Uganda: Development Bank DFCU I-III

Ex-post evaluation

OECD sector	24030 – Financial intermediaries of the formal sector	
BMZ project ID	1989 66 590 DFCU I 1994 65 030 DFCU II 1996 65 019 DFCU III	
Project-executing agency	Development Finance Corporation of Uganda (DFCU-Group)	
Consultant	Not applicable	
Year of ex-post evaluation	**2005**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation (disbursement)	01/1991	06/1992
Period of implementation (months)	72 months	108 months
Investment costs	no information available	EUR 17.00 million
Counterpart contribution	no information available	EUR 9.84 million
Financing, of which Financial Cooperation (FC) funds	EUR 7.16 million	EUR 7.16 million
Other institutions/donors involved	none	none
Performance rating (all three projects)	3	
• Significance / relevance	3	
• Effectiveness	3	
• Efficiency	3	

Brief Description, Overall Objective and Project Objectives with Indicators

The project executing agency for the three credit lines DFCU I-III was the Development Finance Corporation of Uganda (DFCU), a Ugandan development bank. The target group of the project was mainly small and medium-sized private enterprises (SMEs) in the Ugandan industrial sector.

The overall objective of the projects DFCU I-II were to improve the balance of payments, to create jobs and to strengthen the private sector and the financial sector in general. The overall objective of the credit line DFCU III was to expand the production capacities of the enterprises operated by the target group and to ensure their profitable operation. The concrete project objectives of the credit lines DFCU I and II were to sustainably increase production, to improve the overall productivity of the target enterprises and to enhance the performance of DFCU. The project objectives for the DFCU III credit line were the improvement of the credit supply to the target enterprises as well as the enhancement of the performance of the bank. In general terms the different target systems of the projects DFCU I-III were adequate. From today's perspective, the target system would have to be formulated in a uniform and consistent manner since the projects DFCU I-III do no differ in any significant degree, neither in terms of substance nor in fact. The project purpose as defined from today's point of view would be to give private SMEs in

Uganda permanent access to formal financial services. The purpose is to contribute to economic growth and to broaden and deepen the financial system in Uganda. A total of EUR 7.16 million were made available for the three credit lines.

Project Design / Major Deviations from the original Project Planning and their main Causes

DFCU was set up in 1964 as a commercially oriented development bank. Since the start of the cooperation with DFCU in the context of Financial Cooperation at the beginning of the 1990s, however, both the shareholder structure and the organisational set-up and business orientation of DFCU changed substantially. In 1994 DFCU took over the Uganda Leasing Company. In 1998/1999 the "DFCU Group" was completely restructured. In 2000 DFCU took over the Sun Trust Bank, which acts today under the brand name of "DFCU Bank". Overall, DFCU as a group has developed into an integrated bank focussing on the area of corporate finance. Besides long-term financing and leasing (corporate banking), DFCU also covers the areas of retail banking and mortgage loans (private banking).

The FC projects were implemented in the period 1992-2001. In the years 1998 and 1999 the project-executing agency DFCU was restructured. In the period 1992 to 1999 DFCU financed altogether 22 final projects (FC funds: EUR 5.96 million). As from 1999 the extension of long-term loans under FC programmes was terminated. As had been agreed, FC funds of EUR 1.2 million were provided for the first use of funds by DFCU Leasing to expand its long-term leasing business.

The average investment amount of the 22 final projects was EUR 750,000 each, of which around 36% each were financed from FC funds. The projects supported private industrial enterprises, which on principle belong to the target group as defined for the project. Financing was provided mainly for enterprises active in the processing of agricultural products (7 projects), the manufacturing industry (9 projects) and horticulture (3 projects) (other projects: 3). Full disbursement of the three credit line was achieved after nine years (planned: 6 years). Altogether, the total investment volume of the 22 projects financed was approximately EUR 17 million. Thus, with every Euro of FC invested almost another 2 Euros could be mobilised. We consider this ratio as very favourable.

As regards the first use of FC funds, the performance of the financed final projects was not satisfactory. Only 11 of a total of 22 projects can be described as "successful" (67% of the funds provided, including the funds extended to DFCU Leasing; 61% of the funds provided without DFCU Leasing). A final project is considered as successful if the enterprise is still in operation today and works profitably with full coverage of costs. With the help of the investments financed the enterprises were able to expand their production and to create new jobs. Due to their export activities, eight project companies contribute to improving the balance of payments of the country. Talks with managers from the companies have confirmed that the financing provided under the projects DFCU I – III during the 1990s had a significant positive influence on the development of these companies. The remaining 11 final projects must be considered as failures. 9 enterprises do no longer exist today. In the case of 2 companies production was changed completely and has nothing to do with the originally financed investment.

The success indicators defined at the time of the project appraisal, namely "payment arrears of over three months account for less than 15% of the total portfolio", "the default ratio of the total portfolio after realisation of securities is below 10%" and "the operational efficiency of DFCU (measured by the operative costs in relation to the loan portfolio) is below 3%", were not achieved by DFCU in the course of the project implementation. However, the indicators chosen are little meaningful with regard to the achievement of the project objectives.

The three credit lines did, however, make a substantial contribution to promoting the industrial sector in Uganda. Around two thirds of the projects (measured by the financing volume) were successful. Especially the talks with the staff from the DFCU group in the context of the final evaluation conducted in Uganda made clear that the failures were largely due to the lack of institutional capacity within DFCU at the time of project implementation. The majority of unsuccessful projects failed due to the lack of management capacities at the enterprises, in terms of both know-how and seriousness of the partners. The fact that part of the credit funds made available were used for private purposes makes clear that, on the one hand, the necessary financial control of the projects did not exist and that, on the other hand, the required selection mechanisms were not implemented in a stringent manner.

The FC projects did not have the intended positive structural effects on the Ugandan financial sector. In fact, DFCU discontinued the extension of FC financed investment loans in 1999 after FC funds made available for first use had been fully used. At this time, half of the sub-loans had failed their purpose and the performance of DFCU overall was not sufficient. However, with the restructuring of the DFCU in the years 1998/1999 the new management consequently started to realise the securities that had been furnished under these loans. The consequence: Almost 90% of the FC funds provided for the first use could be recovered. Currently these funds are being employed very successfully on a revolving basis in the second and third use to refinance normal business operations, especially in the three areas of leasing, mortgage loans and also long-term finance, which has by now been taken up again. In addition, as contractually agreed DFCU used remaining funds of EUR 1.2 million on a revolving basis for the successful and sound expansion of its long-term leasing business.

As regards the achievement of the overall objectives it has to be stated that these were not sufficiently fulfilled in the period 1992 to 1999. However, the situation changed as from 1999. DFCU successfully used the remaining funds that had not been disbursed at the first-use level to expand its leasing business (new financing instrument). All reflows of funds received under the above-mentioned investment loans have been used (on a revolving basis at the second and third use level) equally successfully and on a sustained basis in DFCU's other areas of business, among others long-term investment financing, which has been resumed. These are positive structure-building developmental impacts of the FC project, which, given the bad performance of the project-executing agency in the years 1992 to 1999, had actually not been expected. Taking into account the special positive development from 1999 onwards we judge the achievement of the overall objectives and the project objectives overall as (still) sufficient.

Key Results of the Impact Analysis and Performance Rating

Today the DFCU Group represents an important pillar of the Ugandan banking sector. In addition, it is certainly one of the most innovative banks in Uganda. It is the fourth largest financial institution and maintains 13 branch offices. In terms of business volume it is of central importance for the Ugandan banking sector. Still more important, however, is the innovative strength of the group. The DFCU Group is market leader in the leasing business and one of the most important providers of long-term financing. The FC funds provided helped to substantially strengthen the refinancing base of the DFCU Group and make an important contribution to strengthening DFCU’s capacity to sustainably expand its business areas in the future as well. It is already apparent today that in the next few years the group will play an important role in the area of SME financing. Even bearing in mind that the three credit lines, which are evaluated here, contributed only indirectly to building up the institution, their importance for the growth process of the DFCU Group cannot be denied.

The extension of loans under the three FC credit lines was implemented without any regard for gender. Three of the 22 projects promoted were initiated by women. Under all projects jobs were created for both men and women, with the actual percentage distribution depending strongly on the industry.

Environmental aspects were explicitly taken into account in the loan appraisal procedure. In the event of environmentally sensitive projects environmental impacts assessments (EIAs) were conducted by the Ugandan environmental authority. Due to the use of modern production and disposal technologies most of the projects had generally positive environmental impacts.

The risks to the sustained developmental effectiveness of the three FC projects are on the level of the enterprises promoted and the DFCU Group level. From today’s point of view, due to the positive business development and the balanced shareholder structure of the project-executing agency, the latter risk can be considered as low. As was the case at the time of the project appraisal, there is still the risk at the level of the enterprises promoted that in the long run the enterprises do not operate successfully in the market. However, as far the projects are concerned that have operated successfully up to now, it can be assumed that only in exceptional cases the enterprises concerned will fail in the market due to stronger competition.

In a summarized assessment of all impacts and risks described above we have arrived at the following rating of the project's developmental effectiveness:

<u>Effectiveness</u>

The concrete project objectives of the credit lines DFCU I and II were to sustainably increase production, to improve the overall productivity of the target enterprises and to enhance the performance of DFCU. The project objectives for the DFCU III credit line were the improvement of the credit supply to the target enterprises as well as the enhancement of the performance of the bank. In our assessment of the developmental effectiveness of the projects we distinguish two periods, namely the periods before and after the restructuring of DFCU in the years 1998/1999. In the period 1992 to 1999 only 67% of FC funds (in terms of volume) were invested successfully on a first-use basis in small and medium-sized enterprises (SME) in the industrial sector. In the course of the restructuring, as from 1999, DFCU consequently started to collect the outstanding (and overdue) loans and to realise the related securities. In this way 87% of the funds could be saved. In addition, as contractually agreed DFCU used the remaining (first use) funds of EUR 1.2 million for the successful and sound expansion of its long-term leasing business. In the second and third use the FC funds were used on a revolving basis to refinance the long-term lending business and the leasing business on a sustained basis. The overdue ratio at the time of the final evaluation was around 6% in the area of long-term financing and just under 11% in the leasing business. This performance represents an acceptable auxiliary indicator to substantiate that the funds invested were used successfully and productively by the SMEs and will be available to the DFCU Group (from reflows including interest payments) on a long-term basis for further lending activities. Most of the target enterprises were able to increase their productivity as a result of the investment measures. In particular since its restructuring DFCU has made an important contribution to improving the supply of long-term loans to SMEs. In addition, it successfully introduced a new financing instrument (leasing) in the market. At the time of the final evaluation the position of the DFCU Group in the Ugandan financial sector had been clearly strengthened. Overall we judge the effectiveness of the project – taking special account the positive development of DFCU since 1999 – still to be sufficient (**sub-rating 3**).

<u>Relevance/significance</u>

The overall objective of the projects DFCU I-II were to improve the balance of payments, to create jobs and to strengthen the private sector and the financial sector in general. The overall objective of the credit line was to expand the production capacities of the enterprises operated by the target group and to ensure their profitable operation. Only two thirds of the FC funds provided for long-term financing and for the expansion of the leasing business were employed successfully in the first use. At the second use and third use levels the funds were in general employed without any major problems. Overall, the enterprises promoted made an important contribution to the development of the Ugandan industrial sector and helped to create and safeguard jobs. At the same the enterprises were very much export-oriented in their operations. In this respect they also had a positive impact on the balance of payments. The three FC projects made an important contribution to reducing financing bottlenecks of SMEs, especially in the industrial sector. However, from today's perspective the access to long-term refinancing in local currency (instead of foreign currency as assumed at the time of the project appraisal) represents a major problem in Uganda. Still it has to be stated that, especially with regard to the first-use of funds, the impacts actually achieved fell short of the impacts that had been expected. Overall we judge the achievement of the overall objectives – taking special account of the positive development of DFCU since 1999 – still to be sufficient (**sub-rating 3**).

<u>Efficiency</u>

The lending terms of the DFCU Group were set in conformity with the market. On principle, this also applies to the loans financed from FC. However, certain problems occurred with regard to the first use of FC funds. In some cases the funds committed were not entirely used for the agreed project purpose. This is due to unsatisfactory and little professional selection of borrowers and a monitoring process which was inadequate at the time of project implementation

(1992-1999). But due to the much more favourable experience gained since 1999 we consider the allocation efficiency as still sufficient. Our judgement of the production efficiency is rather critical. Due to high administrative costs and a disadvantageous cost-income ratio the cost structure is unfavourable. Nevertheless, we assume that already in the course of the 2005 business year the situation will improve substantially due to the expected growth in the business volume. Overall we judge the effectiveness of the project – taking special account of the positive development of DFCU since 1999 – to be sufficient (**sub-rating 3**).

Overall, under consideration of the aspects of effectiveness, relevance and efficiency we assess the project as having **adequate developmental effectiveness (rating 3)**. DFCU successfully and sustainably established and expanded two new financing instruments (leasing and long-term loans) in the Ugandan market. It opened up new customers groups (SMEs) in a long-term basis. Thus, the project made an important structure-building contribution to broadening and deepening the financial sector in Uganda. However, this judgement has to be put into perspective since the positive assessment of the three FC projects benefited substantially from the restructuring of the DFCU Group, which was successfully implemented in the years 1998/1999 ("windfall profit") and to which the FC projects did not make an active contribution. Thus, the direct contribution of the FC projects to the turnaround of the DFCU Group is limited. Indirectly, however, FC has been a reliable and long-standing partner of the DFCU Group – especially in difficult times – and as such has made an important contribution to stabilising the long-term refinancing base and enabled the DFCU Group to gain useful experiences in terms of institutional advancement.

General Conclusions

The example of the DFCU project evaluated here shows that in most developing countries the availability of long-term financing for investment projects/capital investments constitutes a major bottleneck with regard to the promotion of growth and employment. FC projects in the financial sector with the focus on SME promotion have to be planned and implemented strictly in line with the requirements laid down in the BMZ sector strategy paper on "Financial System Development". A strict "financial sector perspective" should be applied when determining the project design and concept. The focus should in particular be on the capacity and efficiency of the financial intermediary. In the DFCU I-III projecs evaluated here this was not the case. Besides having qualified and motivated staff (market-conforming incentive mechanisms!) the financial intermediary acting as project-executing agency must in particular have an adequate lending technology, appropriate organisational structures and management information systems in order to be able to use the FC funds provided in an efficient, targeted and sustainable manner (on a revolving basis). The successful turnaround of DFCU in the years 1998/1999 impressively underlines the effectiveness of this approach. Before the restructuring DFCU was a relatively inefficient financial institution with a weak management, an incentive system that did not work and sub-optimal lending technology. In 1998 DFCU was restructured strictly according to market-economy principles. A competent and qualified management team was recruited from commercial banks (abroad). Market conforming and performance-related incentive mechanisms were implemented. The business processes, in particular the lending process, was restructured. Overdue loans were monitored systematically and securities furnished for the loans were realised consequently. As a result the "loan discipline" increased noticeably. The overall orientation of the financial institution was readjusted (among others, through the acquisition and integration of a commercial bank). As a result the refinancing base (deposits) was diversified and the dependence on donor funds was reduced substantially. The Supervisory Board adopted an ambitious three-year plan as a guideline for the re-orientation of the different areas of business of the bank. Since the implementation of the new orientation DFCU has developed into an innovative bank, which has the best position of all banks in the Ugandan financial sector.

Legend

Developmentally successful: Ratings 1 to 3	
Rating 1	Very high or high degree of developmental effectiveness
Rating 2	Satisfactory developmental effectiveness
Rating 3	Overall sufficient degree of developmental effectiveness
Developmental failures: Ratings 4 to 6	
Rating 4	Overall slightly insufficient degree of developmental effectiveness
Rating 5	Clearly insufficient degree of developmental effectiveness
Rating 6	The project is a total failure

Criteria for the Evaluation of Project Success

The evaluation of the "developmental effectiveness" of a project and its classification during the ex-post evaluation into one of the various levels of success described in more detail below concentrate on the following fundamental questions:

- **Are the project objectives reached to a sufficient degree (aspect of project effectiveness)?**
- **Does the project generate sufficient significant developmental effects (project relevance and significance measured by the achievement of the overall development-policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?**
- **Are the funds/expenses that were and are being employed/incurred to reach the objectives appropriate and how can the project's microeconomic and macroeconomic impact be measured (aspect of efficiency of the project conception)?**
- **To the extent that undesired (side) effects occur, are these tolerable?**

We do not treat **sustainability**, a key aspect to consider for project evaluation, as a separate category of evaluation but instead as a cross-cutting element of all four fundamental questions on project success. A project is sustainable if the project-executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms, or to carry on with the project activities on their own and generate positive results after the financial, organisational and/or technical support has come to an end.