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Ex post evaluation – Uganda

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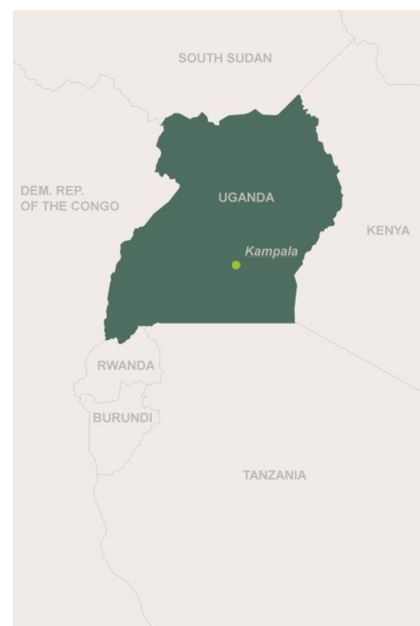
Sector: 24010 Financial policy and administrative management
Project: CP programme development of the financial sector (BMZ No.: 2007 65 305). Pooling of individual projects [CRB (22508) and DPF (22355)]*
Programme-/Project executing agency: Bank of Uganda (central bank)



Ex post evaluation report: 2014

		Project A (Planned)	Project A (Actual)	Project B (Planned)	Project B (Actual)
Investment costs (total)	EUR million	3.00	2.94	3.00	1.74
Own contribution	EUR million	-	-	-	-
Funding	EUR million	3.00	2.94	3.00	1.74
of which BMZ budget funds	EUR million	3.00	2.94	3.00	1.74

*) Random sample 2014

Description: The financial sector programme carried out in conjunction with German Technical Cooperation supported the consolidation of the Ugandan financial system by institutionally deepening its infrastructure. Component A - Credit Reference Bureau (CRB): support the establishment of a private credit reference bureau by assuming part of the costs for creating a Financial Card System (FCS) based on biometric data and subsidising the credit bureau service usage fees for participating financial intermediaries. Component B - Deposit Protection Fund (DPF): participation in the initial capitalisation of the deposit guarantee fund for regulated Microfinance Deposit Taking Institutions (MDIs) to boost the mobilization of local refinancing funds.

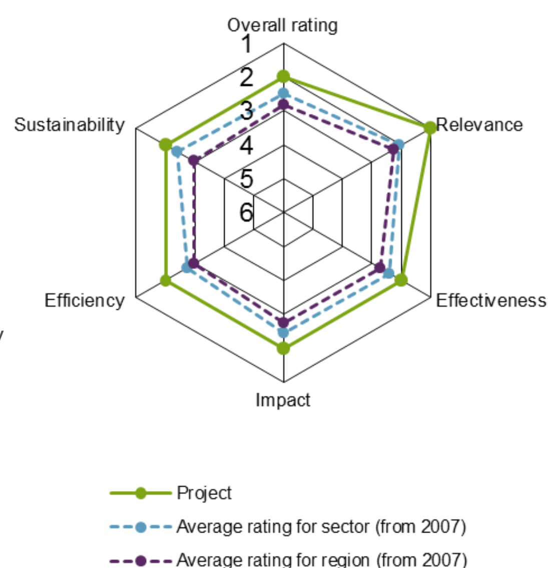
Objectives: The financial sector programme was to make a contribution to deepening the formal financial sector and to developing a functional and stable financial system in Uganda (programme objective). The programme components targeted improved access to financial services (loans, savings deposits) for poorer levels of the population and the economy (especially micro, small and medium-sized companies, MSMEs) (module objectives).

Target group: The target groups were borrowers and small savers who at the launch of the programme had few opportunities (if any) to obtain loans under reasonable conditions as well as to deposit their savings safely and productively. Ugandan financial institutions in the regulated financial sector were also to benefit indirectly from the more efficient lending and the improved funding through customer deposits.

Overall rating: 2

Rationale: As part of the programme, two key building blocks of modern financial system development (credit agency and deposit guarantee system) were successfully set up in accordance with current standards. Both systems are used actively and enhance the benefits of the financial system for both the customer and the financial institution. This development also impacted favourably on deepening the Ugandan financial system as a whole.

Highlights: In the absence of a national ID card or some other identification system, cards issued during the lending process were successfully used to help identify customers at the CRB.



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Rating according to DAC criteria

Overall rating: 2

General conditions and classification of the project

The Ugandan financial sector comprises a variety of institutions that can be classified into four categories ("tiers"), ranging from commercial banks in Tier 1 to financial intermediaries that are not regulated by the central bank (Tier 4). In spite of the many players involved, the ratio of private sector loans to GDP is about 10-20%, i.e. markedly below the average of the OECD countries (currently around 200%) and below that of other economies in Eastern Africa (for example Kenya at 35%). Nonetheless, it is common - particularly for customers that have low household incomes - to take on excessive debt through financial intermediaries due to lack of information, which means they are not able to repay their loans at a justifiable cost. The central bank of Uganda has endeavoured to prevent these developments in recent years. These efforts included establishing a deposit guarantee fund for Tier 1-2 institutions, which as part of the programme was to be complemented by a deposit guarantee fund for micro-finance institutions that are also permitted to accept customer deposits (MDIs, Tier 3).

Relevance

Efficient exchange of information constitutes a key component of modern financial infrastructure. The lack of information exchange in the Ugandan banking sector, which enables households to take out excessive loans with different institutions at the same time, unnoticed, and therefore go into debt, was correctly assessed as a crucial shortcoming of the financial system at the start of the programme. Structural over-indebtedness among households reduces disposable household income in the long term and increases the vulnerability of households to adverse shocks. Consequently, it is damaging for the prosperity of the households affected, especially in a context where safeguarding a minimum subsistence level cannot be guaranteed in the event of a private insolvency. The problem of over-indebtedness can also result in "good" financial intermediaries no longer wanting to supply certain groups of low-income households with loans, thereby preventing the deepening of the financial sector. Studies confirm that excessive debt often involves the simultaneous drawing of several loans at different lenders. Before the establishment of the credit reference bureau as part of the programme, it was very difficult for financial intermediaries to assess the repayment capabilities of potential customers before lending them money. It can be assumed that besides certain groups of customers taking on excessive debt, this also led to inefficient risk premiums for borrowers that were actually solvent. Component A of the project addressed this central failing of the financial system and targeted the development of a functioning system for the exchange of information between financial intermediaries regulated by the central bank, thereby enabling the early detection of over-indebtedness trends. Such a system was designed to generate significant, positive impacts on customers (less debt, better conditions) and on financial intermediaries (fewer non-performing loans) as well as deepen and consolidate the financial system (lower risk premiums, new profitable customer groups).

The ability to deposit savings is as much a key component of a functioning financial system as the ability to take out loans. Customers can use savings to cushion the impact of adverse events. Before the programme started though, smaller Ugandan financial intermediaries in particular found themselves up against customers who were sceptical regarding the safety of their deposits. This scepticism presumably reduced the volume of deposits made by poorer households. While there was already one deposit guarantee mechanism in place for commercial banks in Tiers 1-2 at the time of the project appraisal, the deposits at MDIs in Tier 3 were unsecured at this point. The establishment of a deposit guarantee fund had the aim of guaranteeing deposits of MDI customers up to a certain level, and thereby increasing the overall savings rate of this customer group. This measure was designed to have a positive impact on protecting households from negative shocks and on the refinancing opportunities for MDIs. Both components focused on the Ugandan government's strategy to develop the financial system, and were in line with the plans of German development cooperation to support this strategy.

Since both of the components tackled key failings of the Ugandan financial system from today's perspective and were also expected to have positive effects on households as well as financial institutions, we rate the relevance of both components as very good overall.

Relevance rating: 1

Effectiveness

The programme components targeted improved access to financial services (loans, savings deposits) for poorer levels of the population and the economy (especially micro, small and medium-sized companies, MSMEs) (module objectives). The achievement of the module objectives defined during the programme appraisal can be summarised as follows:

Indicator	Status PA	Ex post evaluation
(1) Increase in number of borrowers at regulated financial institutions (Tiers 1-3)	2008: 346,303	Met; end-2013: 577,186
(2) Increase in overall credit volume at regulated financial institutions (Tiers 1-3)	2008: UGX 2,466 billion (Ugandan schillings)	Met; end-2013: UGX 8,802 billion
(3) Increase in number of customers with savings deposits at MDIs (Tier 3)*	2008: 279,498	Met; end-2013: 634,414
(4) Increase in number of savings deposits at MDIs (Tier 3)*	2008: UGX 37.1 billion	Met; end-2013: UGX 92.6 billion

*) The actual increase in indicators 3 and 4 is even higher than the figure stated here since one MDI moved into a higher tier between 2008 and 2013 and was no longer included in the assessment base in 2013.

For the purposes of the ex-post evaluation the aforementioned indicators were refined in light of the increase in the figures between the start of the programme and the time of the evaluation. The figures confirm that both the number as well as the overall volume of loans in the financial sector rose sharply between 2008 and 2013 and larger parts of the population now use loan and savings deposit services. Ideally, the impact of the credit reference bureau in Component A was also to be measured via an improvement in the credit quality of the participating institutions and/or improved conditions for creditworthy customers of these institutions. It is difficult to quantify both of these effects because of the overlapping impacts of Component A with general economic developments. However, the self-evaluations of participating institutions reveal that they base their lending decisions partly on information from the credit reference bureau, and the number of borrowers becoming insolvent for reasons of structural over-indebtedness has fallen. The participating institutions also reported that customers with a good credit history actively use it to get the most favourable offers from the various institutions and therewith improve their conditions.

However, the effectiveness of the credit reference bureau is limited by the fact that institutions from Tier 4 (financial institutions not regulated by the central bank) and other private-sector businesses do not participate in the system. If customers from these Tier 1-3 institutions draw loans from these sources too (e.g. in the form of instalment loans when buying consumer goods), the information supplied by the credit reference bureau system on the solvency of the customer is not nearly as useful. This is particularly a problem with micro-customers, who in some cases raise a large part of their funds from informal sources. An expansion of the system is desirable, and a set target of the participants.

In the current system almost 1 million financial cards have already been issued for identification purposes (among roughly 18 million economically active citizens aged 15-64). In spite of the now dated technology, the installed identification scanners generally function fine. Users of the credit reference bureau report that most problems are caused by incorrect data entries by the participating institutions themselves. But the operator of the bureau and the executing agency have installed adequate mechanisms designed to safeguard the integrity of the data.

The deposit guarantee fund for MDIs currently guarantees deposits of up to UGX 3 million (about EUR 850) at three participating institutions. The share of guaranteed deposits in the total MDI deposit volume amounts to roughly 50%. The MDIs pay fees on the total volume of their deposits (and not only the guaranteed deposits) to the DPF. The volume of deposits has risen sharply since 2008 (see indicator 4) and Component B of the programme has contributed to this trend. However, customers are still somewhat sceptical with regard to the safety of their deposits at MDIs, partly because the funds available for campaigns to strengthen awareness of the MDI deposit guarantee system among the population were not fully utilised. Furthermore, there are reservations in the evaluation that the fund with its current capital resources would not be able to cushion the default of a large MDI, even if deposits are offset against existing claims from loans to customers. Moreover, the profits gained from diversifying risks at just three participating institutions are low. The executing agency counteracts these reservations with risk-adjusted premiums and the targeted monitoring of MDIs. It is planned to merge the MDI's deposit guarantee fund with that of the banks, which would enhance the diversification.

In spite of the misgivings regarding the effectiveness of the deposit guarantee fund for MDIs, the evaluation finds that both components are largely in line with state-of-the-art standards that apply around the world for deposit guarantee mechanisms and credit reference bureaus. Under Component A it had also been ensured early on that the financial cards system has created a suitable mechanism for identifying customers which is essential for the operation of a credit reference bureau, and in other countries – under similar circumstances – had hindered the successful development of CRB systems. The effectiveness of Component A is therefore rated good and in some parts even better, while the effectiveness of Component B is still rated good. The effectiveness of the programme overall is consequently rated good.

Effectiveness rating: 2

Efficiency

The credit reference bureau is operated by a private company with significant experience in this field of business. At the start of the programme, the operator received a licence providing a monopoly for three years to guarantee an acceptable risk/reward relationship. This monopoly licence has since been extended several times as the planned liberalisation of the market to take in competitors for the current operator proved difficult on account of unresolved ownership issues regarding data that has already been captured. From an FC perspective, subsidising the costs of a private operator (via the monopoly licence) and the users of the system (via temporary, direct subsidies of inquiry costs and hardware) proved to be a good way to establish a functioning credit reference bureau and mobilize own funds of the operator. In spite of this, the costs for participating institutions are significant, particularly after the phasing out of support for credit bureau inquiries. The smaller institutions are particularly affected by these costs since the correlation between costs and credit volume rises under fixed inquiry costs and small credit volumes. Although these costs are generally passed onto customers, they represent a competitive disadvantage compared to unregulated Tier 4 institutions. To take account of this fact, inquiries for micro credits (< 1 million UGX) are less expensive, but they are still high in comparison to the size and short term of the loans.

The correlation between the guaranteed deposits and the capital required for this in the deposit guarantee fund is sub-optimal given the weak diversification in the small MDI sector. In actual fact, a leverage factor of roughly 6 was achieved between the fund capital and the guaranteed deposits. However, the risk of a certain leverage value rises the lower the diversification is. It is clear from discussions with market participants that this disadvantage is only partially compensated for by greater trust in the sector (which is hard to quantify). To achieve better diversification, the deposit guarantee fund should be merged with that for Tier 1-2 institutions. The merger of the two funds was conceived at the start of the programme (the level of guaranteed deposits was based on the level of guaranteed deposits in the fund for banks), but accord-

ing to information from the project-executing agency, it could not be implemented from the outset because of the absence of approval of the necessary regulatory framework.

The efficiency of Component A is rated as good overall, while that of Component B is satisfactory given the low diversification. Based on the extensive impact of Component A on the financial system, however, the overall efficiency is rated good.

Efficiency rating: 2

Impact

The financial sector programme was to make a contribution to deepening and consolidating the formal financial sector and to developing a functional and stable financial system in Uganda (programme objective). The volume of lending by the Ugandan financial sector to the private economy has grown much faster since 2008 than in previous years, and has risen roughly four-fold since the start of the programme in 2008. Thus the financial sector has deepened since 2008, also taking population growth into account. Both the share of credits in the private economy (as a % of GDP) and the share of credits in the financial sector in general (as a % of GDP) have risen by about 5 percentage points since 2008, despite the economic crisis in 2012. This development was facilitated by the establishment of a credit reference bureau. At the same time, the share of non-performing loans relative to the total credit volume in Tiers 1-3 has risen modestly since 2008. This fact can be attributed to the low starting level (ratio of non-performing loans in 2008: 2%) and to the slower economic growth in 2012. Nonetheless, most market participants report that fewer loans are becoming non-performing because customers are already over-indebted at the time of drawing down a loan. In any case, a credit reference bureau cannot offer full protection against non-performing loans caused by weaker economic development or general business risks of customers if.

Financial intermediaries generally pass on the costs of inquiries at the credit reference bureau to customers. For customers taking out small, short-term loans, the costs often total several percent of the credit volume and have a tangible, negative impact on household incomes. However, the relevance of these costs drops sharply with higher credit volumes. It is unlikely that these costs affect a significant part of the solvent customers in the Tier 4 sector, a sector where the costs are much higher anyway and which is normally consulted for other reasons (quick liquidity, no formalities, etc.).

The "Doing Business Report" of the World Bank gives Uganda a much better evaluation in the categories depicting the targets of the programme than at the start of the programme. In 2008, Uganda was ranked 158th in the "ease of getting credit" indicator. In 2013 the country is now in position 40. For the "depth of credit information" indicator, Uganda now has a score of 5 (on a scale of 0-6), after the country still had 0 points on this scale back in 2008 (source: World Bank database). In certain areas with high competition (especially urban areas in Kampala), the ability to inquire about credit information at any time runs the risk of banks competing for solvent clients in an unsustainable manner (client poaching), for example by making inadequate offers to lure them over. The central bank is compensating for this trend with the support of German DC, by promoting the areas of consumer protection and responsible finance with various initiatives.

As part of Component B, micro-finance customers are now also able to raise their household income sustainably through savings deposits. That said, given its size the deposit guarantee fund only reaches a relatively small proportion of customers in the entire financial system. The fund currently guarantees a volume that corresponds to about 4% of the volume of existing deposit guarantee funds for Tier 1-2 customers (here too, only deposits up to UGX 3 million are guaranteed). This means limited deposits are secured for more than 600,000 customers. Component B would presumably have had a greater impact had there been more consistent publicity work.

The impact of Component A is rated as very good given the increase in the alternatives available to customers, the deepening of the financial system and the proactive avoidance of excessive structural debt. In spite of the small dimensions and the sluggish publicity campaign, the impact of Component B is still rated as good. All told we rate the overarching developmental impact of the programme as good.

Impact rating: 2

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Sustainability

Following the market entry at the start of the programme, the private operator of the credit bureau built up a sustainable and profitable business with the help of the monopoly licence and the additional income from running the FCS. Both the FCS and the credit reference bureau are fully functional, and there are no signs that this functionality could in any way be restricted in the future in its current form. However, the evaluation identifies some risks that go hand in hand with the planned liberalisation of the market (see Efficiency). Some other providers of credit bureau services have already expressed an interest in obtaining a licence to operate such a bureau in Uganda. Yet the success of liberalising the market depends heavily on the reaction of the current operator. The limited size of the market means that the current operator may well not continue to serve the market when faced with competition. But at the same time, the current operator is also the owner of the cleaned and quality-assured data collected so far. When moving into a situation where there is competition it must be ensured that the present quality of data is not lost. Any advantages of competition in the market must also be viewed in the context of higher fixed costs (as each operator must bear the same fixed costs). The necessary separation of the FCS from the running of the credit reference bureau following the admittance of several credit reference bureau operators requires that the future operator of the FCS is able to pursue this independent business profitably. Since the number of newly issued FCs is naturally falling on a steady basis (existing customers do not need a new FC), according to the evaluation mission there are severe question marks hanging over the sustainability of a business model focusing solely on operating the FCS. Additionally, the Ugandan government is planning to introduce a national passport for all Ugandans that could be used for identification and would make an additional FCS obsolete. Even though the national passport programme is only making slow progress, this also raises the business risk of a potential FCS operator.

The capital resources of the deposit guarantee fund for MDIs have risen modestly since the launch in 2012. Nonetheless, there are some doubts that the fund could cope with an insolvency of the largest MDI in the market. Thus the sustainability of the fund must be ensured by the project-executing agency through constant monitoring and early intervention in the event of problems. To secure sustainability in the longer term, the fund should be merged with the existing fund for banks. Similarly to expanding the credit reference service to the private sector, this development is reliant on the completion of the new, comprehensive financial sector regulation. The draft regulation is currently in limbo at political committees in Uganda.

From today's perspective we rate the sustainability of both components as good, despite the listed risks. The project-executing agency needs to address these risks proactively to ensure the positive impacts continue to prevail.

Sustainability rating: 2

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Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Ratings level 1-3 denote a positive assessment or successful project while ratings level 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Ratings 1-3 of the overall rating denote a "successful" project while ratings 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (rating 3).