhere to be particularly common in fragile states such as Somalia where 66 percent of account holders report using their account to receive remittances, in Zimbabwe with 55 percent, and Sierra Leone with 45 percent.

Demirgüç-Kunt and Klapper (2012) and World Bank (2012) also find evidence, which suggests existence of a weak linkage between financial service usage and financial depth (measured by credit to the private sector as a share of GDP). This weak relationship raises questions regarding the drivers of cross-country differences in financial use and access. This ambiguity also suggests that while there might be room for policy reforms to increase the level of financial inclusion in Africa (World Bank, 2008), it would require policymakers to go beyond financial deepening, for solutions that build inclusive financial systems. What we know is that access to finance do not necessarily depend on financial deepening, implying that financial systems can become deep without delivering access to the majority.

## 2.3 Mobile money

The rapid spread of mobile phones a growing number of Africans using mobile money as alternative to traditional banking. In Sub-Saharan Africa, 16 percent of adults interviewed in 2011 (Demirgüç-Kunt and Klapper, 2012) report having used a mobile phone in the past 12 months to pay bills, send or receive money. In Kenya (—where the M-Pesa is a popular mobile money service since it was first launched in 2007), 68% of adults in the survey report using mobile money. On a similar scale, more than half of adults in Sudan used mobile money. Mobile money users are likely to be those excluded from formal

financial services. For example, 43% of adults in Kenya and 92% in Sudan who report having used mobile money in the past 12 months do not have a formal account.

Slightly more than 35% of adults in East Africa report using mobile money. Apart from Algeria where 44% of adults report having used a mobile phone to pay bills or send/receive money), North Africa lags behind other regions in use of mobile money (only 3% of adults used mobile money) perhaps due to regulatory constraints imposed on the mobile money operators and banks (Demirgüç-Kunt and Klapper, 2014). With limited interaction between mobile users and formal financial system, integration of the financial system and progress in achieving financial depth remains slow.

### 2.4 Savings

The 2012 Global Findex data show that 50% of adults in West Africa and 16% in North Africa have ever saved money although it still provides no clue how much money they saved or how many times they saved. Thirteen percent (13%) of adults in Africa (and 35% of savers) report having saved at a formal financial institution in the past year. A wide variation exist across countries, with more than 16% of adults (and 50% of savers) in Southern Africa and 35% in West Africa report having saved at a financial institution, while only 4% of adults (and 27% of savers) report having formally saved in North Africa.

The Global Findex survey puts Nigeria, South Africa and Kenya as having the largest formal savings practices among the countries surveyed. Close to 100 million adults in Sub-Saharan Africa saved with informal financial institutions such as ROSCAs. About 30% of adults (and 59% of savers) in West Africa saved informal financial institutions. In general, people tend to use both formal and informal financial systems although a large share of the respondents uses *only* informal system. More than 30% of those who save in Sub-Saharan Africa report having only saved with informal system in the past 12 months. Forty six percent (46%) of the respondents in West Africa and 37% in Central Africa saved in informal financial institutions. Surprisingly, more than 50% of all respondents in North Africa and about 50% in Central Africa who indicated to have saved some money used neither the formal nor informal financial system such ROSCAs , or a person outside the family. While the Global Findex survey provides no information on these alternative

savings methods, they might include traditional systems such as livestock or other forms of assets and saving in the houses (in a box or under the mattress).

Access to credit and insurance

The Global Findex survey put the number of adults (in Africa) reporting to having borrowed money in the past 12 months at 44%, which is 10 percentage point higher than global average (34%). In East Africa, 58% of adults report having borrowed money either from formal or informal financial institutions, compared to North Africa with only 34%. About 40 percent of adults in Africa report having borrowed money from friends or family in the past 12 months. For 28% of the individuals, this was their only source of credit. Credit from families or friends was the most popular source in all sub-regions. Only 3% of adults in Central and West Africa had access to formal credit in the past one year. South Africa had the highest access rate to formal credit with 8% of adults reporting to have borrowed formal financial institutions. Credit from a private informal lender featured highly in Central and East Africa (7%). Regarding access to electronic cards, only 3% of adults in Africa report having a credit card; with the majority (7%) being in Southern Africa. Family and friends remained the most common source of credit in all sub-regions. Despite the low usage of formal financial services, the 96 per cent of Africans who cannot access formal financial services do use other forms of financial services. These range from very simple systems such as keeping savings under the roof or in pockets on the body, saving money with an individual in the community, rotational savings and credit associations, to using microfinance institutions.

Table 2.1 Usage of financial services in 34 African countries (percent of the population age 15 and above in 2014 )

| | Accounts at Financial Institution | | Borrowed Money in the Past Year | | Borrowed from financial institution | | Holding Mobile Account | | Saved Money in the past year | | Saved at Financial Institution | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Country | Rural | Country | Rural | Country | Rural | Country | Rural | Country | Rural | Country | Rural |
| Angola | 29.32 | 18.75 | 29.84 | 29.11 | 2.82 | 1.59 | -- | -- | 53.06 | 47.54 | 14.86 | 8.24 |
| Benin | 15.98 | 12 | 39.59 | 38.71 | 7.65 | 5.84 | 2.02 | 1.33 | 61.1 | 60.48 | 7.14 | 5.78 |
| Botswana | 49.24 | 49.57 | 69 | 69.3 | 13.03 | 12.67 | 20.75 | 21.43 | 58.17 | 56.14 | 26.61 | 27.15 |
| Burkina Faso | 13.42 | 12.02 | 46.37 | 47.02 | 5.03 | 5.26 | 3.08 | 3.11 | 50.82 | 52.06 | 8.66 | 7.51 |
| Burundi | 6.94 | 6.32 | 60.34 | 60.89 | 1.51 | 1.49 | 0.75 | 0.71 | 34.9 | 35.03 | 4 | 3.8 |
| Cameroon | 11.35 | 11.47 | 56.65 | 55.09 | 1.95 | 2.34 | 1.8 | 1.51 | 63.96 | 57.9 | 7.72 | 7.81 |
| Chad | 7.7 | 7.77 | 41.02 | 41.78 | 2.36 | 2.46 | 5.75 | 5.39 | 48.58 | 50.01 | 4.63 | 4.15 |
| DRC | 10.91 | 7.53 | 56.86 | 60.54 | 2.4 | 1.8 | 9.21 | 9.18 | 65.2 | 68.77 | 4.72 | 2.03 |
| Congo Rep | 16.68 | 11.76 | 41.61 | 41.62 | 4.39 | 1.84 | 1.99 | 1.3 | 55.9 | 58.13 | 9.79 | 8.45 |
| Cote D' Ivoire | 15.14 | 10.3 | 48.42 | 48.17 | 2.26 | 1.82 | 24.26 | 25.98 | 63.23 | 65.38 | 8.85 | 5.34 |
| Ethiopia | 21.79 | 18.65 | 43.52 | 44.59 | 7.36 | 7.63 | 0.03 | 0.03 | 48.11 | 47.7 | 13.63 | 12.9 |
| Gabon | 30.15 | 24.15 | 37.83 | 36.87 | 4.33 | 4.02 | 6.65 | 3.93 | 56.01 | 52.92 | 18.01 | 13.49 |
| Ghana | 34.62 | 29.95 | 36.43 | 34.38 | 8.1 | 6.17 | 13.01 | 10.26 | 55.32 | 53.64 | 18.59 | 13.43 |
| Guinea | 6.17 | 4.05 | 52.17 | 54.87 | 1.96 | 1.58 | 1.47 | 1.29 | 45.19 | 45.39 | 2.87 | 1.76 |
| Kenya | 55.21 | 53.06 | 79.19 | 78.54 | 14.92 | 15.64 | 58.39 | 56.33 | 76.06 | 75.09 | 30.18 | 27.7 |
| Madagascar | 5.73 | 2.82 | 57.33 | 59.08 | 2 | 1.25 | 4.36 | 2.96 | 39.67 | 37.54 | 3.26 | 1.59 |
| Malawi | 16.14 | 14.34 | 66.31 | 65.7 | 6.03 | 5.77 | 3.84 | 3.14 | 59.71 | 57.5 | 7.05 | 6.12 |
| Mali | 13.25 | 11.21 | 41.46 | 42.98 | 2.74 | 2.64 | 11.64 | 12.45 | 44.9 | 46.16 | 2.89 | 1.79 |
| Mauritania | 20.45 | 16.72 | 46.61 | 48.65 | 7.68 | 6.39 | 6.48 | 6.68 | 41.2 | 40.52 | 10.57 | 8.77 |
| Mauritius | 82.21 | 80.68 | 28.77 | 30.69 | 17.06 | 17.46 | 0.86 | 0.98 | 54.16 | 48.36 | 35.53 | 30.02 |
| Namibia | 58.06 | 53.31 | 45.98 | 44.79 | 6.86 | 5.66 | 10.36 | 6.09 | 56.94 | 53.64 | 26.69 | 23.38 |
| Niger | 3.49 | 3.46 | 70.73 | 77.98 | 1.37 | 1.13 | 3.85 | 4.16 | 61.02 | 57.02 | 1.98 | 1.7 |
| Nigeria | 44.17 | 38.93 | 44.82 | 39.63 | 5.29 | 4 | 2.29 | 1.78 | 68.98 | 69.92 | 27.07 | 25.55 |
| Rwanda | 38.14 | 34.29 | 51.26 | 47.92 | 8.18 | 7.14 | 18.1 | 15.78 | 55.18 | 53.87 | 25.53 | 22.02 |
| Senegal | 11.92 | 6.98 | 56.6 | 59.46 | 3.52 | 2.43 | 6.19 | 3.34 | 59.05 | 59.25 | 6.57 | 3.54 |
| Sierra Leone | 14.15 | 9.93 | 57.51 | 61.82 | 4.01 | 3.91 | 4.45 | 4.64 | 65.4 | 65.9 | 10.94 | 6.31 |

Table 2.1 contd.

| | Accounts at Financial Institution | | Borrowed Money in the Past Year | | Borrowed from financial institution | | Holding Mobile Account | | Saved Money in the past year | | Saved at Financial Institution | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Country | Rural | Country | Rural | Country | Rural | Country | Rural | Country | Rural | Country | Rural |
| Somalia | 7.86 | 4.39 | 56.98 | 60.05 | 2.05 | 1.42 | 37.07 | 30.55 | 37.2 | 33.98 | 2.82 | 0.91 |
| South Africa | 68.77 | 68.59 | 85.58 | 84.95 | 12.09 | 10.46 | 14.43 | 13.5 | 66.36 | 63.83 | 32.73 | 30.19 |
| Sudan | 15.27 | 13.13 | 45.5 | 43.76 | 4.19 | 4.09 | - | - | 41.26 | 37.35 | 7.47 | 5.95 |
| Tanzania | 19.04 | 14.36 | 55.58 | 55.08 | 6.5 | 6.47 | 32.36 | 27.98 | 59.24 | 58.3 | 9 | 6.81 |
| Togo | 17.61 | 13.81 | 28.58 | 28.84 | 3.67 | 3.43 | 1.14 | 1.3 | 37.55 | 34.45 | 6.67 | 5.28 |
| Uganda | 27.78 | 28.7 | 78.97 | 80.65 | 15.7 | 16.11 | 35.1 | 35.51 | 75.18 | 74.91 | 16.78 | 17.29 |
| Zambia | 31.29 | 30.85 | 67.99 | 67.87 | 4.82 | 4.06 | 12.11 | 11.23 | 70.12 | 72.49 | 16.84 | 15.82 |
| Zimbabwe | 17.19 | 13.19 | 62.4 | 61.69 | 4.04 | 3.22 | 21.6 | 18.1 | 51.97 | 48.05 | 5.19 | 3.38 |
| Sub Saharan Africa | 28.9 | 23.58 | 54.49 | 54.16 | 6.29 | 5.98 | 11.51 | 11.46 | 59.56 | 57.77 | 15.9 | 12.96 |
| East Asia & Pacific | 68.76 | 64.27 | 41.21 | 42.74 | 10.98 | 9.58 | 0.4 | 0.36 | 70.96 | 67.44 | 36.49 | 32.72 |
| Latin Am & Caribb | 51.14 | 45.74 | 32.74 | 31.08 | 11.31 | 10.71 | 1.72 | 0.99 | 40.58 | 38.72 | 13.46 | 11.82 |
| Middle East | 13.97 | 10.67 | 45.73 | 46.27 | 5.62 | 5.01 | 0.68 | 0.44 | 30.45 | 26.08 | 3.99 | 2.41 |
| South Asia | 45.49 | 42.76 | 46.66 | 50.48 | 6.39 | 6.84 | 2.65 | 1.6 | 36.25 | 32.95 | 12.67 | 11.19 |
| World | 60.7 | 55.77 | 42.37 | 44.38 | 10.69 | 9.62 | 2.02 | 1.94 | 56.45 | 53.48 | 27.38 | 24.22 |

Source: Otchere (2016) based on data from Demirgüç-Kunt and Klapper (2012)

# 3 Financial systems in Uganda

## 3.1 Supply of financial services

The development of inclusive financial systems where different types of financial institutions can tailor their services to the needs of poor clients is reflected in the tiered approach to the regulation of microfinance that was adopted in the policy statement of the Bank of Uganda in July 1999 (BoU, 1999). The policy statement classifies institutions that provide microfinance services into four categories or tiers, namely:

- Tier I: Commercial banks with a fully fledged banking license. A few commercial banks are engaged in microfinance, notably Centenary Rural Development Bank Ltd (CERUDEB);
- Tier II: Credit institutions. There is only one institution under this category i.e. Commercial Microfinance Ltd (CMFL) that is currently involved in microfinance services;
- Tier III: Microfinance deposit-taking institutions (MDIs);
- Tier IV: All other – MFIs, including NGOs, savings and credit cooperatives (SACCOs), financial services associations (FSAs) and other community-based organisations whose core activity is to provide financial services to their members.

While Tier I and II classified institutions are regulated under the Financial Institutions Act (FIA), 2004; Tier III institutions are regulated under the Micro Deposit Taking Institution Act 2003. Institutions under Tiers I, II and III (formal financial sector) are supervised by the Bank of Uganda (BoU) (see Figure 1). However, the institutions under Tier IV (informal financial sector) are neither regulated by law nor supervised by the BoU.

Uganda's financial services industry remains dominated by the banking sector. In March 2007, Uganda's banking sector consisted of 15 commercial banks, 12 of which are foreign-owned. In 2005, foreign-owned banks together held 84% of total assets, with the

two biggest banks, Stanbic Bank and Standard Chartered, holding a market share of about 52% and 55%, of total assets and total deposits respectively (www.bou.or.ug).In contrast to commercial banks, credit institutions can take deposits and give loans but are restrained from FOREX operations. The credit institutions operate almost exclusively in Kampala, with the exception of PostBank Uganda Ltd (PBU), which offers savings and credit services up-country and has 21 branches.[3] Commercial Micro-finance Ltd provides microfinance services through six branches focusing on urban areas. The Microfinance Deposit-Taking Institution Act of 2003 allows MDIs to mobilise (and lend out) deposits – under the supervision of the BoU. The MDI Act incorporates most key principles of modern banking supervision, while taking into account the specific and unique features of MFIs. So far, four Ugandan MFIs have been licensed as MDIs.

## 3.2 Financial outreach and exclusion

Despite the large number of microfinance providers and the introduction of the MDI Act, most low income households especially in rural areas do not have access to sustainable financial services. Sustainable providers of microfinance services such as MDIs still have a limited outreach to clients at the village level where most Ugandans live. It is estimated that in Uganda only 2.4% of the population estimated to be living below the poverty line access microfinance services which is low relative to other countries. Moreover, on the lending side all regulated providers of financial services including MDIs tend to concentrate on financing non-farm economic activities although farming is the main source of income for most Ugandan households.

Against this background it is understandable that microfinance started to play an important role on the policy agenda in 2001 when the President acknowledged the role that microfinance can play in alleviating poverty, and accordingly put some effort in pressing the private microfinance industry to augment its outreach which led to the creation of the Microfinance Outreach Plan (MOP) as an instrument to control damage by preventing the government from directly intervening in the microfinance sector.

[3] Until November 2005 when BoU granted a license for lending operations, PBU was a savings-only institution.

As described above, in 2006 the concept “bonna bagaggawale” was introduced by the President, where the Ugandan government is planning to increase poor people’s access to rural financial services through channeling financial and technical support to SACCOs through the state-owned PostBank Uganda (PBU).

Overall, there are about 219 formal service outlets in the country, comprising all the branches of commercial banks, credit institutions and MDIs combined. With 75 districts in the country, there are, on average, two formal finance outlets per district serving a population of about a half million people.

Aggregate data on microfinance are scanty and unreliable. However, recent studies indicate that very small percentage of the Ugandan population (0.9 per cent) is utilising microfinance services. This ratio represents only 2.4 per cent of the population estimated to be living below the poverty line (Ayoki, 2006).

**Table 3.1. MFI outreach: Top countries (credit clients as a percentage of population)**

| Country | % | Country | % |
|---|---|---|---|
| Bangladesh | 13.1 | Senegal | 1.6 |
| Indonesia | 6.7 | Nepal | 1.5 |
| Thailand | 6.5 | Mali | 1.5 |
| Sri Lanka | 4.3 | Niger | 1.4 |
| Vietnam | 4.3 | Honduras | 1.2 |
| Cambodia | 3.0 | El Salvador | 1.2 |
| Malawi | 2.6 | Nicaragua | 1.1 |
| Togo | 2.4 | India | 1.1 |
| Gambia, The | 1.7 | Bolivia | 1.1 |
| Benin | 1.7 | Ethiopia | 0.9 |

Source: Based on Daley-Harris, 2003.

The current trend is reflected in the heavy concentration of MFIs in and around Kampala and a few major towns with limited geographical outreach – what some people refer to as the 'Kampala–Mbarara microfinance highway'. High operational costs experienced by MFIs and the influence of high treasury bill interest rates have made these MFIs maintain high interest rates on loans, ranging from 22–48 per cent per annum and 2–5 per cent per month.

Uganda’s financial system is still very shallow. The government has a target to increase in financial depth (measured by M3/GDP) from the current level of about 20 per

cent to 29 per cent of GDP by 2013/14. The volume of private sector credit is low compared to neighbouring countries (see Table 3.2). Agricultural finance is almost non-existent, and rural outreach of financial services is weak. Only a small proportion of the population has access to formal financial services.

**Table 3.2. Financial intermediation across countries, 2003 (%)**

| | Private Credit/GDP | Bank Deposits/GDP | Loan/Deposit Ratio | Overhead Costs |
|---|---|---|---|---|
| Uganda | 7.0 | 19.6 | 42.1 | 7.9 |
| Tanzania | 6.8 | 22.2 | 40.9 | 7.0 |
| Kenya | 22.6 | 42.9 | 60.1 | 6.1 |
| Sub-Saharan Africa | 19.1 | 31.3 | 74.2 | 6.1 |
| Low-income countries | 15.0 | 30.7 | 70.0 | 5.9 |

Source: Terberger, 2006.

The majority of the poor has no savings accounts, does not have access to loans from formal financial institutions and has no insurance policies. Instead, many rely on informal services – ranging from the most traditional (saving in boxes at home) to a cooperative system (see Table 3.2).

## SACCOs

For over 20 years, the cooperative movement in Uganda has been neglected by government and donor agencies because of mismanagement and political influence. It is only recently that the government has created a high-level task force (chaired by the deputy speaker of parliament) for the revival of cooperatives, particularly SACCOs. Even then, the government strategy is too focused on increasing the number of SACCOs without sufficiently taking into account the demand side and the capacity of these institutions.

**NGO-type MFIs**

The majority of these institutions are registered both as NGOs and as companies limited by guarantee. Most NGOs receive considerable support from donors and serve clients with fairly short-term loans with group guarantees and frequent payment schedules. The interest rates and fees charged for small loans can total the equivalent of a 36–80 per cent

nominal annual effective interest rate, which in part is needed to cover high operating expenses. The number of Tier IV MFIs other than SACCOs is not exactly known, as neither the NGO Board nor the Registrar of Companies keeps separate records of institutions offering financial services to the poor.

**Table 3.3. Financial sector intermediation and financial exclusion in Uganda**

| | ← Informal financial sector → | | | | |
|---|---|---|---|---|---|
| Segment | Primary sector (unregulated) | Informal sector (unregulated) | | Semi-formal sector (self- regulated) | Formal sector (regulated) |
| Financial activity/intermediaries | Use of traditional system (no use of institutions)<br>Keeping money on the body<br>In holes/boxes<br>Under mattress<br>Livestock<br>Friends & family | Use of indigenous system<br>Moneylenders*<br>Money keepers*<br>Money guards* | Use of community institutions<br>Groups: ROSCAs**, non-ROSCAs** | Use of legally recognised institutions<br>SACCOs**, non-deposit- taking MFIs**<br>(1200+ MFI outlets) | Use of formal system<br>Commercial Banks: local & global = 15<br>Credit institutions (7), MDIs (4) |
| Types of financial exclusion faced by people in the sector | Type 3 Financial exclusion **(no bank or MDI)**<br>No Access to formal sector/ semi-formal sector | Type 2 Financial exclusion **(un-banked)**<br>No access to Formal finance Non-indigenous finance | Type 1 Financial exclusion **(under-banked)**<br>No access to<br>• Formal sector | | |

Note: **provides both savings and credit services (and insurance services in most cases); * most provide either savings or credit services. SACCOs are governed by cooperative society by-laws.

Well-performing NGOs have a chance to access bank loans. These wholesale relationships permit banks to utilise their comparative advantage in mobilising savings, whereas the NGOs utilise their comparative advantage of making small loans with non-traditional collateral. Unfortunately, most of these institutions are assumed to be quite weak, only about a dozen is recognised as having potential to become important players in the financial market and eventually transform to microdeposit-taking institutions in the future.

### Moneylenders and money keepers

Moneylenders are quite different from the other Tier IV institutions as they are not incorporated, but mainly individuals lending money from their own sources and on their own account. Moneylenders can be found at all social levels, from the remote rural village to the parliament's floor. Legally, they operate under the Moneylenders Act 1952,

but since there is no central registry for moneylenders, the exact size of the sector is unknown.

To reduce the risk of theft, or to be able to deny claims from family members, relatives and friends, many people use (business) people, whom they trust to keep money for them. In most cases, there is no documentation – no receipt or signature as proof of deposits. The deposits earn no interest and can be withdrawn at short notice. The money keepers maintain enough liquidity to service the claims of their depositors, but they may use the funds to finance their own business transactions or for lending.

### CBOs[4]

There are other CBOs engaged in the microfinance business, which are or are not registered at district level. Exact numbers are hard to know, but it is estimated that there are more than 10,000 of these organisations are scattered across the country. There are different forms of organisations such as community-based village banks, FSAs,[5] and savings and loan associations (SLAs).[6] Some of these organisations are savings-based self-help groups but often they are created with the expectation of receiving external assistance.

### Informal self-help groups/associations

Informal groups ('self-help' as they are sometimes called) are mechanisms to cope with daily problems in the community. ROSCAs and accumulating savings and credit association (ASCAs or non-ROSCAs) are good examples. They have been in existence for centuries. Prior to the monetisation of the rural economy, workplace and social associations dominated. Today, ROSCAs and ASCAs frequently offer assistance in savings and credit services. Some groups perform additional functions, such as the provision of basic health and accident insurance and emergency aid through mutual aid mechanisms.

---

[4] Sometimes these are called SIDAs (sub-county integrated development associations).

[5] FSAs are small locally managed MFIs that provide savings and loan services to their shareholders. The model was developed by Ahmad Jazayeri in Uganda and Tanzania as a means to provide financial services to low-income people. In 2003, FSAs in Southern Uganda had around 13,000 members.

[6] CARE has created around 600 SLAs, with around 13,000 members in the Western Nile region.

### Traditional systems

Traditional systems include saving money in wooden or metallic boxes at home, or in a belt made of cloth material tied around the waist (called *ekitamba* in Luganda, *omweko-omushumi* in Lukiga and *alid* in Luo – used especially by elderly women), or keeping money under the mattress, among other methods. This system also comprises holding financial savings in form of livestock and poultry.

## 3.3 Informal financial system in Uganda: Dataset

Section 4 is a product of a wide consultation and survey that took place from May to September 2007. Based on survey data from 5 districts of Uganda: Kampala, Kumi, Lira, Mbarara and Wakiso, the section explores the opportunities and challenges relating to the provision of and access to finance, for the majority of people who operate in the informal economy in Uganda. The 5 districts represent the four major geographical regions: Kumi represents eastern region; Lira represents northern region; Mbarara represents western region; and Wakiso with the capital, Kampala represents central region.

Regional disparities are high with a concentration of poverty in the northern parts of the country and the rural areas. Northern Uganda is still affected by armed conflict with the Lord Resistance Army. Millions of people in the war-ravaged parts of the country still live in camps and cannot return to their home villages and hence they cannot pursue their economic activities or cultivate their land. Though relative peace has been observed over the last year, the current peace talks between government and the rebel group have so far not indicated that the conflict will necessarily come to an end in the near future.

When economic activities are considered, the central region accounts for most of the businesses and employment in the country, and the northern the least. Kampala district alone controls more than 30 per cent of all businesses and formal finance services outlets in the country. Most of the formal businesses are concentrated in major towns (Kampala accounted for 45 per cent of total formal businesses in 2002).

A total of 317 individuals who use the services of informal financial providers were randomly selected and interviewed in the five districts (see Table 3.4). We also interviewed 89 informal financial services providers identified by the respondents (see Table 3.5).

In addition to formal interviews using questionnaires, key informant interviews and focus group discussions were conducted to provide additional insights into complex issues around savings and credit activities in different localities.

**Table 3.4. Sample distribution of respondents by district**

| District | No. of individuals | | | No. of informal financial providers | | |
|---|---|---|---|---|---|---|
| | *Urban* | *Rural* | *Total* | *Urban* | *Rural* | *Total* |
| Kumi | 32 | 35 | 67 | 14 | 14 | **28** |
| Mbarara | 33 | 33 | 66 | 14 | 11 | **25** |
| Lira | 33 | 33 | 66 | 12 | 11 | **23** |
| Kampala | 56 | - | 56 | 2 | - | **2** |
| Wakiso | 31 | 31 | 62 | 2 | 2 | **4** |
| **TOTAL** | **185** | **132** | **317** | **44** | **38** | **120** |

The 89 informal financial services providers interviewed include MFIs, ROSCAs, SACCOs private moneylenders. ASCAs, money keepers (shopkeepers) and community self-help groups. The individual questionnaires provided the necessary lead as to the type of institutions that existed in the area, and therefore those that could be interviewed.

# 4 Demand for and access to financial services

## 4.1 Demand for financial services

No systematic assessment of the demand side of the financial market, particularly in micro finance sector has yet been carried out. Bank of Uganda (BoU) is thinking of commissioning some work in this area, which will also consider the impact of credit on agricultural production.

The only reliable source of data on demand for financial services by households and enterprises are the national household surveys. Unfortunately, these surveys do not provide time series data, they tend to be too much aggregated and most current data is not always available. The last published survey in the series is 2003 and thus does not capture information on the recently formalized microfinance institutions that very not established before 2004. Most recently, the South African based FINMARK Trust commissioned by the DFID

(Department for International Development)/FSDU (Financial Sector Deepening in Uganda) Project carried out a FINSCOPE survey on the demand side. However, by the time of that report only preliminary data that to some extent have been included in the report were available.

### 4.1.1 Sources of income

Table 4.5 shows that even in livestock-dominated areas, crop enterprises constitute the most important source of earnings for over 50 per cent of the respondents in all areas except in Kumi where most of the people earn mainly from livestock. Very few people indicated wage employment as an important source of earning: 13 per cent in Mbarara, 5 per cent in Kumi, 4 per cent in Lira and 1 per cent in Wakiso, which suggests that most of the people are self-employed. Organisational support and transfer earnings are lacking in all the areas, but non-agriculture enterprises all play very small role. This underdeveloped small and medium enterprises (SMEs) sector is potentially an important niche that banks hoping to expand their outreach could target.

**Table 4.5. Most important sources of income**

| | Subsistence crop farming | Subsistence livestock farming | Commercial crop farming | Commercial livestock production | Wage employment | Non-agriculture enterprise | Property income | Transfers | Organisational support | Other |
|---|---|---|---|---|---|---|---|---|---|---|
| Kampala | 2 | 1 | 52 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Kumi | 19 | 51 | 28 | 0 | 5 | 1 | 5 | 0 | 0 | 15 |
| Mbarara | 12 | 16 | 36 | 2 | 13 | 1 | 4 | 0 | 1 | 12 |
| Lira | 16 | 31 | 44 | 4 | 4 | 0 | 3 | 0 | 0 | 17 |
| Wakiso | 1 | 2 | 58 | 0 | 1 | 0 | 1 | 1 | 0 | 1 |

The small size of the non-farm SME sector has been reported in early studies, notably the 2003 Household Survey conducted by the Uganda Bureau of Statistics, which indicates that in 2002/03 only 35.7 per cent of households operated a non-crop enterprise (see Table 4.6). The majority of these enterprises are very small-scale, and only about 15 per cent of households with non-agricultural enterprises employ any labor (GoU, 2004).

**Table 4.6. Number of households operating enterprises**

| Residence | Estimated households (thousands) | | Households with non-crop enterprises | | Proportion | |
|---|---|---|---|---|---|---|
| | 1993/94 | 2002/03 | 1993/94 | 2002/03 | 1993/94 | 2002/03 |
| Rural | 3,208 | 4,095 | 1,152 | 1,596 | 35.9 | 39.0 |
| Urban | 563 | 844 | 90 | 167 | 15.9 | 19.8 |
| **Total** | **3,771** | **4,938** | **1,241** | **1,763** | **32.9** | **35.7** |

Source: Uganda Bureau of Statistics, 2003.

Concerning savings, over 20 per cent of the people interviewed in Kampala had an account with an MFI, 14 per cent in commercial banks and 16 per cent saved at home. Saving at home is the most widely used system: used by 43 per cent of respondents in Lira, 16 per cent in Kampala, 38 per cent Wakiso and 20 per cent in Kumi. Both Lira and Kumi are agro-based societies, poorly served with bank microfinance networks when compared to Kampala and Wakiso.

Table 4.7 shows the proportion of people in the surveyed districts who saved with different informal finance service providers. Use of certain service providers is dominant in certain areas/regions of the country, while others are common across regions and in rural and urban areas. ROSCAs are the second most widely used system after commercial banks, especially in relatively poor areas where infrastructure is poor. Lira and Kumi are leading in use of ROSCAs and also happen to be the districts where use of friends and relatives as money keepers is most common.

**Table 4.7. Number of individuals who saved with different informal service providers**

| | Kampala | Kumi | | Mbarara | | Lira | | Wakiso | |
|---|---|---|---|---|---|---|---|---|---|
| | Urban | Urban | Rural | Urban | Rural | Urban | Rural | Urban | Rural |
| Moneyender ROSCAs | 0 | 3 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| Friends and relatives | 1 | 10 | 10 | 3 | 4 | 5 | 6 | 2 | 0 |
| NGO/MFI | 24 | 1 | 3 | 6 | 5 | 2 | 7 | 6 | 9 |
| Commercial bank | 14 | 14 | 10 | 20 | 8 | 9 | 13 | 4 | 5 |

People evaluate different forms of savings in terms of how easy they will be able to access their savings whenever they need them. They may also be attracted by interest paid on deposits and other additional services a provider willing to offer, as well as safety (security) of their deposits. Easy access to fund appears as the most important advantage for saving money at home (see Table 4.9).

Despite a variety of risks such as theft and fire, many people still entrust others with their cash to keep (money keepers). Formal financial institutions are out of reach of most people or the services are not relevant to their needs. About 40 per cent of the respondents reported that one of the biggest disadvantages in using commercial banks is high service charges by banks. High charges also emerged as the greatest disadvantage of saving with MFIs (see Table 4.8). This has implications for any product planned especially for the poor. Bank charges or cost of saving must be kept low enough to convince individuals to save with formal financial institutions.

The advantage of keeping money at home was revealed to include easy access to funds, although most people acknowledged that it is the most insecure way of keeping savings and is prone to wasteful spending or risks such as theft (see Box 1).

**Table 4.8. Advantages and disadvantages of different forms of savings mechanisms**

| Savings | Advantages | | | | Disadvantages | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Easy to access | Pays good interest | Provides other services | Security | Security | SNR | EAT | F&T | LPG | HC |
| At home | *133* | *0* | *4* | *8* | *49* | *1* | *32* | *28* | *3* | *3* |
| Friends, relatives and neighbours | 4 | 1 | 1 | 0 | 1 | 1 | | | 3 | 1 |
| Commercial bank | 59 | 12 | 15 | 10 | 5 | 1 | 6 | 1 | 7 | 39 |
| MFI | 38 | 5 | 11 | 7 | 2 | 1 | 9 | 0 | 5 | 17 |
| Shopkeeper | 3 | 0 | 0 | 0 | 2 | 0 | 0 | 1 | 0 | 0 |
| Money keeper/guard | 2 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| ROSCA | 34 | 7 | 5 | 6 | 9 | 3 | | 15 | 6 | 1 |
| Private moneylenders | 2 | 2 | 0 | 0 | 0 | 1 | 0 | 2 | 0 | 0 |
| SACCO | 24 | 4 | 6 | 8 | 5 | 5 | 0 | 2 | 1 | 3 |
| Post office | 2 | 1 | 0 | 0 | | | 1 | | | 1 |
| Burial society | 1 | 0 | 0 | 0 | | | | | | |
| Building society | 3 | 0 | 0 | 1 | | | | | | |

Note: SNR = sector not regulated, EAT = easy access triggers trivial spending, F&T = fire and theft, LPG = low probability of getting the money back, HC = high charges.

### Forms/modes of informal savings

Savings occur in monetary and non-monetary assets. Major reasons for maintaining financial savings included providing business capital, school fees, medical insurance (treatment), marriage expenses, and as a hedge against inflation (see Table 4.9).

**Box 11: A man loses all his savings from his hut**

On 9 May 2007, *New Vision* published a story of a 99-year-old man, Mr Antonio Guma of Adalafu village in Pajuru sub-country, Arua District (northern Uganda), who lost a treasure box containing over USh48 million (over GB£14,000). Thugs broke into this house Monday night that week (7 May 2007). The metallic box contained his savings and rent from a piece of land in Arua municipality's Oli Division, from which he earns USh10,000 (GB£3) daily.

The area is used as an open bar for selling local brews like '*kwete*', '*malwa*' and locally distilled spirits. It is popularly known as 'Club'. 'I had placed the box next to my bed', Guma said. Because of poor sight, he had made it a routine to feel for the box every night and place its keys into his pockets before he went to bed. He had saved an additional USh1.29 million (GB£391) that day, which he received after selling a mahogany tree on his plot. The night he lost the money, he felt the box three times before he fell asleep at around 9pm. He was woken up at around 3am by his wife who sleeps in the next house after she found that his door was open.

Guma, a former butcher, said he was planning to construct a commercial building and complete his house. One of his daughters, Teddy Gasi, said they had tried to get their father to bank his money in vain. She suspected that the robbery was an insider job and said the family was investigating the matter (*New Vision*, 9 May 2007).

Interestingly, many respondents cited education as the major reason for saving. This explains the plight of parents in the struggle to have their children educated. In Uganda, the government's contribution to the cost of schooling is limited because of budget constraints. Most of the costs, especially at secondary and tertiary education levels, are borne by parents. Even in primary education, standards in the government-supported schools have declined and parents prefer to take their children to private schools.

**Table 4.9. Reasons for holding/maintaining financial services**

| Reason | No. of respondents | Percentage of respondents |
|---|---|---|
| Provision for old age | 45 | 14.2 |
| To start business or invest | 141 | 44.5 |
| To earn interest | 42 | 13.2 |
| Saving for children | 118 | 37.2 |
| To receive payments | 19 | 6.0 |
| Funeral expenses | 28 | 8.8 |
| Marriage expenses | 18 | 5.7 |
| Sickness | 140 | 44.2 |
| Paying school fees | 181 | 57.1 |
| Hedge against inflation | 2 | 0.6 |
| Paying taxes | 8 | 2.5 |
| Others | 37 | 11.7 |

There are no education loan facilities in the country. Savings for this purpose are enormous and a very long term problem.

Table 4.10 indicates other forms of savings that people use. Holding financial savings (cash reserve) maintains flexibility in future use, but also incurs the risk of inflation and of demands from friends, relatives or community members. For these reasons, many prefer to hold their savings in the form of livestock, land, dry food (grain) or standing crops, for example, cassava, buildings and jewelry. In Uganda, inflation is a major problem. Often livestock is the preferred 'currency'. Missing or unattractive savings services are also part of the reasons why 'rich people' would rather hold their savings in form of livestock and land. These 'security assets' are easily convertible to cash when a family is in need. Other modes of savings highlighted included, dry food (16.9 per cent), land (24 per cent) and buildings (17.4 per cent).

**Table 4.10. Other forms of savings**

| Savings | No. of respondents | Percentage |
|---|---|---|
| Dry food | 41 | 16.9 |
| Live stock | 82 | 33.9 |
| Land | 58 | 24 |
| Buildings | 42 | 17.4 |
| Jewelry | 1 | 0.4 |
| Foreign currency | 0 | 0.0 |
| Other | 18 | 7.4 |

Source: Survey data, May 2007

Sometimes, people use their cash to buy grain, which they keep in a granary and sell piecemeal whenever they are in need of cash. Focus group discussions also revealed that some households maintain a garden of reserve crops such as cassava. For instance, in Lango region, northern Uganda, a cassava garden is referred to as a 'bank'.

Distance to the nearest bank, security of traveling with cash in congested cities and towns, lack of information about banking services (savings mobilisation, credit, information on opening bank accounts, etc.), difficulty in knowing staff in the banks, low interest on savings and other things were mentioned as major reasons for saving in traditional forms (livestock, land, as well as keeping money at home) or saving with local informal service providers. Focus group discussions also indicated that presence of banks

would encourage individuals to save as long as the procedures for opening and operating bank accounts were well explained and simplified, especially for the poor, most of whom are semi-literate.

## 4.2 Access to credit

Considering the number of borrowers by source, MFIs and ROSCAs are the most common credit providers both in rural and urban areas. Access to microfinance credit seems to be much higher in urban areas than rural, whereas ROSCAs are more widely used in rural areas, except in Lira District (see Table 4.11).

This is expected for Lira District because these are the areas where some communities have been living in internally displaced people camps, which are in many cases close to town. Incidentally, individuals in Kumi and Lira actively use all types of institutions.

**Table 4.11. Number of individuals who borrowed from informal service providers**

| | Kampala | Kumi | | Mbarara | | Lira | | Wakiso | |
|---|---|---|---|---|---|---|---|---|---|
| | Urban | Urban | Rural | Urban | Rural | Urban | Rural | Urban | Rural |
| MFIROSCAs | 19 | 10 | 13 | 3 | 4 | 3 | 9 | 9 | 6 |
| Moneylender | 0 | 5 | 4 | 2 | 0 | 4 | 1 | 1 | 2 |
| Commercial bank | 3 | 4 | 4 | 8 | 5 | 4 | 4 | 1 | 0 |
| Friends & relatives | 0 | 3 | 3 | 0 | 1 | 7 | 3 | 1 | 0 |

When the number of loan applications made in the 12 months prior to the survey is considered (see Table 4.12), most people tend to seek credit from MFIs (76 per cent), ROSCAs (44 per cent), formal banks (33 per cent), moneylenders (19 per cent), friends and relatives (18 per cent) and employers (1 per cent).

On average, each individual had made 14 loan requests or applications to MFIs within the previous years, which reinforced the client's desire to borrow especially from MFIs because they are the only source available (ther reason provided by 25 per cent of loan applicants). People also sought credit from ROSCAs because they were the only source available in the area (20 respondents) and because of the low cost of borrowing (they do not charge interest or charge very low rates on loans).

**Table 4.12. Reason for applying for a loan from a given source**

| | % | Only source available | Low interest | Flexible repayment terms | Known to management | Terms negotiable | Most important source | |
|---|---|---|---|---|---|---|---|---|
| Formal bank | 33 | 5 | 9 | 7 | 0 | 3 | 21 | 9 |
| Moneylenders | 19 | 5 | 2 | 1 | 4 | 3 | 21 | 2 |
| Landlord | 3 | 0 | 0 | 1 | 0 | 0 | | 1 |
| Employer | 1 | 1 | 0 | 0 | 0 | 0 | | 0 |
| Friends/relatives | 18 | 5 | 4 | 1 | 4 | 3 | | 1 |
| MFIs | 76 | 25 | 18 | 8 | 1 | 10 | | 14 |
| Trader/shopkeeper | 8 | 1 | 1 | 0 | 1 | 1 | | 2 |
| ROSCA | 44 | 20 | 10 | 6 | 2 | 4 | | 2 |
| Gov credit scheme | 1 | 0 | 0 | 0 | 1 | 0 | | 0 |
| Trade credit | 2 | 0 | 0 | 0 | 0 | 1 | | 0 |

Note: These were multiple responses, and percentages may not add up to 100.

Friends and relatives were also often approached because they could be the only source available or known to respondents, in addition to the low cost of borrowing from this source as most friends and relatives did not charge interest on their loans. MFI also take advantage of the gaps created by the commercial banking sector.

**Table 4.13. Intended purpose of loans applied for**

| | To acquire assets | | | To purchase farm inputs | | 0ff-farm | Consumption | | Services |
|---|---|---|---|---|---|---|---|---|---|
| | Land | A house/ to build | Livestock | Farm tools/ implements | e.g. seed, fertilizer Inputs/ capital | Consumer goods/ ceremonies | | Health | |
| Formal bank | 3 | 5 | 2 | 0 | 0 | 10 | 1 | 6 | 0 |
| Moneylender | 2 | 2 | 0 | 0 | 0 | 1 | 3 | 6 | 1 |
| Landlord | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 2 |
| Employer | | | | | | | | | |
| Friends/relatives | 0 | 1 | 0 | 1 | 2 | 1 | 0 | 2 | 3 |
| MFI | 1 | 4 | 1 | 0 | 1 | 17 | 6 | 11 | 1 |
| Trader/shopkeeper | 0 | 0 | 1 | 1 | 1 | 0 | 1 | 2 | 1 |
| ROSCA | 1 | 4 | 3 | 3 | 3 | 1 | 9 | 4 | 11 |
| Govt credit scheme | | | | | | | | | |

Source: Survey data, May 2007

We noted from Table 3.12 that many respondents borrow from particular institutions because they are the only sources available to them. This finding suggests that the poor distribution of the bank branch network could be one of the reasons why people resort to services from informal sector.

### Collateral required for loans

The results show that where physical collateral is required, land is the most common type of security that borrowers offer in order to secure a loan (9.6 per cent), followed by a house (8.4 per cent). Livestock (cattle) are not so common as a form of security to obtain a loan. However, amount of loan requests by clients determine what sort of collateral he/she will be required to produce (see Table 4.14). For example, the respondents (9.6 per cent) who used land to secure loans received average loans of USh875,000 (GB£250). This is substantial amount of money that has to be well secured. Those who borrowed USh200,000 (GB£57) or less did not need land to secure the loans (see Table 4.14) but had personal guarantors. Even where a house was used for security such loans normally exceeded USh600,000 (GB£171). About 12 per cent of the respondents acquired loans without security, mainly from friends and relatives.

**Table 4.14. Collateral/security used by clients to secure loans**

| | No. of clients that used this security (%) | Loan amount (USs) |
|---|---|---|
| None | 20(12%) | 547,000 |
| Land | 16(9.6%) | 875,000 |
| Livestock | 11(6.6%) | 379,000 |
| House | 14(8.4%) | 636,214 |
| Future harvest | 1(0.6%) | 0 |
| Vehicle | | |
| Group guarantee | 26(15.7%) | 0 |
| Personal guarantors | 27(16.3%) | 201,735 |
| Monthly salary | 49(29.5%) | |

Source: Survey data, May 2007

### Sources of dissatisfaction with informal sector services

There were three major areas of dissatisfaction with services from informal financial providers, as highlighted by respondents: the amount of loan granted (19 per cent) i.e. loan too small; type of security demanded by credit providers (for example, land) beyond the means of most people (11 per cent); long application procedures (2 per cent); and short repayment/gestation periods (7 per cent)]. The amount of credit that they consider to be reasonable is USh1.5 million (GB£428.6), with an average repayment period of five months.

**Table 15. Source of income and access to financial services**

| Main source of income | By access to Financial services | | | | | | |
|---|---|---|---|---|---|---|---|
| | Frequency | Percentage | ROSCA | MFI | Friends & relatives | Formal bank | Moneyle nder |
| Growing crops | 46 | 14.6 | 17 | 12 | 7 | 10 | 3 |
| Rearing animals | 7 | 2.2 | 0 | 2 | 1 | 1 | 0 |
| Manufacturing | 1 | 0.3 | 0 | 0 | 0 | 0 | 0 |
| Transport | 12 | 3.8 | 1 | 3 | 1 | 4 | 0 |
| Trade/commerce | 192 | 60.8 | 19 | 47 | 6 | 12 | 10 |
| Hotels/restaurants | 7 | 2.2 | 1 | 2 | 0 | 1 | 2 |
| Construction | 4 | 1.3 | 1 | 0 | 1 | 0 | 1 |
| Education services | 6 | 1.9 | 0 | 2 | 0 | 2 | 0 |
| Health services | 5 | 1.6 | 0 | 1 | 0 | 0 | 0 |
| Community services | 9 | 2.9 | 0 | 1 | 0 | 1 | 0 |
| Artisan | 7 | 2.2 | 3 | 2 | 1 | 0 | 1 |
| Transfers | 1 | 0.3 | 0 | 0 | 0 | 0 | 0 |
| Organisational support | 1 | 0.3 | 0 | 0 | 0 | 0 | 0 |
| Other | 18 | 5.7 | 2 | 4 | 1 | 2 | 1 |

Source: Survey data, May 2007

### Some determinants of access to financial services

*Source of income*

Given that most of the survey was carried out on those in rural trading centres and urban areas, most of the respondents were involved in trade and commerce (60.8 per cent) as their main source of income. Other key sources of income highlighted by the respondents included: growing of crops (14.6 per cent), transport (3.8 per cent) and rearing animals (2.2 per cent). Of these, especially those in trade and commerce, get their loans from the MFIs, ROSCAs, commercial banks and moneylenders. Surprisingly, SACCOs did not feature much in providing loans. The target population for formal bank products intended for these individuals would be those involved in trade-related activities.

*Distribution of branch networks*

Distribution of branch networks is an important determinant of access to financial services. In Kampala and Wakiso, most respondents reported to be within 2km of the formal financial sector, compared to more than 5km in Kumi, Mbarara and Lira districts. This is as expected because most bank branches are found mainly in Kampala and Wakiso districts. Table 4.16 shows the distribution of bank branches by district in Uganda. In all districts, however, most respondents reported the distance to nearest informal provider to be less than 2km.

**Table 4.16. Distance to nearest service providers and access to financial services**

| | Formal financial provider | | | Informal financial provider | | |
|---|---|---|---|---|---|---|
| | < 2km | 2-4km | 5km+ | < 2km | 2-4km | 5km+ |
| Kampala | 56 | 0 | 0 | 46 | 0 | 10 |
| Kumi | 27 | 0 | 37 | 48 | 6 | 5 |
| Mbarara | 12 | 7 | 31 | 45 | 8 | 7 |
| Lira | 23 | 10 | 30 | 46 | 10 | 3 |
| Wakiso | 61 | 0 | 2 | 59 | 10 | 3 |

Source: Survey data, May 2007

*Literacy level*

Most of the respondents (more than 75 per cent) were able to write and read. The majority had primary and secondary education (see Table 4.17), and also a good number had been educated up to tertiary level. This is a sign that at least most respondents has the basic education to enable them understand bank procedures.

Education of potential borrowers influences access to financial services. Across different providers, very few respondents without any formal education could access financial services.

**Table 4.17. Education levels and access to financial services**

| | None | Primary | Secondary | University | Other tertiary | Able to read and write | **accessing source, %** |
|---|---|---|---|---|---|---|---|
| ROSCAs | 2 | 19 | 16 | 0 | 7 | 33 | 75 |
| Friends & relatives | 1 | 7 | 7 | 0 | 3 | 15 | 83 |
| MFIs | 3 | 33 | 31 | 2 | 7 | 64 | 84 |
| Formal banks | 1 | 11 | 9 | 1 | 11 | 30 | 90.9 |
| Moneylenders | 1 | 8 | 4 | 0 | 5 | 15 | 83 |

Source: Survey data, May 2007

Of those who had access to formal banks, 91 per cent had some form of education, compared to 84 per cent for MFIs, 83 per cent for moneylenders and friends and relatives, and 75 per cent for ROSCAs (see Table 4.17). Those with university education were able to access service only from MFIs and formal banks. This suggests that access to financial services only requires a basic form of education – probably the ability to read and write.

*Housing status of loan applicant*

Those in permanent houses, iron roofed houses and those who own their own homes tended to access financial resources from all forms of providers (formal and informal) (see Table 4.18). Their housing status gave them a high rating by providers. Permanent residence, whether presented as security for a loan or not, acts as some form of security to the various providers.

### Non-bank services and other facilities used by respondents

*Type of identification document used by individuals* – Most of the respondents reported using national identity cards as a mode of identification. It should be noted here that in Uganda there is no system of issuing national identity cards. However, before the presidential and parliamentary elections of January 2006, all voters were issued with voter cards. These voter cards were misinterpreted tobe national identity cards. It should also be noted, however, that most of the financial institutions accept voter cards as an identity card in a country with no national identity system. Other major forms of identification included local administration cards, driving licenses and passports (captured under 'others' category). The government is, however, in the process of acquiring providers to issue independent national identity cards.

**Table 4.18. Respondents' residential status and access to credit by source**

| | | % access to credit | | | | | |
|---|---|---|---|---|---|---|---|
| **Status of housing** | % | ROSCA | ASCA | SACCO | Self-help group | Moneylender | Commercial bank |
| Owned | 47.5 | 59.1 | 61.1 | 48.7 | 51.5 | 50 | |
| Rented | 49.4 | 40.9 | 33.3 | 47.3 | 36.4 | 50 | |
| Free house – from employer | 9.9 | 0 | 5.6 | 1.3 | 12.1 | 0 | |
| Free house from relative | 0.6 | 0 | 0 | 0 | 0 | 0 | |
| Grass thatch | 14.6 | 45.5 | 44.4 | 14.7 | 3.1 | 11.1 | |
| Wooden plank roof | 0 | 0 | 0 | 0 | 0 | 0 | |
| Iron sheet roof | 85.1 | 54.5 | 55.6 | 85.5 | 93.9 | 88.9 | |
| Asbestos roof | 0 | 0 | 0 | 0 | 0 | 0 | |
| Tiled roof | 0.3 | 0 | 55.6 | 0 | 93.9 | 0 | |
| Tin roof | 0 | 0 | 0 | 0 | 0 | 0 | |
| Cement/concrete roof | 0 | 0 | 0 | 0 | 0 | 0 | |
| Permanent residence | 52.5 | 70.5 | 66.7 | 55.3 | 54.6 | 55.6 | |
| Temporary residence | 47.5 | 29.5 | 33.3 | 44.7 | 45.5 | 44.4 | |

Source: Survey data, May 2007

*Fuel for lighting and heating*

The results in Table 4.20 show that 41 per cent of the households in Kampala use electricity for lighting. It should be noted that electricity use for lighting is highest in Kampala.

**Table 4.19. Type of identification document used by respondents**

| | Kampala | Kumi | | Mbarara | | Lira | | Wakiso | |
|---|---|---|---|---|---|---|---|---|---|
| Type of document | Urban | Urban | Rural | Urban | Rural | Urban | Rural | Urban | Rural |
| Driving license local administrative identify card | 0 | 0 | 0 | 5 | 3 | 2 | 1 | 0 | 17 |
| National identity card | 36 | 24 | 24 | 2 | 2 | 12 | 8 | 20 | 0 |
| Others | 0 | 1 | 4 | 6 | 12 | 9 | 11 | 0 | 0 |

Source: Survey data, May 2007

A big proportion (70 per cent) of the population, especially in rural areas, still use *tadoba* (small paraffin tins fitted with wick) for lighting (especially in Kumi and Lira districts). Lantern use has increased, and solar, battery and wax candles are the least used sources of energy for lighting. This can be explained by the poor electricity distribution network in the countryside.

**Table 4.20. Main sources of fuel for lighting and heating used by respondents**

| | Kampala | Kumi | | Mbarara | | Lira | | Wakiso | |
|---|---|---|---|---|---|---|---|---|---|
| **Source of lighting** | Urban | Urban | Rural | Urban | Rural | Urban | Rural | Urban | Rural |
| Solar, battery electricity | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Candle (wax) | 1 | 0 | 0 | 1 | 1 | 1 | 1 | 3 | 0 |
| Candle (paraffin tin with wick) | 0 | 20 | 25 | 2 | 10 | 5 | 12 | 1 | 0 |
| **Heating:** | | | | | | | | | |
| Electricity | 3 | 26 | 0 | 4 | 1 | 4 | 3 | 1 | 0 |
| Charcoal | 49 | 0 | 5 | 24 | 26 | 9 | 9 | 33 | 21 |
| Solar | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Firewood | 1 | 9 | 29 | 0 | 5 | 6 | 6 | 1 | 4 |
| Paraffin | 1 | 0 | 0 | 0 | 0 | 7 | 7 | 0 | 0 |
| Biogas | 2 | 0 | 3 | 3 | 0 | 0 | 3 | 0 | 0 |

Source: Survey data, May 2007

Charcoal stoves are the most used source of heating, especially in urban areas. Firewood is also another popular source, especially in rural areas. Electricity is not often used

because of its high cost. With the partial liberalisation of the electricity sector, electricity prices have gone up significantly.

*Financial remittances*

In Wakiso and Kampala, many of the respondents were immigrants, living outside their permanent homes. The average distance to their home areas was 154km for Kampala, and 129.8km and 113.8km for Wakiso urban and rural areas respectively. Many people send remittances, but most do not use the formal sector. This is again as expected because of the poor bank branch network and high charges for such transactions.

**Table 4.21 Informal respondents' financial remittances**

| | Kampala | Kumi | | Mbarara | | Lira | | Wakiso | |
|---|---|---|---|---|---|---|---|---|---|
| | Urban | Urban | Rural | Urban | Rural | Urban | Rural | Urban | Rural |
| Average distance from permanent home (km)No. living outside permanent home | 154.0 | 18.8 | 26.5 | 64.3 | 44.4 | 86.9 | 22.1 | 129.8 | 113.8 |
| No. sending remittances home | 27 | 18 | 3 | 23 | 16 | 26 | 13 | 23 | 6 |
| No. of remittances per year (average) | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Amount of remittance per month (average) | -- | -- | -- | -- | -- | -- | -- | -- | -- |

Source: Survey data, May 2007

*Main source of information*

Respondents largely depended upon loca media channels (mainly radio) as their main source of information (6–100 per cent). Also about a quarter of people relied upon word-of-mouth as their main source of information. This can easily lead to distortion of information. A negligible percentage of the respondents got information on financial services through visits by providers or their agents. This might be a result of the high cost of making such visits.

Use of mobile phones, landline telephones and computers to gather information in both rural and urban areas was substantial (see Table 22). In all the districts, traders advertise themselves by giving mobile phone numbers. Taxi drivers are contacted by

phone, and retailers try to avoid unnecessary travel by making inquiries over the phone for supplies. The study found that a majority of people (73 per cent) in the areas visited used mobile phones, despite the relatively high price for mobile telephone calls.

It was reported that many people had no form of telephone access before the acquisition of mobile phones. In the sample, 98 per cent used mobile phones for making calls and 99 per cent used them for receiving calls or messages (97 per cent). However, only 30 per cent indicated that they had access to computers, with internet usage occurring among only 15 per cent (see Table 22).

**Table 4.22 How clients get information about different credit sources**

| | Media (advert /announce ment) | Visit by provider/ agent | Source is within locality | By word-of-mouth | Was doing business with provider already | Other |
|---|---|---|---|---|---|---|
| Formal bank | 9 (9.1%) | 3 (9.1%) | 2 (6.1%) | 7 (21.2%) | 3(9.1%) | 9 (27.3%) |
| Moneylender | 2 (11.8%) | 0 | 7 (41.2%) | 4 (23.1%) | 2(11.8%) | 2 (11.8%) |
| Landlord | 1 (50%) | 0 | 0 | 1 (50%) | 0 | 0 |
| Employer | | | | | | |
| Friends/relatives | 2 (11%) | 2 (11%) | 7 (38.9%) | 3 (16.7%) | 0 | 3 (16.7%) |
| MFI | 17 (22.4%) | 19 (25%) | 20 (26.3%) | 5 (6.6%) | 3(4%) | 12 (15%) |
| Trader/shopkeeper | 0 | 0 | 6 (100%) | 0 | 0 | 0 |
| ROSCA | 0 | 8 (18%) | 10 (22.7%) | 11 (25%) | 7(15.9%) | 8 (18.2%) |

Source: Survey data, May 2007

Within less than 15 years of mobile telephone operation in Uganda, there has been a remarkable rise in demand. In the process, many have complained about the quality and price of mobile telephone services. In the sample, most people complained about high unit cost of mobile telephone calls, occasional network failures and poor connectivitiy (see Table 25).

**Table 23. Access to ICT facilities among respondents**

| Technology/ facility | No. with access | Purpose | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Information | Internet | Making calls | Receiving calls | Sending text messages | Receiving messages | |
| Computer | 27(30%) | 24 (27%) | 13 (15%) | | | | | 18 (21%) |
| Landline telephone | 188 (80%) | | | 177 (75%) | 160 (52%) | | | 158 (51%) |
| Mobile telephone | 205 (72.7%) | | | 200 (98.5%) | 201 (99%) | 199 (97.5%) | 199 (97.5%) | |

Source: Survey data, May 2007

**Table 4.24. Problems with mobile phones**

| | Kampala | Kumi | | Mbarara | | Lira | | Wakiso | |
|---|---|---|---|---|---|---|---|---|---|
| Type of problem | Urban | Urban | Rural | Urban | Rural | Urban | Rural | Urban | Rural |
| Tariffs too high | 32 | 8 | 7 | 19 | 10 | 18 | 8 | 20 | 16 |
| Lack of durable handsets | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 | 0 |
| Network failures | 0 | 13 | 8 | 8 | 4 | 6 | 6 | 1 | 1 |
| Poor connectivity | 0 | 1 | 2 | 0 | 0 | 0 | 0 | 0 | 0 |
| Charging the battery | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

Source: Survey data, May 2007

## Informal financial providers and financial outreach

### Type and location of providers

Survey data reveal that SACCOs (31.5 per cent), ROSCAs (18 per cent), private moneylenders (14.6 per cent) and self-help groups (12.4 per cent) are the most common forms of financial transactions in the informal sector (see Table 4.24). Of the 89 institutions on which information was collected, 50 were based in urban areas while 39

were in rural areas. There was also no major difference in the distribution between urban and rural areas. However, moneylenders seem to be more active in urban areas than rural.

SACCOs and ROSCAs cut across the entire district sample and remain a key saving channel for both rural and urban populations. Moneylenders are more active in Kampala and Kumi districts, representing 40 and 30 per cent of the district sample of providers, respectively. Self-help savings schemes are also common across the urban and rural areas. This seems to suggest that access to banking services (for example, distance to the nearest commercial bank) may not be the only explanation why individuals tend to save with informal institutions.

As regards the registration status of the surveyed institutions, 49 (55.1 per cent) were registered with some authorities.

**Table 4.25. Types of financial service provider by location and district**

| | District | | | | | Location | | |
|---|---|---|---|---|---|---|---|---|
| **Type of Business** | **Mbarara** | **Kumi** | **Lira** | **Wakiso** | **Kampala** | **Rural** | **Urban** | **Total** |
| Formal Banks | 1 (4%) | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) | 0 (0%) | 1 (2%) | 1 (1%) |
| MFI | 0 (0%) | 1 (3.85%) | 0(0%) | 0 (0%) | 4 (40%) | 0 (0%) | 5 (10%) | 5 (5.6%) |
| ROSCA | 7 (28%) | 1 (3.85%) | 8 (34.5%) | 0 (0%) | 0 (0%) | 8 (20.5%) | 8 (16%) | 16 (18%) |
| Self-help | 0 (0%) | 4 (15.4%) | 7 (30.4%) | 0 (0%) | 0 (0%) | 6 (15.4%) | 5 (10%) | 11 (12.4%) |
| Moneylender | 1 (4%) | 8 (30.8%) | 0(0%) | 0 (0%) | 4 (40%) | 5 (12.9%) | 8 (16%) | 13 (14.6%) |
| Landlord/ shopkeeper | 0 (0%) | 3 (11.6%) | 0 (0%) | 0 (0%) | 0 (0%) | 2 (5.1%) | 1 (2%) | 3 (3.4%) |
| Village bank | 3 (12%) | 0 (0%) | 0 (0%) | 0(0%) | 0 (0%) | 2 (5.1%) | 1 (2%) | 3 (3.4%) |
| ASCA | 1 (4%) | 0 (0%) | 2 (8.7%) | 1 (20%) | 0 (0%) | 1 (2.6%) | 3 (6%) | 4 (4.5%) |
| Other | 2 (8%) | 0 (0%) | 2 (8.7%) | 1 (20%) | 0 (0%) | 3 (7.7%) | 2 (4%) | 5 (5.6%) |
| **Total** | 25 (100%) | 26 (100%) | 23 (100%) | 5 (100%) | 10 (100%) | 39 (100%) | 50 (100%) | 89 (100%) |

Source: Survey data, May 2007
Figures in parenthesis represent % (of district or location samples), while figures not in parenthesis represent frequencies

Twenty-one of these (43 per cent of those registered) were registered with local authorities, 13 with the Registrar of Companies and 15 (30.6 per cent) were registered with other institutions that included the Central Bank and area magistrates (see Table 25).

**Table 4.26. Legal status of financial service providers used by respondents**

| | Business registered | | | Why not registered | | | |
|---|---|---|---|---|---|---|---|
| **Type of Business** | **Yes** | **No** | **Total** | **Not necessary** | **Bureaucracy** | **Avoid Tax** | **Other** |
| Formal bank | 1 | 0 | 1 | 0 | 0 | 0 | 0 |
| MFI | 5 | 0 | 5 | 0 | 0 | 0 | 0 |
| ROSCA | 6 | 10 | 16 | 5 | 2 | 1 | 2 |
| Self-help | 2 | 9 | 11 | 9 | 0 | 0 | 1 |
| Moneylender | 6 | 7 | 13 | 1 | 1 | 0 | 5 |
| Landlord/ shopkeeper | 2 | 1 | 3 | 0 | 0 | 1 | 0 |
| Village bank | 1 | 2 | 3 | 2 | 0 | 0 | 0 |
| ASCA | 2 | 2 | 4 | 1 | 0 | 0 | 1 |
| Other | 4 | 1 | 5 | 2 | 0 | 0 | 0 |
| **Total** | 49 | 40 | 89 | 25 | 3 | 4 | 12 |

Source: Survey data, May 2007

Forty informal providers (44.9 per cent) were not registered with any legal authority. The major reason for not registering is that most of the institutions (62.5 per cent of those unregistered) thought that registration was not necessary. However a few enterprises also suggested the long bureaucratic problems and efforts to avoid the tax system were reasons for not seeking registration.

### Informal sector savings and transactions

MFIs, SACCOS and private moneylenders mobilise/handle substantial amounts of cash in the largely informal sector (see Table 4.27).

**Table 4.27. Amount of cash handled by providers per month, by type of business**

| Type of Business | Mean (UShs) | Standard Deviation | Observations |
|---|---|---|---|
| Formal bank | 3,000,000 | 0 | 1 |
| MFI | 18,000,000 | 0 | 1 |
| ROSCA | 859,813 | 1,812,321 | 16 |
| Self-help | 230,182 | 351,541 | 11 |
| Moneylender | 3,776,923 | 5,044,329 | 13 |
| Village bank | 901,850 | 790,827 | 3 |
| Landlord | 1,133,333 | 901,850 | 3 |
| ASCA | 1,600,000 | 264,635 | 4 |
| Other | 916,000 | 830,379 | 5 |

Source: Survey data, May 2007

On average, USh18 million (GB£5,143), USh9.9 million (GB£2,832) and USh3.7 million (GB£1,079) are handled every month bu MFIs, SACCOS and private moneylenders,

respectively. Other resources are mobilised by landlords, ASCAs, ROSCAs and self-help groups. Some are handling turnovers of over USh100 million (GB£28,571).

Across the districts, substantial amounts of cash go through the informal system, except in Lira where an average of USh0.5 million (GB£143) is received as total savings from members or lent out to members by a provider. The highest cash transactions occur in Kampala with a mean of USh17 million (GB£4,857) per month (see Table 4.28) and a standard deviation of USh21 million.

Low levels of cash in circulation in Lira district are to be expected because of insurgency in most northern districts. Many households are displaced and survive on handouts from humanitarian agencies and NGOs. However, the recent peace effort in the north could turn business around, as has been witnessed by a recent surge in trade between Uganda and Southern Sudan. Neverthless, given events in Juba, the likelihood of the peace talks being successful remains unclear.

**Table 4.28. Amount of cash handled by informal finance providers per month, by district**

| District | Mean (UShs) | Standard Deviation | Observations |
|---|---|---|---|
| Mbarara | 5,754,080 | 22,200,000 | 25 |
| Kumi | 3,107,538 | 5,500,231 | 26 |
| Lira | 704,217 | 1,555,215 | 23 |
| Wakiso | 5,870,000 | 10,700,000 | 5 |
| Kampala | 17,000,000 | 21,000,000 | 6 |
| **Location** | | | |
| Urban | 6,525,348 | 18,500,000 | 46 |
| Rural | 1,923,821 | 5,108,672 | 39 |
| **Total** | **4,414,059** | **14,200,000** | **85** |

Source: Survey data, May 2007

The activities of informal service providers are more pronounced in the urban areas than in rural areas. On average, more than USh6.5 million (GB£1,864) are mobilised per month in the urban areas (with a standard deviation of USh18.5 million) compared to an average of USsh1.9 million (GB£550) per month in the rural areas. Again, this is not surprising since it is in the urban areas where most of the income/savings generated activities can be found.

Informal providers' sources of funding

Table 4.29 shows that most institutions used either own funds or group members' contributions. Further analysis shows that landlords, village banks and private moneylenders mainly used their own capital for funding their activities.

SACCOs, ROSCAs and self-help groups rely more on group members' contributions to fund their activities. In a few cases, however, these groups also get funding from retained profits and family contributions, as well as external sponsors (government and NGOs). Incidentally, only SACCOs, ROSCAs and MFIs had received funding from banks and other loans.

On the use of funds, most of the funds were loaned out to members or other borrowers (67 per cent). Other uses included rent payment and interest expenses. Some ROSCAs and SACCOs indicated that they invest in other forms of assets on behalf of their members. Some of these assets include land and buildings.

**Table 4.29 Source of fund main uses of these funds**

| Source of funds | | | Main use of funds | | |
|---|---|---|---|---|---|
| | **No.** | **%** | | **No.** | **%** |
| Own capital | 29 | 33.3 | Loans extended | 58 | 67.4 |
| Family contributions | 2 | 2.3 | Interest expense | 3 | 3.5 |
| Retained profits | 5 | 5.8 | Wage payments | 1 | 1.2 |
| Client savings | 6 | 6.9 | Rent expenses | 4 | 4.7 |
| Group members contribution | 36 | 41.4 | Admin. expenses | 1 | 1.2 |
| Loans | 2 | 2.3 | Others | 19 | 22.1 |
| Banks | 3 | 3.5 | **Total** | **86** | **100** |
| External sponsors: govt | 1 | 1.2 | | | |
| External sponsors: NGO | 2 | 2.3 | | | |
| Other sources | 1 | 1.2 | | | |
| **Total** | **87** | **100** | | | |

Source: Survey data, May 2007

With 67 per cent of the funds allocated for lending, there is certainly a serious problem of undercapitalisation for these institutions.

Informal providers: Results from selected case studies

SACCOs

Although most SACCOs have had serious problems of weak management and leadership in the past (including fraud, insider lending, poor financial performance and improper record keeping), the study found that some SACCOs have provide a viable financial

solution in rural areas. They also have good potential to increase their outreach to cover most rural people. The case presented below (see Box 2) is one among several good examples we came across in rural areas.

ROSCAs

ROSCAs are an important source of informal loans in Uganda.[7] They are known by different names: in the central region they are called *Munno Mukabi*, which literally means, 'a friend in need'. ROSCAs are effective channels for mobilising savings from the informal sector (see Box 4).

As they are used by all social classes in society and by both low- and high-income earners – from peasants in the villages to bank employees and members of parliament, ROSCAs especially those among salaried workers are potential partners for commercial banks and other formal financial institutions planning to improve their outreach. Credit from ROSCAs is not only intended for consumption expenditure, including education and medical, but also to acquire assets such as household property, vehicles or for building.

Savings in ROSCAs protect income from unintended consumption, either their own consumption or that of others in their extended family. As such, ROSCAs appear to provide the right balance between distance and accessibility in cases of need, on the one hand, and protection from unintended use, on the other.

Since ROSCAs depend solely on members' contribution, lack of financial resources for lending is the most serious challenge in this sector. Other factors are weak management (improper record keeping), no clear governance system and planning. Only a few ROSCAs have potential to become important players in the market and could be transformed to a non-ROSCA in the future. Lack of legal identity (as most are not registered and do not have constitutions) makes it difficult for ROSCAs to access external funds or pursue collaboration with banks.

[7] ROSCAs are formed by members of the community. Some are formed by workmates and neighbours, friends and relatives and business colleagues. This makes it easy to establish and maintain contact. Occupation, gender and place of residence are the common bond of the group. Membership size varies between 5 and 50 individuals or more, although large groups may reorganize into sub-groups to reduce geographical dispersion. Most ROSCAs are managed by a committee elected from within the members, though decisions are made jointly in group meetings. They meet frequently, i.e. every week,every fortnight or monthly. Members pay their contribution at every meeting.

### ASCAs

All individuals who belong to ASCAs make regular contributions with the objective of accumulating capital that can be paid (to contributing members) or lent out for specified purposes. What makes ASCAs different from ROSCAs is that ASCAs do not pay out each collection completely, as most ROSCAs do. A number of ASCAs are registered and conduct their businesses from established offices and employ personnel. The Box 4 shows that ASCAs are good mobilisers of informal savings.

Box 5 also illustrates that ASCAs have the potential to forge links with formal financial institutions such as commercial banks, credit institutions and micro-deposit-taking institutions. They are self-selecting regarding their membership and hence are able to overcome the problem of information asymmetry. New members are required to pass a period of regular savings before they are eligible for loans. They also have effective ways of applying financial sanctions and enforcing loan contracts.

### Moneylenders

Communities, especially in rural areas, are not aware that when they borrow from individuals, they are actually dealing with moneylenders as most moneylenders do not disclose their identity. As a result, it is often difficult to know the exact number of moneylenders and they operate in diverse ways (see Box 6). When selecting borrowers, moneylenders ask for valid identification documents such as an identity card or passport (and in some cases, an introduction letter from the local council, employer or a guarantor). The applicant must demonstrate the capacity to pay. However, moneylenders face similar challenges of default that are common to other financial providers (Box 7).

The challenge of default is being faced by the moneylenders on a day-to-day basis. As a result, banks are less willing to lend to moneylenders because of the high risks involved. Most moneylenders fear to take defaulters to court because they know they are operating illegally. However, upon assessment of the nature of risks, many moneylenders now require some borrowers to deposit collateral such as land title deeds or a vehicle registration card with signed transfer forms (in the moneylender’s name), among other measures. A common practice is that borrowers sign a sales contract instead of a loans

contract, and in case of default, the moneylender simply appropriates the security, even if it is of higher value than the original loan amount. Dozens of moneylenders in urban areas now employ the services of lawyers (as highlighted in Box 5).

**MFIs**

Over the past ten years, microfinance activities have attracted publicity in Uganda and the pioneering work of a number of MFIs and individuals has changed public opinion. However, complaints are still heard from government and the public about the lending methods used by these institutions and the cost of borrowing, some of which are highlighted in Box 8.

High interest rate charges, short repayment periods, no grace periods and group lending were major complaints among the respondents across all communities visited. In Nakawa Market in Kampala, women complained that some of the group members had escaped without repaying loans and the few members that remained had to bear the burden of repayment. They were not happy that MFIs have shifted this responsibility entirely to group members, that they should be the ones to pursue defaulting members.

*Existing linkages with commercial banks and other agencies*

All the SACCOs interviewed had bank accounts, and some had benefited from commercial banks/MDI loans, or funds from government or donor programmes. In Kumi, for instance, MIDO Cooperative Society had a savings account with Stanbic Bank. Also some ROSCAs had accounts in MDIs and commercial banks, and had received loans from these institutions (see Figure 5).

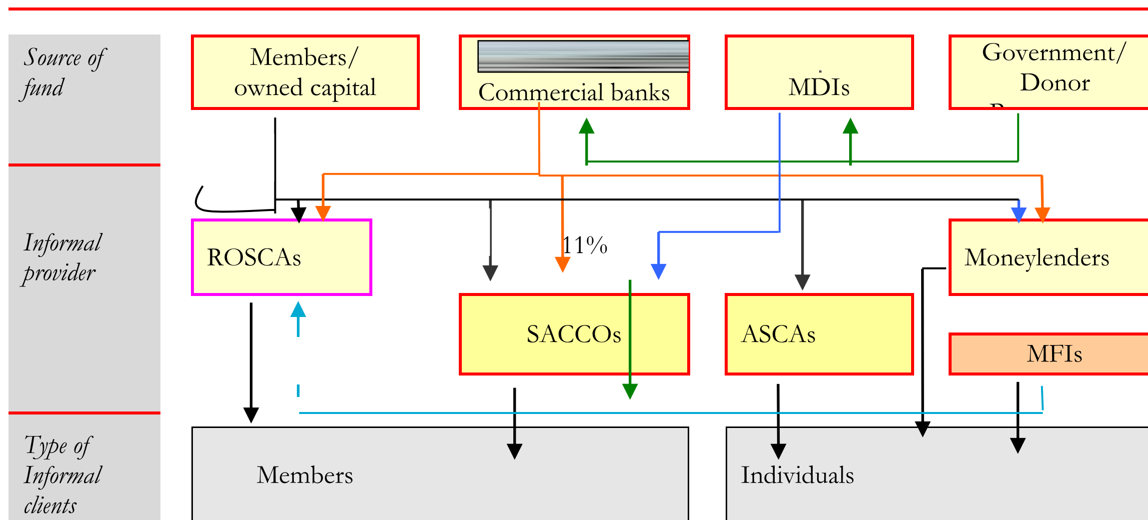
Considering own capital contributions and membership fees as own finance, and as noted in Figure 5, most informal institutions use own capital to fund their activities: ROSCAs 87.5 per cent, SACCOs 64.3 per cent, ASCAs 100 per cent, moneylenders 100 per cent, and MFIs 33.3 per cent). This could be a major constraint to their activities.

MFIs, SACCOs and ROSCAs were found to access resources from other sources to finance their operations: 33.3 per cent, 10.7 per cent and 6.3 per cent, respectively). Products that target these institutions to stimulate capitalisation and savings mobilisation would be key to the formal financial sector.

### Major constraints experienced in the informal financial market

A narrow capital base is one of the major challenges currently facing most informal finance institutions. Out of 54 responses that highlighted this problem, 30 ranked it as the biggest challenge and another 15 ranked it as the second most serious challenge (see Table 30). This explains the magnitude of the challenge. The findings suggest that a big opportunity exists for the formal banking sector to facilitate the existing financial gap.

Figure 5 Informal providers and links with other agencies in the financial sector




Note: Figures in percentage depict the share of the provider's budget financed by the indicated source.

**Table 30. Major problems faced by informal financial service providers**

| Problem | Frequency | Rank | | | |
|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 |
| Small markets | 21 | 3 | 12 | 3 | 3 |
| Small capital base | 54 | 30 | 15 | 8 | 1 |
| Low repayment rates | 39 | 11 | 12 | 6 | 3 |
| Fraud/theft | 23 | 8 | 4 | 7 | 4 |
| Poor infrastructure | 17 | 2 | 3 | 7 | 3 |
| Insecurity | 14 | 3 | 3 | 4 | 3 |
| Fire | 4 | 1 | 3 | 0 | 0 |
| Inflation | 6 | 1 | 3 | 1 | 1 |

Source: Survey data, May 2007

Another challenge identified is low repayment rates by clients, where 39 respondents highlighted this as the leading challenge, while 12 rank it second. These constraints have impacted negatively on outreach and access to financial services.

# 5 Conclusions and Recommendations

## 5.1 Conclusions

Our analysis demonstrates that the outreach of financial services in Uganda, especially in rural areas is weak. The majority of respondents rely on services offered by informal financial providers. Convenient and safe deposit facilities, term finance and agricultural credit are not available in many areas and much-needed education co-financing and healthcare facility, insurance and risk hedging mechanisms are completely lacking.

The second conclusion to be drawn from the study is that bank charges (or cost of savings) and access to funds (deposits) are very important determinants of a decision to save with a commercial bank or any financial institution. People are willing to demand services of financial provider if they know that the cost of accessing the service will not affect their savings substantially and provided that they can conveniently access their money.

Another conclusion that can be drawn from the study is that informal financial service providers have been successful in serving the unbanked because they offer flexible conditions for both savings and credit, for example, they are always available for their clients and they offer differentiated loan products – different loan amounts and types to suit their clients' needs. The strength of the informal providers is also embedded in their ability to exploit social ties to mobilise, assess information about clients, monitor and guarantee credit.

However, informal financial service providers are seriously undercapitalised as most of them depend largely on members' contribution. They are not able to satisfy the growing and diverse needs of their clients. Also, most of the informal providers charge exceptionally high interest on loans and they have cumbersome repayment schedules (for example, compulsory weekly meetings for loan repayment). Moreover, informal providers allow very short-term repayment periods, with no grace periods for investment

funds. They hardly provide any agriculture finance or offer longer-term deposit products, which could enable them to provide term finance.

There is thus underutilised potential in informal markets that commercial banks can exploit. This includes designing products to fill the current gaps both on the asset and liability sides, for example, differentiated lease products, education facilitation products, health insurance, safe deposit facilities and agriculture finance.

## 5.2 Recommendations

Most individuals borrow and save in order to finance education and health-related expenses. Development of products targeting education, for example, in collaboration with education institutions would be a great relief for parents. At the same time, it would yield long-term benefits to the banks. These could be annual loans to finance childrens' education that are paid directly to the schools.

In addition to increasing financial outreach in rural areas, commercial banks also need to pay attention to segments of the urban market that are often neglected, for example, people operating in markets, including market vendors. Expanding branch networks is just one way to moblise group savings and facilitate group lending, but it is not the only and perhaps not the best way. There are several options such as the use of electronic cards that may not necessarily require the physical presence of the bank. The E-Purse (Smart) Card system that has been developed by Bank of Uganda could be a plausible alternative to maintaining bank branches in remote areas.

Another option available to commercial banks that would enable them to extend their outreach to the unbanked is to forge a partnership with well-managed informal financial services providers particularly SACCOs in rural areas, and market vendor associations in major urban centres. In Uganda, specific products targeting SACCOs have great potential and a high chance of success provided the participating SACCOs are selected carefully. There has been renewed support from government to try to build management and financial resource capacity of SACCOs. If implemented, SACCOs will attain some capacity and structures, in the next two to three years that will enable them to become important players in the financial market. This should be a great opportunity for the

formal banking sector, but we need to add the caution that the new generation of SACCOs stem from the new government scheme of 'wealth for all' (now Operation Wealth Creation) and are prone to political influence. Some may not be the right partners for this kind of collaboration.

A credit bureau that would reduce information asymmetry hence the cost of lending would be crucial. Its effectiveness would improve once national identity cards are introduced by 2008. This will make interventions in line with the current recommendations more plausible.

In addition, banks need to look into ways of making it convenient and cheaper to transfer money (domestically and internationally). Most individuals do not use the formal banking sector to transfer money to their permanent home areas because of high bank charges and poor branch networks. The Post Office that is much preferred because of their wider networks is very expensive. Western Union is also shunned by many as being too expensive.

Finally, in view of the constraints that make it difficult for people to access the services of formal financial institutions, such as poor distribution of branch networks (long distance to the nearest bank) and the high risk of travelling with funds in congested cities and other urban areas, we recommend that banks devise ways of introducing convenient safe deposit facilities for certain areas where they are needed (for example,. market places). Increased public awareness about banking services (savings mobilisation, credit, information and procedures of opening bank account etc.) is needed. Also needed is an attractive savings product to encourage savings, plus the simplifying of loans procedures. Banks also need to consider how they can work to reduce high bank charges and simplify the requirements for operating bank accounts, for example, minimum deposit requirements and account balances.

## References

Allen, Franklin; Carletti, Elena; Cull, Robert; "Qj" Qian, Jun; Senbet, Lemma and Valenzuela, Patricio. 2014. "The African Financial Development and Financial Inclusion Gaps", *Policy Research Working Paper* 7019, World Bank, Washington, D.C.

Beck, Thorsten, Asli Demirguc-Kunt and Maria Soledad Martinez Peria. 2007. "Reaching Out: Access to and Use of Banking Services Across Countries", *Journal of Financial Economics,* 85, 234-66

Clarke, George R.G., L. Colin Xu, and Heng-Fu Zou. 2006. "Finance and Income Inequality: What Do the Data Tell Us?," *Southern Economic Journal* 72, 578-596.

Demirgüç-Kunt, Asili, and Leora, Klapper. 2012. "Measuring Financial Inclusion: The Global Findex", *World Bank Policy Research Working Paper Series* 6025.

Demirgüç-Kunt, Asili and Leora Klapper. 2013. "Financial Inclusion in Africa: Setting the Stage", in: Triki, Thouraya and Faye, Issa (eds.). 2013. *Financial Inclusion in Africa*, Tunis: African Development Bank (AfDB).

Alliance for Financial Inclusion (AFI). **2013.** "Defining and Measuring Financial Inclusion", in: Triki, Thouraya and Faye, Issa (eds.). 2013. *Financial Inclusion in Africa*, Tunis: African Development Bank (AfDB).

Dabla-Norris, Era; Yan Ji, Robert Townsend, D. Filiz Unsal. 2015. "Identifying Constraints to Financial Inclusion and Their Impact on GDP and Inequality: A Structural Framework for Policy, International Monetary Fund.

Lerner, Josh and Tufano, Peter. 2011. "The consequences of financial innovation: A counterfactual research agenda", *Annual Review of Financial Economics*, 3:41-85.

Mention, Anne-Laure and Torkkeli, Marko (eds). 2014. *Innovation in Financial Services: A Dual Ambiguity*, Cambridge Scholars Publishing.

Mention, Anne-Laure and Torkkeli, Marko. 2014. "Innovation in Financial Services: Unveiling Ambiguity", in: Mention, Anne-Laure and Torkkeli, Marko. (eds). 2014. *Innovation in Financial Services: A Dual Ambiguity*, Cambridge Scholars Publishing.

Otchere, Isaac. 2016. Financial inclusion and development in Africa: gaps, challenges and policy recommendations, 18th AERC senior policy seminar 22nd-23rd March, 2016 Nairobi, Kenya, Revised: April 2016.

Terberger, E. 2006. *Country Programme Evaluation 2006 – Uganda. Focal Area Evaluation Report: German DC in Financial Sector Development*,

Uganda Bureau of Statistics. 2003. *Uganda National Household Survey: Socio Economic Survey 2002/2003*, Kampala

UNDP. 2005. *Uganda Human Development Report 2005*, UNDP.