AMFIU

Association of Microfinance Institutions of Uganda

MICROFINANCE INDUSTRY

REPORT 2021-2022

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EXECUTIVE SUMMARY

The Uganda Microfinance sector is one of the sectors supporting the development of the economy and empowering people economically as well. The regulations in place have supported the growth of the sector by providing guidelines that streamline the operations of the sector to the benefit of both the shareholders and their customers.

This report gives the Country's overview in Chapter One, the Global Financial Services Sector in Chapter Two, Uganda's Financial Services Sector in Chapter Three and then Performance analysis in Chapter Four. Data was collected from 80 financial institutions that submitted reports through the Performance Monitoring Tool and analysed by the Performance Monitoring System at AMFIU.

A Stress Testing exercise in addition was conducted by International Financial Corporation (IFC) a member of the World Bank Group in line with the financial data submitted in 2021.

Performance Highlights: 2021

INDICATOR	SACCO	MFI	MDI
Average Loan Disbursed	2,589,435	909,728	3,659,108
Portfolio Yield	50.17 %	65.97 %	44.02 %
Operation Self Sufficiency	101.16 %	96.14 %	112.83 %
Return on Assets	3.78 %	-1.42 %	0.13 %
Return on Equity	9.15 %	-4.67 %	0.39 %
Operating Expense Ratio	40.11 %	51.96 %	32.39 %
Capital Adequacy Ratio	45.36 %	48.93 %	30.26 %
Portfolio at Risk	18.18 %	10.28 %	5.25 %

BANK

ACRONYMS

aBi	Agricultural Business Initiative
AMFIU	Association of Microfinance Institutions of Uganda
Bn	Billion
BoU	Bank of Uganda
CGAP	Consultative Group To Assist the Poor
CI	Credit Institution
CRB	Credit Reference Bureau
DE	Debt to Equity
DFS	Digital Financial Services
ESG	Environment Social and Governance
FI	Financial Institution
FIA	Financial Institutions Act 2004
FSDU	Financial Sector Deepening Uganda
FSPs	Financial Service Providers
GDP	Gross Domestic Product
GNI	Gross National Indicator
GoU	Government of Uganda
GWPs	Gross Written Premium
ICT	Information and Communications Technology
MDI	Microfinance Deposit-taking Institution
MFI	Microfinance Institution
MoFPED	Ministry of Finance, Planning and Economic Development
MSCL	Microfinance Support Centre Limited
MSMEs	Micro Small and Medium Enterprises
NFIS	National Financial Inclusion Strategy
NGO	Non-Governmental Organization

NIN	National Identification Number
NIRA	National Identification and Registration Authority
NITA	National Information Technology Authority
NPS	National Payment System
OER	Operating Expense Ratio
OSS	Operating Self Sufficiency
PAR	Portfolio at Risk
PMS	Performance Monitoring System
PMT	Performance Monitoring Tool
PRIDE	Promotion of Rural Initiatives and Development Enterprise
PY	Portfolio Yield
ROSCAs	Rotating Savings and Credit Associations
SACCO	Savings and Credit Co-operative
SMEs	Small and Medium Enterprises
SPM	Social Performance Management
SPTF	Social Performance Task Force
UBOS	Uganda Bureau of Statistics
UCA	Uganda Cooperative Alliance
UCCFS	Uganda Central Cooperative Financial Services
UCSCU	Uganda Cooperative Savings and Credit Union
UGX	Uganda Shillings
UMRA	Uganda Microfinance Regulatory Authority
UNHS	Uganda National Household Survey
US	United States
VSLAs	Village Savings and Loan Associations

MICROFINANCE

CHAPTER ONE:

INTRODUCTION AND COUNTRY OVERVIEW

1. INTRODUCTION

As an umbrella body, AMFIU continues to collaborate with other development partners to build a strong and sustainable microfinance sector in Uganda through implementation and coordination of various activities aimed at enhancing the professional delivery of financial services that include; performance monitoring, research and information dissemination, capacity building, financial inclusion initiatives and digital financial services among others. This is the fifth report on the state of Microfinance in Uganda and its main purpose is to give an overview of the microfinance sector.

1.1 Objectives of the Report

i. To present updates on the current performance of the sector, indicate emerging issues as well as opportunities that can support the sector and further contribute to the growth and development of the country at large.
ii. To present financial and social analysis of financial institutions in the microfinance sector.

1.2 Methodology

Information presented in the report has been gathered from literature of various stakeholders, face to face interaction with financial institutions as well as financial data submitted by financial institutions to AMFIU on a quarterly basis using the Performance Monitoring Tool (PMT).

1.3. Population and Country Level Overview

1.3.1 Demography

According to Worldometer report the population of Uganda was estimated to be 49,044,537 as of Monday, October 17, 2022. According to United Nations data, Uganda's population growth rate is currently 3.32%. The growth rate has remained around 3% for the past several decades in Uganda. This is influenced heavily by the country's fertility rate of 4.78 births per woman. At this growth, over 1 million people are added to the population each year.

1.3.2 Economy

According to preliminary data from the BoU annual report 2020/2021, Real GDP grew by 3.3% in FY2020/21 slightly higher than the 3.0% registered in FY2019/20. On the demand side of the economy, growth was driven by final consumption expenditure and investment spending particularly in the transport sector.

On the other hand, aggregate demand was hampered by an increase in imports that outstripped the marginal growth in exports. The manufacturing and service sectors registered growth rates of only 2.1percent and 2.5 percent, respectively but below the historical average. The agricultural sector grew by 3.5 percent, which was below the 4.8 percent growth rate registered in the previous year.

Growth in private sector credit declined to 8.1 percent in FY 2020/21 from 11.7% in FY2019/20. Most of the deceleration was on account of shilling denominated lending which grew by 9.9 percent, lower than the 15.6 percent growth rate registered in FY2019/20.
The growth in private sector credit also remained uneven across major sectors of the economy, with the mining and quarrying and trade sectors registering negative growth rates in FY2020/21.

1.3.3 Characteristics of households and household population

According to the Uganda National Household Survey (UNHS)conducted by the Uganda Bureau of Statistics (UBOS), Uganda's population was estimated at 40.9 million persons in 2019/20 indicating an increase of about 3.2 million persons from 37.7 million estimated from the 2016/17 survey.

The sex ratio was estimated at 97 females per 100 males. The proportion of the population aged below 14 years constituted slightly less than half of the total population (44 %). The urban population increased by two percentage points from 25 percent in 2016/17 to 27 percent in 2019/2020 as shown below:

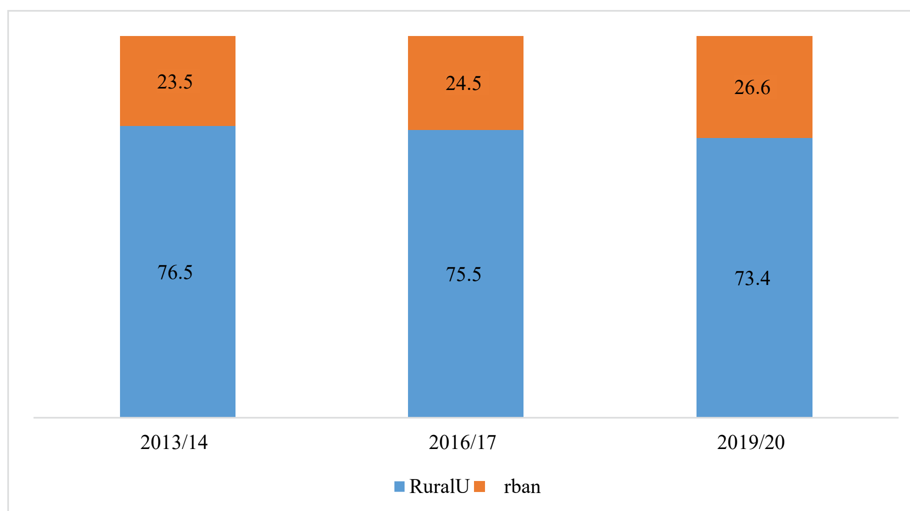


Chart 1: Rural/Urban Residence

Source: UNHS 2019/2020

The average household size in Uganda was estimated at 5 persons with no observable changes between 2016/17 and 2019/20. On household headship, three in every ten households (31%) were headed by females while Karamoja sub-region had the highest percentage of female headed households (65%). Five percent of the population had lived in another place before their current residence. Four in every ten persons (42%) moved from rural to other rural areas while 12 percent moved from rural to urban areas.

1.3.4 Household expenditures, income poverty and inequality of income

According to findings from the UNHS 2019/2020, in absolute numbers, the persons in poverty increased from 8 million to 8.3 million respectively over the 2016/2017 to the 2019/2020 survey period. This implies that, one in five persons in Uganda lives in poverty. There are about 3.5 million persons living below the food poverty line. Overall, the incidence of rural poverty is more than two times higher than that of urban poverty, but the gap seems to be closing especially with strong growth in agriculture.

At regional level, in the 2016/17-2019/20 period, poverty increased and was more severe in the northern region both in terms of absolute numbers (3 million persons) and by percentage share of the population (35.9%) compared to the 2012/13-2016/17 period when poverty was higher in the eastern region. This marks a switch in the severity of poverty at regional level. The COVID pandemic has to a great extent disrupted Uganda's poverty reduction path.

Based on the new poverty line of USD1.77 per person per day (equivalent to UGX87,000) the share of Ugandans living in poverty stood at 30.1 percent, representing 12.3 million poor persons in 2019/20. Thus, using the upper poverty line increases the number of poor persons by 4 million from that estimated using the existing poverty line of USD1.0 of 8.3 million. Nearly 33.8 percent of the rural population and 19.8 percent of the urban population are living in poverty.

The mean per household monthly income increased from UGX 324,288 in 2016/17 to UGX 339,263 in 2019/20 representing an annualized growth rate of 1.4 percent. The growth is driven by rural areas with per household consumption expenditure of UGX 285,119 in 2019/20 from UGX 269,197 in 2016/17, translating into an annualized growth rate of 1.8 percent. The per household consumption expenditure among urban households remained unchanged.

1.3.5 Households in subsistence economy

The findings from the Uganda National Household Survey 2019/2020 indicate that 39 percent of households (3.5 million) were in the subsistence economy compared to 61 percent (5.4 million) in the non-subsistence economy in 2019/20. The proportions do not differ from that of the 2016/17. Of the 3.5 million households in the subsistence economy, 62 percent were engaged mainly in subsistence agriculture, 24

percent were in income generating activities, 12 percent were earning a wage/salary and two percent were not working at all. Acholi sub-region had the largest share of households under the subsistence economy (78 percent). The largest share of households contributing to the subsistence economy were those engaged in subsistence farming (45%).

Poverty in Uganda remains a rural phenomenon, but urban poverty is on the rise. The share and number of poor persons in urban areas significantly rose. Overall, the incidence of rural poverty is more than two times higher than the incidence of urban poverty, but the gap seems to be closing especially with strong growth in agriculture.

1.3.6 Housing and household characteristics

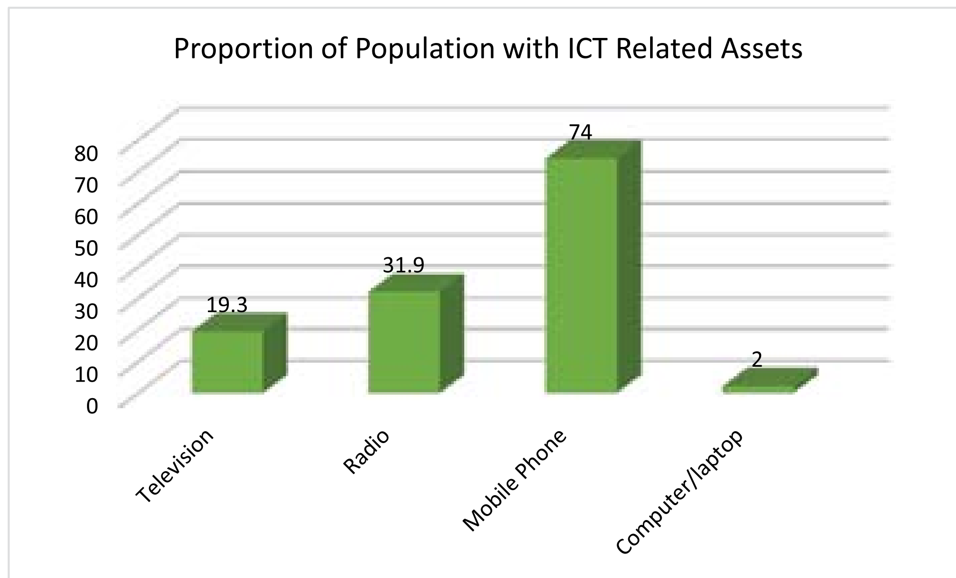
Overall, 81 percent of households live in owner occupied dwellings, 15 percent in rented dwellings while five percent live in free dwellings according to the 2019/2020 UNHS. The majority of households in rural areas live in owner occupied dwellings (90%) compared to 52 percent in urban areas. Seventy-six percent of the households live in dwellings with iron sheet roofs while 23 percent have thatched roofs.
Overall, 69 percent of the households live in dwellings that are constructed with brick walls while 28 percent have dwellings with walls made of mud and poles. Majority of the households (27%) use solar kit for lighting, 19 percent use grid electricity and 11 percent used solar home systems. Seven in every ten households in Uganda (73%) use firewood for cooking while two in every ten households (21%) used charcoal. Wood fuel use constituted 94 percent.

1.3.7 Information and Communication Technology

Uganda's population is increasingly getting connected to the world of digital information via mobile phones and the internet services because of the potential of enhancing one's social transformation and economic growth. Consequently, it is becoming a norm to own a cell phone, irrespective of the person's age today. The country has seen an increase in ICT infrastructure development and services uptake.

Seventy four percent of the households owned a mobile phone as shown in the graph below. Thirty two percent of the households owned at least one set of a radio. Three percent of the population aged 10 years and above had used a computer in the last 3 months and for those that had used a computer, 59 percent used desktops. Overall, 84 percent of household members reported that they used the internet for social networking; 86 percent reported that they used the internet via their mobile phones.

Chart 2: Proportion of Population with ICT related Assets



Source: UNHS 2019/2020

1.3.8 Household enterprises

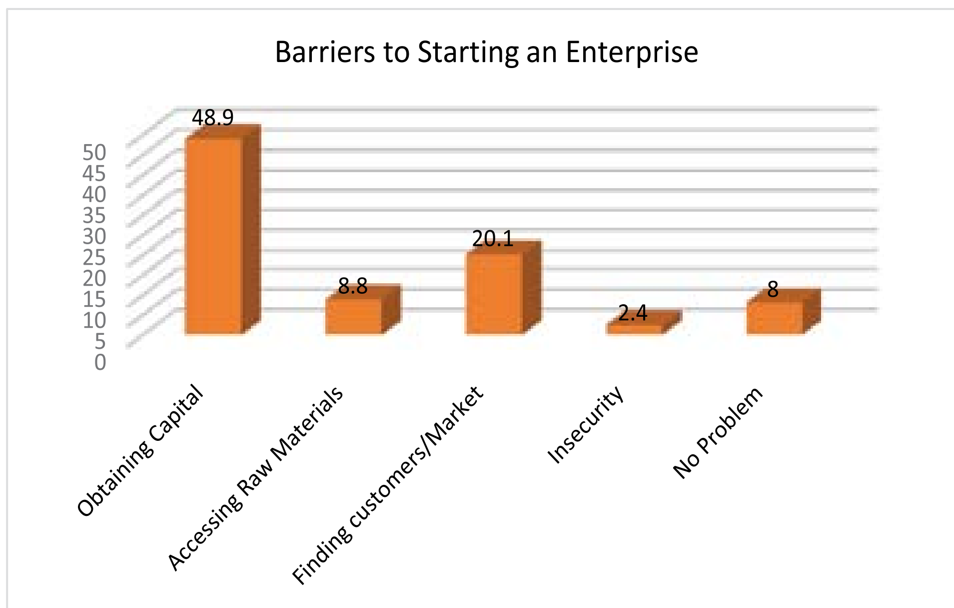
Findings from the UNHS2019/2020 show that about 35 percent of the households were operating enterprises before the Covid-19 pandemic and this reduced to 28 percent during the Covid-19 pandemic. Two-thirds (66%) of the persons engaged in household enterprises were working owners followed by paid employees (19%).

Eight in every ten (81%) of the household enterprises used their own savings as the main source of startup capital.

Only one percent of the household enterprises took loans from SACCOS (cash rounds) to startup their business activity. Overall, trade (47%) and manufacturing (21%) were the most common enterprises operated by the households accounting for more than two-thirds (68 percent) of all the activities.

Based on findings from the UNHS, about one half (49%) of the household enterprise operators reported that obtaining start-up capital was their major barrier to starting an enterprise. This was followed by Finding customers/market was the second reported major problem for starting the enterprises (20%) as shown in the graph below:

Chart 3: Barriers to Starting an Enterprise



1.3.9 Financial inclusion

Overall, fifty-one percent of households keep money at home/secret place, 27 percent save with Village Savings and Loan Associations (VSLAs) and only 12 percent were using commercial banks as savings mechanisms. About half (51 %) of the population uses mobile money services.

Twenty percent of the population had memberships with informal financial institutions. Informal channels as a source of loans accounted for 57 percent of the sources. Only 16 percent sought loans/credit from banks. Twenty-four percent of adults sought loans from other formal financial services other than banks. One in four households that sought loans/credit in rural areas (24%) sought it to buy consumption goods and services compared to one in every five (20%) in urban areas.

CHAPTER TWO:

THE GLOBAL FINANCIAL SERVICES SECTOR

2. Introduction

According to the Economist Intelligence report, the financial services industry constitutes at least 20% of the global economy and the impact of the financial sector on economic growth is significant. Findings from the Financial Services Global Market Report 2022 indicate that the global financial services market grew from $23,319.52 billion in 2021 to $25,588.3 billion in 2022 at a compound annual growth rate of 9.7%. The Russia-Ukraine war disrupted the chances of global economic recovery from the COVID-19 pandemic, at least in the short term. The war between these two countries led to economic sanctions on multiple countries, surge in commodity prices, and supply chain disruptions, affecting many markets across the globe.

2.1 ACCESS TO FINANCE

2.1.1 Account Ownership

Account ownership, the fundamental measure of financial inclusion and a gateway that equips men and women to use financial services in a way that facilitates development. Owners of accounts—whether those accounts are with a bank or regulated institution such as a cooperative, microfinance institution, or mobile money service provider—are able to store, send, and receive money, enabling the owners to invest in health, education, and businesses.

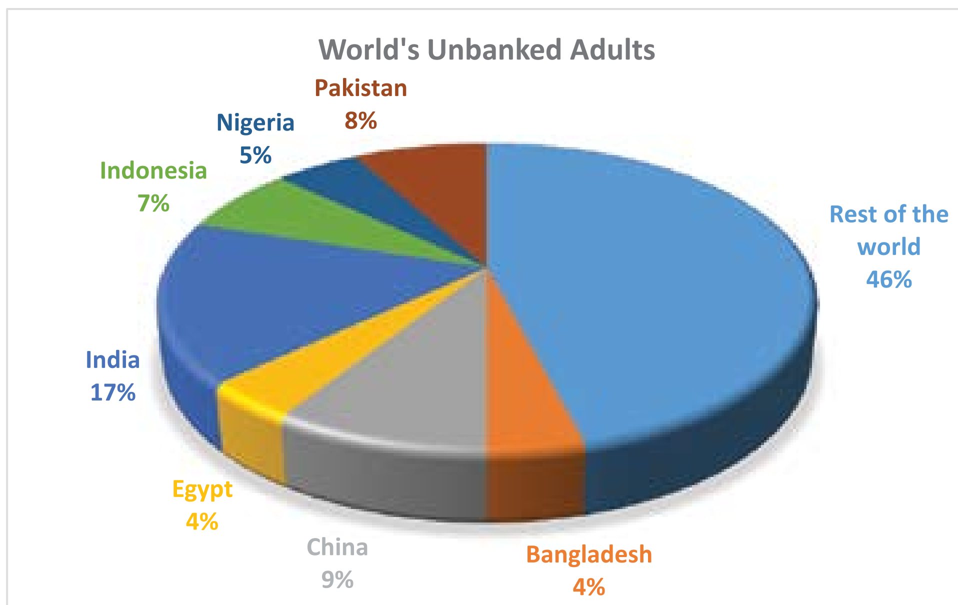
The Global Findex 2021 survey findings revealed growth in account ownership as follows:

- Worldwide, account ownership increased by 50 percent in the 10 years spanning 2011 to 2021, to reach 76 percent of the global adult population.
- From 2017 to 2021, the average rate of account ownership in developing economies increased by 8 percentage points, from 63 percent to 71 percent.
- Mobile money is driving growth in account ownership, particularly in Sub-Saharan Africa, where 33 percent of adults have a mobile money account.
- Recent growth in account ownership has been widespread across dozens of developing economies.This geographic spread is in stark contrast to that from 2011 to 2017, when most of the newly banked adults lived in China or India.
- The gender gap in account ownership across developing economies has fallen to 6 percentage points from 9 percentage points, where it hovered for many years.

Although account ownership increased on average in both high-income and developing economies, the average rate of growth in developing economies was steeper. Overall, account ownership in developing economies grew by 30 percentage points, from 42 percent in 2011 to 71 percent in 2021—a more than 70 percent increase.

Individual economies saw different rates of growth over the past decade. Between 2011 and 2021, economies such as Peru, South Africa, and Uganda drove up the average with account ownership increases of 25 percentage points or more. Uganda, in fact, saw its rate more than triple, from 20 percent to 66 percent. In India, account ownership more than doubled in the past decade, from 35 percent in 2011 to 78 percent in 2021. However, more than half of the world's unbanked adults live in seven countries as shown in the figure below:

Chart 4: Proportion of World's Unbanked Adults



Source: Global Findex Database 2021

2.1.2 Mobile Money

Mobile money has become an important enabler of financial inclusion in Sub-Saharan Africa—especially for women—as a driver of account ownership and of account usage through mobile payments, saving, and borrowing

According to the Global Findex Survey 2021, 55 percent of adults in Sub-Saharan Africa had an account, including 33 percent of adults who had a mobile money account—the largest share of any region in the world and more than three times larger than the 10 percent global average of mobile money account ownership.

Sub-Saharan Africa is home to all 11 economies in which a larger share of adults had only a mobile money account rather than a bank or other financial institution account.

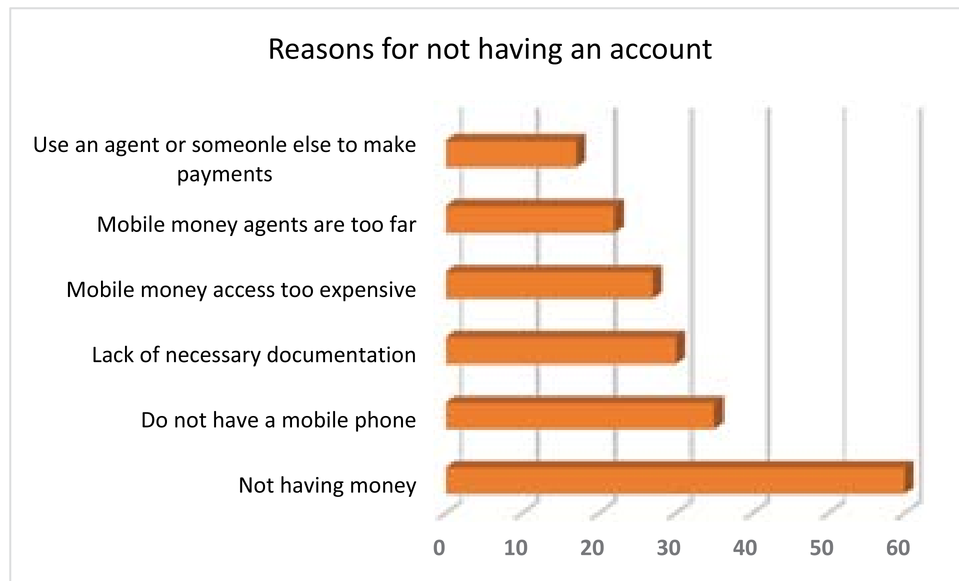
The spread of mobile money accounts has created new opportunities to better serve women, poor people, and other groups who traditionally have been excluded from the formal financial system. Indeed, there are some early signs that mobile money accounts may be helping to close the gender gap.

Although mobile money services were first launched so that people could send remittances to friends and family living elsewhere within the country, adoption and usage have spread beyond those origins. Such services are still a powerful tool for sending domestic remittances, but the Global Findex survey revealed that in 2021 about three in four mobile account owners in Sub-Saharan Africa used their mobile money account to make or receive at least one payment that was not person-to-person.

2.1.3 Barriers to account ownership

Globally, 24 percent of adults are unbanked. The findings of the Global Findex survey 2021 reveal that, lack of money, distance to the nearest financial institution, and insufficient documentation were consistently cited by the 1.4 billion unbanked adults as some of the primary reasons they did not have an account as shown in the figure below:

Chart 5: Reasons for not having an Account

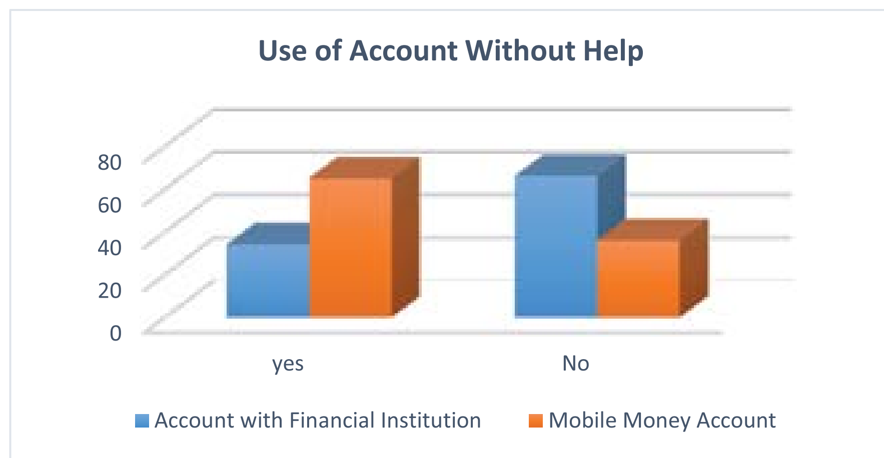


Enabling infrastructure has an important role to play in removing the barriers. For example, global efforts to increase inclusive access to trusted identification systems and mobile phones could be leveraged to increase account ownership for hard-to-reach populations. The chief actors in this effort, such as governments, telecommunications providers, and financial services providers, must also invest in regulations and governance to ensure that safe, affordable, and convenient products and functionality are available and accessible to all adults in their economies.

Financially inexperienced users may not be able to benefit from account ownership if they do not understand how to use financial services in a way that optimizes benefits and avoids consumer protection risks

According to the Global Findex Survey 2021, about two-thirds of unbanked adults said that if they opened an account at a financial institution, they could not use it without help. About one-third of mobile money account holders in Sub-Saharan Africa say they could not use their mobile money account without help from a family member or an agent as shown below:

Chart 6: Use of Account Without Help



Women are 5 percentage points more likely than men to need help using their mobile money account. Inexperienced account owners who must ask a family member or a banking agent for help using an account may be more vulnerable to financial abuse. Also, one in five adults in developing economies who receive a wage payment into an account paid unexpected fees on the transaction.

These issues point to the fact that less experienced financial customers may be more vulnerable to fraud. Thus, investments are needed in numeracy and financial literacy skills, product design that takes into account customer usage patterns and capabilities, as well as strong consumer safeguards to ensure that customers benefit from financial access and to build public trust in the financial system.

Globally, 30 percent of unbanked adults said that they do not have an account because a family member already has one. In some economies, this reason is more likely to be reported by women than by men. Among the unbanked in Turkey, 39 percent of women mentioned this reason and 25 percent of men.

The data reveal significant gender gaps in Algeria, Bolivia, Nepal, Pakistan, and Tunisia, where women are more likely than men to report this reason. Most of these countries also had significant gender gaps in account ownership. By contrast, in China and India men and women were equally likely to say they do not have an account.

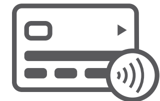
2.2 USAGE OF FINANCIAL SERVICES

The goal of financial inclusion is for account owners to benefit from the use of accounts for digital payments, savings, and appropriate credit because such uses provide a range of positive benefits, which extend far beyond convenience. Among those benefits, account holders, and especially women, enjoy greater security and greater privacy for their transactions.

Like the growth found in account ownership, the Global Findex 2021 survey revealed growth in the use of accounts to make digital payments, as well as to save and borrow as follows:

2.2.1 Digital payments

A digital payment can be made directly from an account without withdrawing cash in primarily two ways: using credit or debit cards or using a mobile phone or the internet. According to the Global Findex Survey 2021, 93 percent of account owners in high income countries used one of these modes to make a payment, while in developing economies, 64 percent of account owners also used these modes. On the whole, there was an increase in the use of digital payments as shown below;



- o The share of adults making or receiving digital payments in developing economies grew from 35percent in 2014 to 57 percent in 2021—an increase that outpaces growth in account ownership over the same period.
- o Thirty-nine percent of adults in developing economies—or 57percent of those with a financial institution account—opened their first account at a financial institution specifically to receive a wage payment or money from the government.
- o Twenty percent of adults living in developing economies, excluding China, made a merchant payment using a card, mobile phone, or the internet—and about 40 percent of them did so for the first time after the start of the pandemic. About one-third of adults in developing economies who paid a utility bill directly from an account did so for the first time after the start of the COVID-19 pandemic—evidence of the role of the pandemic in accelerating digital adoption.

2.2.2 Savings

Findings from the Global Findex Survey 2021 show that globally, 31 percent of adults—or about two-thirds of people who saved any money—reported having saved formally at a financial institution or using a mobile money account. Among all adults, the share who reported saving formally averaged 58 percent in high-income economies and 25 percent in developing economies. Among those who saved in any form, three out of four in high-income economies and more than half in developing economies saved formally. This marks the first time that formal savings is the most common mode of saving in developing economies.

- Twenty five percent of adults in developing economies saved using an account, and an even higher share, 39 percent, used an account to store money for cash management purposes.
- More than half of the people in developing economies who saved any money did so in a formal account in 2021—the first year that formal methods were the most common method of saving.
- Mobile money accounts are an important method of saving in Sub-Saharan Africa, where 15percent of adults—and 39 percent of mobile money account holders—used one to save. Equal shares of adults in Sub-Saharan Africa used a mobile money account and a formal savings account at a financial institution.

2.2.3. Borrowing

Findings from the global Findex Survey 2021 show that, in high-income economies, the dominant way to borrow was by credit card, which is both a payment instrument and a source of credit. Fifty-one (51percent) of adults used a credit card in the past 12 months. Among those who reported borrowing formally, about one-third borrowed from a formal financial institution or mobile money provider, whereas two-thirds borrowed using a credit card but not from a financial institution or mobile money provider.

In developing economies, despite continuing growth in credit card use, on average only 14 percent of adults reported having used one. Exceptions were China, as well as Russia, Türkiye, and Ukraine in Europe and Central Asia, and Argentina and Brazil in Latin America and the Caribbean. In these economies, the share of adults borrowing by using a credit card, but not through a loan from a financial institution or mobile money provider, ranged from close to 40 percent in the three economies in Europe and Central Asia, about 50 percent in China, and about 60 percent in the two economies in Latin America and the Caribbean.

Generally, about 50 percent of adults in developing economies borrowed money, although fewer than half used formal means such as taking out a loan from a financial institution, using a credit card, or borrowing through their mobile money account.

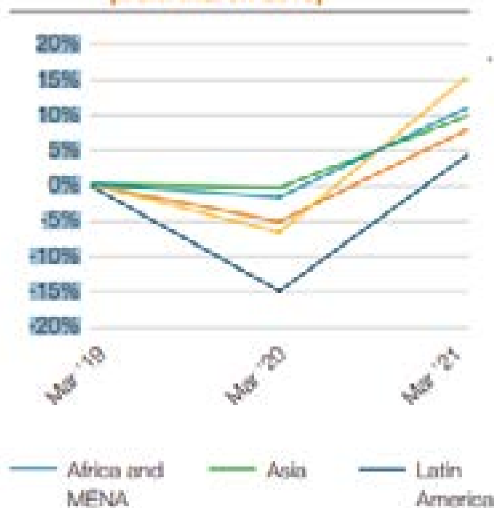
Almost half of borrowers in developing economies borrowed formally, and about an equal share of borrowers cited family and friends as their only source of credit. But in some developing economies, family and friends are by far the most common source of credit. Afghanistan has the highest share of adults who borrowed only from family and friends in both absolute and relative terms: 59 percent of adults or 87 percent of borrowers. Other economies where borrowing only from family and friends dominated include Morocco, where 77 percent of borrowers did so, and Egypt, Jordan, and Pakistan, where about two-thirds did so.

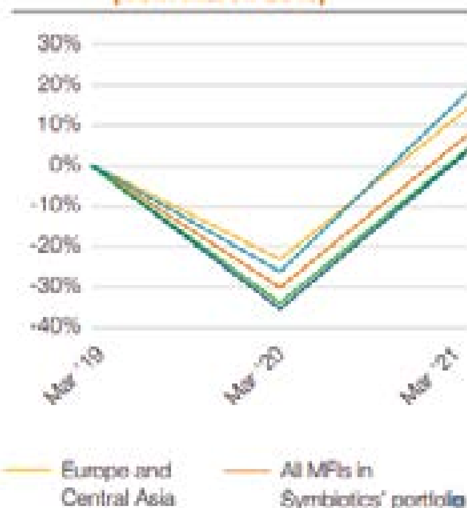
2.3 PERFORMANCE TRENDS

Microfinance institutions (MFIs) are starting to recover, particularly in Africa, and some have managed the crisis better than expected so far. However, the recovery remains fragile. There is pressure on asset quality, and questions remain about how restructured portfolios will impact MFIs' longer-term solvency.

Information from the symbiotic portfolio provided a positive outlook for 2021 as first quarter results confirmed a rebound in key metrics. As at the end of March 2021, monthly disbursements and repayments were in positive territory across all regions for the first time since the pandemic started.

The graphs below present the growth trajectory contrasting the onset of the pandemic in March 2020 with March 2021, with Africa and Eastern Europe and Central Asia showing a significant rebound.





2.3.1 Restructured Portfolio and Portfolio at Risk

Based on information from the joint snapshot report on MFIs from CGAP and Symbiotics, restructured portfolio and portfolio at risk levels increased sharply in 2020. By the end of March 2021, as economic activity resumed strongly in most emerging economies, the MFIs in the Symbiotics portfolio continued to show improved quality in their Portfolio at Risk (PAR 90 plus restructuring) figures.

This was the case across all regions, with Asia showing strong improvement levels. While portfolio levels in Africa continued to improve, they were still in negative growth territory.

The overall number of borrowers continued to decline, except in Latin America and Africa. While lower demand and prudent lending practices were likely to cause this muted trend in borrower growth, these dynamics underscored the risk of excluding poorer clients.

FIGURE 3. Portfolio at risk

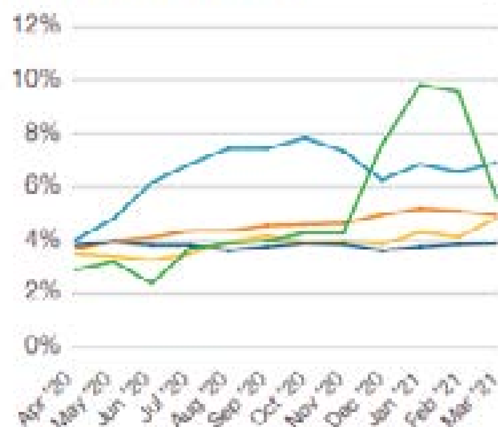
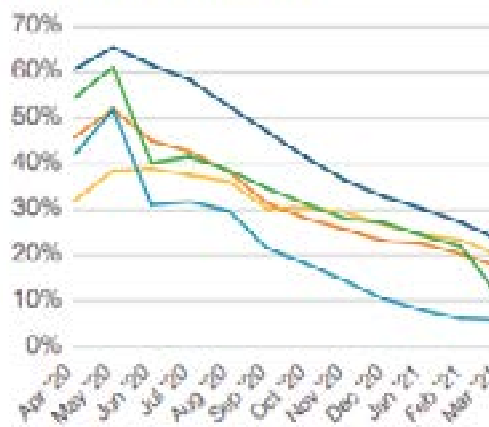


FIGURE 4. Moratorium ratio



Africa and MENA — Asia — Latin America — Europe and Central Asia — All MFIs in Symbiotics' portfolio

CHAPTER THREE : OVERVIEW OF THE FINANCIAL SERVICES SECTOR IN UGANDA

3.1 STRUCTURE OF THE FINANCIAL SERVICES SECTOR

Uganda's financial sector is composed of formal and informal institutions. The formal institutions include Banks, Microfinance deposit taking institutions, Credit institutions, Insurance companies, Development Banks, Pension Funds, Capital Markets, Savings and Credit cooperatives and non-deposit taking microfinance institutions whereas the informal ones are mostly village savings and loan associations.

The financial sector in Uganda is divided into Four Tiers: Tier 1 – Commercial Banks; Tier 2 – Credit Institutions and Finance Companies; Tier 3 – Microfinance Deposit taking Institutions; and Tier 4 that includes SACCOS, non-deposit taking financial institutions, money lenders and Savings Groups.
Tiers 1-3 are regulated and supervised by the Bank of Uganda (BoU) while Tier4 is regulated and supervised by the Uganda Microfinance Regulatory Authority (UMRA)

Table 1: Structure of the Financial Services Sector in Uganda

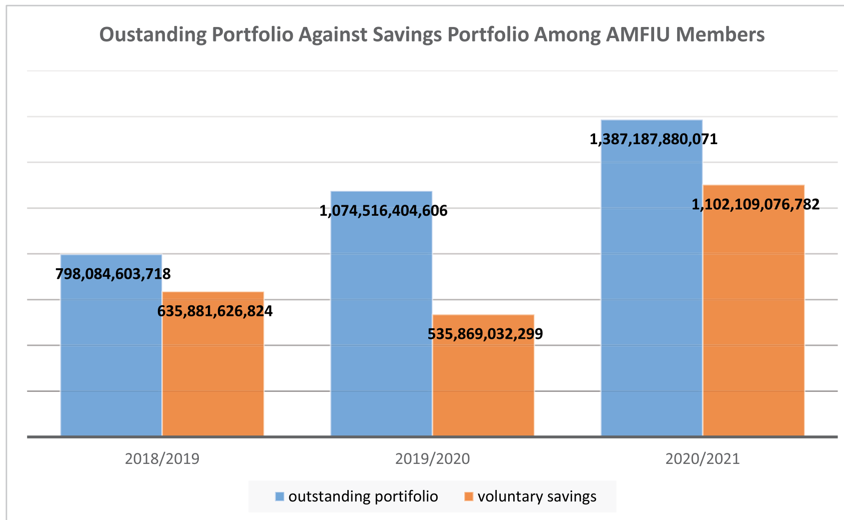
Tier	Type of Institution	Applicable Law	Regulator	Number
Tier 1	Commercial Bank	Financial Institutions Act 2016	Bank of Uganda	25
Tier 2	Credit Institution	Financial Institutions Act 2016	Bank of Uganda	3
Tier 3	Micro Deposit Taking Institution	MDI Act 2003 (Amended 2022)	Bank of Uganda	4
Tier 4	Non deposit taking microfinance Institutions, SACCOs, Money lenders and Savings Groups	Tier4 Microfinance Institutions and Money Lenders Act 2016	Uganda Microfinance Regulatory Authority	Over 5000

3.2 SIZE OF THE MICROFINANCE SECTOR IN UGANDA

2.3.2 Performance Trends

Based on the data submitted to AMFIU by its members, the microfinance sector continued to grow despite the hitch in 2019/2020 caused by the covid-19 pandemic. The graph below shows a trend of performance for financial institutions that includes Banks, MDIs, MFIs and SACCOs that submitted data to AMFIU.

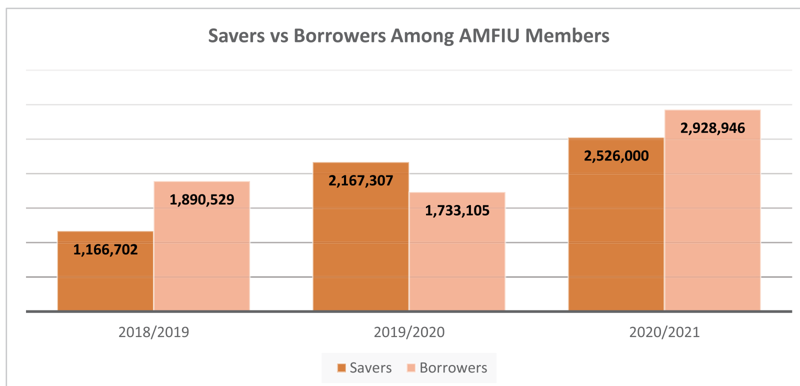
Chart 7: Outstanding Portfolio and Savings Portfolio Among AMFIU Members by Dec 2021



2.3.3 Outreach

As shown in the diagram below, the outreach indicators followed a similar trend with the major challenge being 2019/2020 and then picking up again in 2021.

Chart 8: Number of Savers and Borrowers Among AMFIU Members



3.3 CROSS-CUTTING ISSUES

3.3.1 Digital Financial Services

Innovations in the financial services sector and the proliferation of mobile money has given rise to opportunities for growing Digital Financial Services and financial inclusion through alternative channels. Digital Financial Services are broadly defined to include a range of financial services which are accessed and delivered through digital channels which include payments, credit, savings, remittances and insurance. To be more impactful on SMEs, MFIs and other financial institutions should leverage their interventions and support businesses that are seeking to adopt technology and innovations.

In the 2019 Digital Finance baseline survey conducted by AMFIU, it was noted that digital financial services offer great business optimization for MFIs and SACCOs in Uganda especially with the advent of enhanced technologies that offer gateways for different digital platforms. The following were the findings from the study;

Table 2: Outcomes from AMFIU's DFS Survey

Key Finding	Outcome	
1.	Digital Financial Services Knowledge	86% of the institutions that participated in the study had knowledge about Digital Financial Services. However, this knowledge varied from institution to institution, with only 54% of the institutions being knowledgeable about the Digital Financial Services Map (Journey); over 70% of the institutions had embarked on establishing Digital Financial Services channels including Mobile banking services. However, these were predominantly used for loan payments and others for added services like bill and utility payments and purchase of airtime.

2.	Appropriate Technology (Platforms)	75% of the institutions assessed had adopted usage of some platforms with varying levels of agility and robustness depending on whether an Institution is categorized as an MFI, SACCO or Bank. The institutions all had Core Banking Systems and the systems had been integrated with different platforms to deliver Digital Financial Services
3.	Human Resource Capacity:	The results returned a 55% buy-in by staff, since for the 45% felt that Digital Financial Channels were a threat to their jobs, since more branches were bound to be closed in preference for Agent Bankers, because the operational costs are relatively lower and through Mobile Banking clients are able to selfnavigate and access Financial Products offered, for some of the institutions these staff needed more sensitization and buy-in, otherwise they tell the clients to avoid as much as possible the digital channels.
4.	Client Engagement and Sensitization:	62% of the institutions that had Embraced Digital Financial Services through different platforms like Mobile Banking Services, have endeavoured to engage, educate and sensitize their clients on the advantages of using Mobile financial services driven by digital platforms. However of this number, only 35% of the institutions had been able to cover over 57% of client education and sensitization. This was a slow and gradual process but also costly since such campaigns and drives involve utilizing different communication and marketing channels and media, catering for different segments of clients including the low end and high end, literate and illiterate, Men and Women, Youth and Adults.

5.	Marketing and Communications/ awareness raising:	This was a rather expensive venture for almost 90% of the institutions that participated in the study. However for some institutions, the Digital Financial Services had been mainstreamed alongside other products of the institutions, thus when there is customer sensitization days, or Annual General Meetings, the aspect of Digital Finance was part of the agenda. The field officers and office staff of the institutions also kept informing the clients they interact with about the advantages of the digital platforms they had adopted and explaining the advantages of using technology that included; transacting from their locations at anytime, cost effectiveness and more secure especially with cash handling. Over 57% of the institutions had developed promotional materials like fliers, posters and short messaging so as to create awareness and secure buy-in from the customers.
6.	Partnerships and Collaborations:	Over 90% of the institutions that had embraced the Digital Financial Services had gone into business collaborations and partnerships with Financial Technology Companies (Fintechs)

3.3.2 Mobile Money

According to the BOU Annual report 2021, the value of Mobile money transactions increased by 42.26% to UGX 113.38 trillion from 79.7 trillion, while the volume of transactions increased by 0.73 billion from 3.16 billion to 3.89 billion. The upward trend can be attributed to the increased usage of mobile money digital platform to mitigate the Covid 19 risks associated with handling of paper money.

Relatedly, the number of active mobile money users increased by 21.03% to 21.18 million during the year under review when compared to 17.5 million recorded during the year 2020.

3.3.3 Agency Banking

In 2017, BoU released the agent banking regulations that provided a regulatory framework for agent banking services and was officially launched in 2018 with only 2 banks. According to the FSDU report July 2022, the increase in the number of participants to 22 by 2022, saw 20,463 agents join the shared agent banking network. The platform has cumulatively processed 4.6 million transactions valued at UGX 5.14 trillion (USD 1.4 billion) and 533,532 customers with bank accounts were served between January 2020 and December 2020.

This innovation has helped banks to serve under-served populations better by facilitating Ugandans to open accounts with participating banks from their neighbourhoods. This is especially so in the urban and peri-urban areas where 95% of the agents are based.
The criteria for an enterprise to qualify as an agent includes;

- Consecutively operate an account in a financial institution that is regulated by the Central bank,
- Have a licensed business for at least twelve months,
- Have adequate and secure premises
- Operate real time online transactions

However, the shared agent banking network still has a challenge of outreach, especially in rural and remote areas where most that are financially excluded reside.

3.3.4 Bank assurance

In 2016, the Financial Institutions Act was amended to provide for bank assurance business where under the insurance Act, a financial institution or a Microfinance deposit taking institution can apply for bank assurance through the Insurance Regulatory Authority.

According to the Insurance Regulatory Authority Annual report 2021, the gross written premium income collected through the Bancassurance distribution channel was UShs 103.54billion compared to UShs 83.34 billion generated in 2020 representing an 8.71 percentage growth. This channel is gaining traction and increasing convenience as Consumers access insurance through their respective banks with whom they have existing relationship.

3.3.5 Agriculture Insurance

According to the Insurance Regulatory Authority annual report 2021, In the year 2021, a total of 75,868 farmers were covered and generated UShs 19.8978 billion in GWPs to the Industry (54,287 farmers, and UShs 11.426billion in 2020). The increase in the numbers picked up with the progressive opening up of the economy following the Covid19. Total claims paid increased from UShs 4.116billion in 2020 to UShs 7.505billion in 2021.

3.3.6 Green Financing

For quite sometime, environmental issues have not been a priority in the microfinance industry but recently, there's been a growing perception that incorporating an environmental lens to microfinance is essential and critical for the future of the sector.

Global climate change is likely to affect both directly and indirectly MFIs and their customers because the ecosystem and natural resources that most MF customers depend on for their livelihoods will be hit hard by the altered climatic conditions and this will compromise their ability to pay back their loans.

Therefore, green financing comes to light as an attempt to adapt microfinance products and services with deliberate climate change strategies aimed at enhancing the mitigation and adaptative capacity of MFIs and their customers.

Microfinance Institutions need to consider climate change because climate change, economic development and poverty reduction are linked and can therefore affect the sector in the following ways;

- The low income earners, who are the major target group of MFIs rely greatly on the natural ecosystem resources for their livelihood and yet they have limited coping mechanisms and the lowest adaptive ability to cope with the effects of extreme weather events
- Agriculture emits greenhouse gasses and yet it's the major economic activity of most MF customers. There's therefore the challenge of supporting smallholder farmers who are mordernizing their traditional agriculture to adopt low carbon paths in order to reduce global warming.
- The increased frequency and intensity of natural disasters and disease outbreaks will adversely affect MFIs. Increased health care needs and mortality among their customers will have an effect on their operations
- Reduction in agriculture productivity will make investment in this sector by MFIs less profitable and therefore less attractive.

Therefore, negating the impact of the environment on the financial services sector would cause a risk to the sector. The Universal Standards for Social Performance Management developed by the Social Performance Task Force (SPTF) introduced a seventh dimension on green finance with standards and practices that a financial institution can use to assess its responsiveness to the environment.

MFIs are now moving from a double-bottom line to a triple-bottom line that includes "people, profits and the planet".

3.3.7 Environment Social and Governance (ESG)

Globally, institutional assessments have shifted from just compliance to financial indicators but to viewing the institution as a whole, putting into consideration all factors that affect its operations and thus the emergence of the ESG concept. ESG is used as a framework to assess how an organisation manages risks and opportunities that shifting markets and non-market conditions create.

These shifts include environmental systems, social systems, governance systems and they impact the entire landscape an organisation operates in.
The ultimate focus of ESG is diversity, equity and inclusion and is about the ability to create and sustain long-term value in a rapidly changing world and managing risks and opportunities associated with these changes.

The major components of ESG encompass the following:

Environment – The environmental criteria address an organisation's operations environmental impact and environmental stewardship Social – The social criteria refer to how an organisation manages social relationships with its various stakeholders and creates value for them Governance – The governance criteria refer to an institution's leadership and management philosophy, practices, policies, internal controls and shareholder rights.

ESG has a significant positive impact on fundamental business issues relevant to the long-term success of any organisation that include;

- Enhancing corporate reputation leading to increased customer satisfaction and investor acquisition
- Helps in risk reduction by identifying immediate and long-term risk thus reducing disruptions and losses
- Opportunity management leading to greater workforce productivity and organisation resilience

3.4 THE NATIONAL FINANCIAL INCLUSION STRATEGY

The National Financial Inclusion Strategy (NFIS) is driven by the Ministry of Finance, Planning and Economic Development (MoFPED) and Bank of Uganda. The strategy was put in place with the purpose of promoting financial inclusion with emphasis on five pillars i.e. reduce exclusion and barriers to access financial services, develop the credit infrastructure, build the digital infrastructure, deepen and broaden formal savings, investment and insurance usage as well as protect and empower individuals with enhanced financial capabilities.

Achievements for the 5-year Plan.

- o Implemented the agent banking infrastructure to deepen outreach. By December 2021, there were 20 financial institutions on the Agent banking shared platform operating agents with a total of 11,262 agents deployed across the country.
- o NIRA and NITA put in place a system to enable verification of IDs (NINs) by financial service providers.
- o Established lines of Credit to critical sectors such as Housing, MSMEs & Agriculture.
- o Established a Centralized Registry for Movable Collateral under the Uganda Registration Services bureau was established following the enactment of Security Interest in Movable Property Act of 2019
- o Established an Ombudsman with binding powers to resolve disputes for smaller loans and provide impartial advice
- o Establishment of the Uganda Microfinance Regulatory Authority and issuance of related regulations for licensing, consumer protection and prudential norms, among others.
- o Training & sensitization of judicial officers in commercial courts on creditor's rights and insolvency.
- o Passing of the National Payment Systems (NPS) Act
- o Interoperability among Financial Service Providers (FSPs)
- o Promotion of cashless transactions across the public and private sectors.
- o Provision of a regulatory framework that promotes innovation (Sandbox)
- o Promotion of utilization and uptake of the Agriculture Insurance facility. (Agricultural consortium)
- o Deepen usage and promotion of voluntary pensions to self-employed and informal workers.
- o Financial Capability and Financial Consumer protection Initiatives implemented

3.5 NEW REGULATORY ENVIRONMENT IN THE FINANCIAL SERVICES SECTOR IN UGANDA

3.5.1. Amendment of the Microfinance Deposit taking institutions Act, 2003.

To date Uganda has four regulated MDIs including FINCA Uganda, Pride Microfinance, UGAFODE microfinance and EFC, all regulated by BoU.

In July 2022, Cabinet approved the proposal to amend the Microfinance Deposit taking institutions Act 2003. The amendment will allow for the use of the words Microfinance bank by Microfinance deposit taking institutions and also provide for Islamic banking, agent banking, bancassurance in the microfinance industry and the regulation and supervision of registered societies with savings above UGX 1.5B and share capital in excess of UGX 5.5B.

The amendment will also allow special access to the credit reference bureau by other accredited credit providers and service providers, adopt to new developments in the microfinance industry and synchronize as well as harmonize the MDI Act with other laws and financial sector integration processes.

3.5.2. The National Payments Systems Act

The National Payment System Act 2020 was established to bridge the gap that was existing between the laws governing the previous payment systems which could not offer comprehensive protection in terms of regulating payment systems across the board.

The act is regulated, supervised and overseen by the Central Bank to ensure the safety and efficiency of payment systems, payment service providers, the issuance of electronic money among others.

According to the Act, a person shall not offer a payment service, operate a payment system or issue a payment instrument without a license issued by the Central Bank. However, the requirement to have a licence will not apply to payment instruments issued by the Central Bank or payment systems operated by the Central Bank.

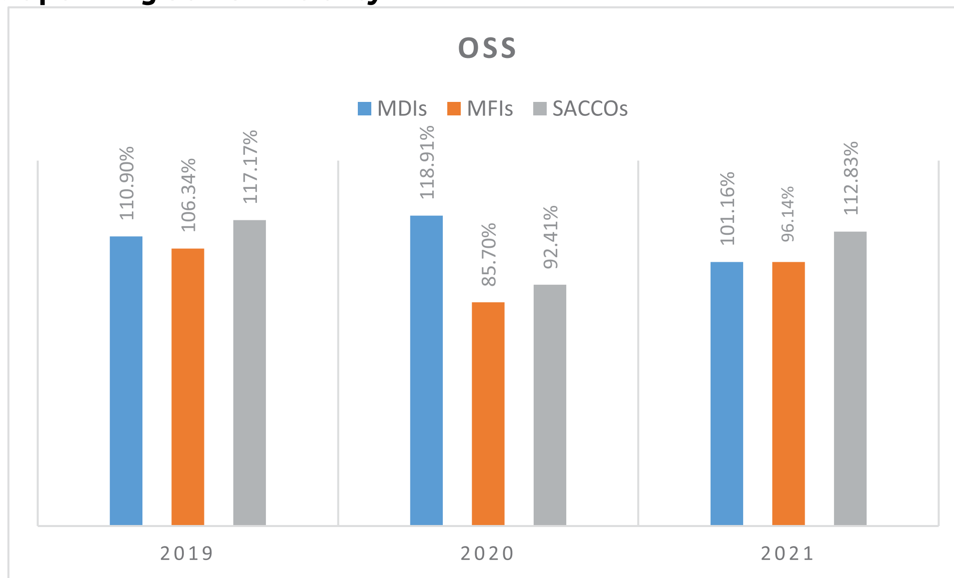
CHAPTER FOUR :
PERFORMANCE ANALYSIS

This analysis represents financial institutions that were able to submit data to AMFIU through the Performance Monitoring Tool. This data is uploaded and analysed by the Performance Monitoring System hosted at AMFIU which aggregates it into Key performance ratios of profitability, efficiency, capital and liquidity as well as the portfolio at risk.

4.1 Operating Self Sufficiency Ratio

Self-sufficiency can also mean sustainability and an institution can only achieve this if it scores an OSS of 100% and above below which it may be hard to survive. From the graph below in 2021, MDIs and SACCOs were able to score an average OSS of 101.16% and 112.83% respectively compared to MFIs that scored less with 96.14%. In 2020, only MDIs were able to score above100% compared to MFIs and SACCOs, and this is highly attributed to the country lockdown due to the Covid 19 outbreak that left many financial institutions at the verge of collapse.

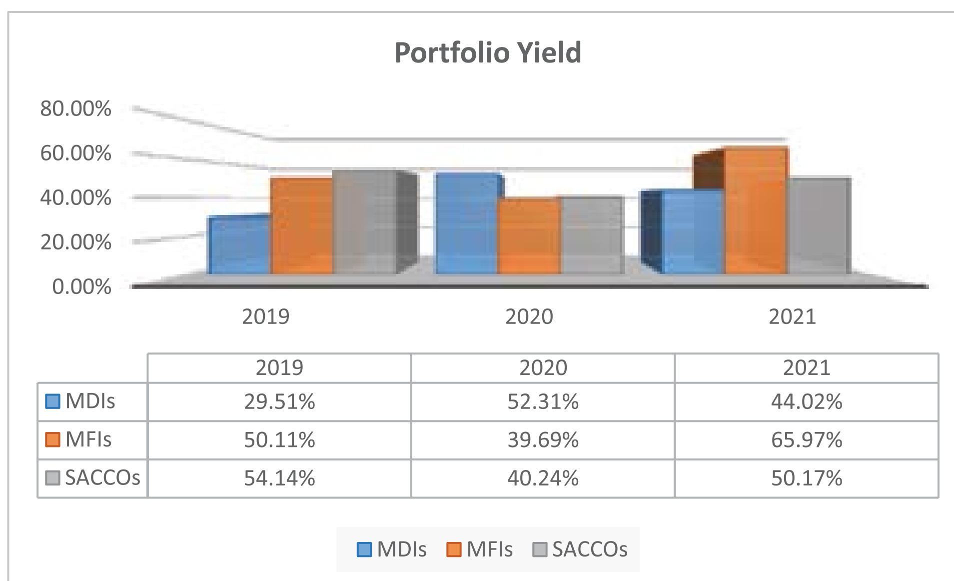
Chart9: Operating Self Sufficiency



4.2 Portfolio Yield (PY)

MFIs and SACCOs on a higher end have been able to generate interest and fees from their portfolio by 65.97% and 50.17% than MDIs who scored 44.02%.

Chart 10: Portfolio Yield



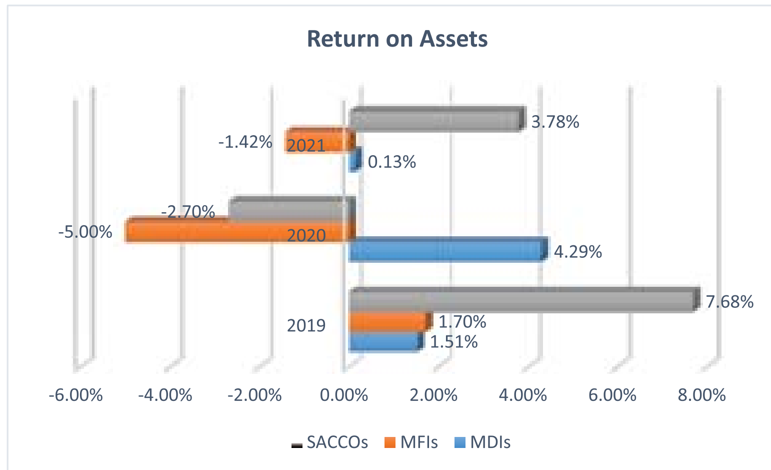
	2019	2020	2021
MDIs	29.51%	52.31%	44.02%
MFIs	50.11%	39.69%	65.97%
SACCOs	54.14%	40.24%	50.17%

4.3 Return On Assets

The ROA ratio measures the income generated by the assets of an institution and its ability to utilize its assets in a profitable manner. SACCOs were able to register a 3.78% return on assets compared to MDIs and MFIs who scored 0.13% and -1.42% respectively.

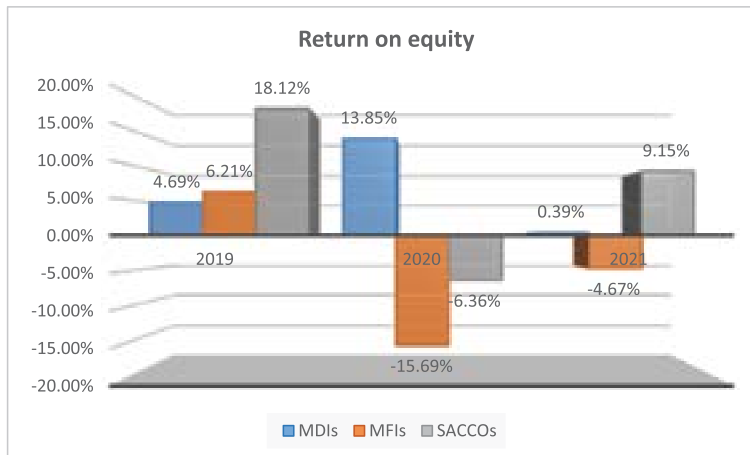
These were quite low scores compared to the industry benchmark of >5% for MDIs and 15% for MFIs and SACCOs.

Chart 11: Return on Assets



4.4 Return on Equity

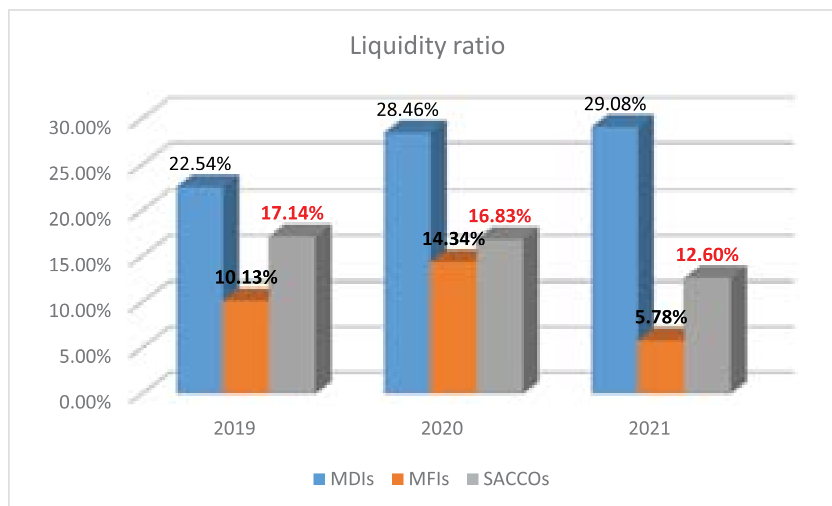
In 2021 it is only SACCOs that managed to score a better percentage of 9.15% Return on equity compared to MDIs and MFIs who scored quite low by 0.39% and -4.67% respectively.



4.5 Liquidity Ratio

The institution's ability to meet near term demands for cash is determined by this ratio. MDIs had the highest liquidity with 29.08%, followed by SACCOs with 12.95% and then by MFIs with 5.78% as indicated in the graph below. Apart from MDIs, SACCOs' and MFIs' liquidity has relatively dropped compared to previous years.

Chart 13: Liquidity

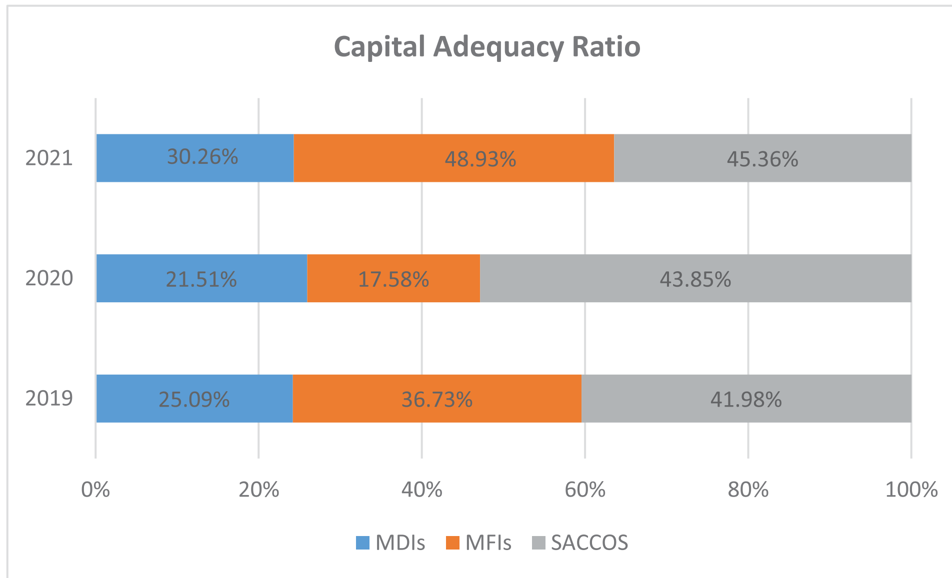


4.6 Capital Adequacy Ratio

The financial institution ability to pay its liabilities and also meet its capital and operation risks is referred to as Capital adequacy. An institution with a good capital adequacy ratio has enough capital to absorb its losses thus less likely to become insolvent.

By the end of 2021 MFIs had the highest ratio of 48.93% less the industry benchmark of >50%, whereas SACCOs had a healthy ratio of 45.36% higher than the benchmark of > 30% yet MDIs were able to score 30.26%.

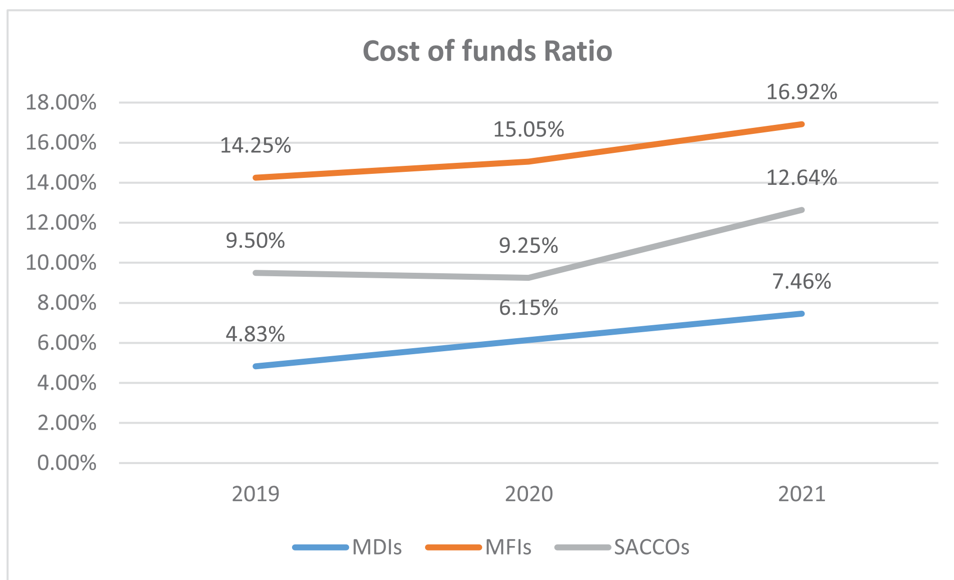
Chart 14: Capital Adequacy



4.7 Cost of Funds

This ratio measures the over all price the institution pays for external borrowings. It reflects actual funding costs and doesnot consider the adjustment for subsidised funding. MFIs registered a cost of funds ratio of 16.92% above the industry benchmark of ≤15% where as SACCOs scored a healthy ratio of 12.64% and MDIs scored 7.46%.

Chart 15: Cost of Funds



4.8 Debt to Equity Ratio

This ratio calculates the weight of total debt and other financial liabilities against shareholder's equity. It shows the extent to which equity supports the overall indebtedness of the institution.

Table 3: Debt Equity Ratio

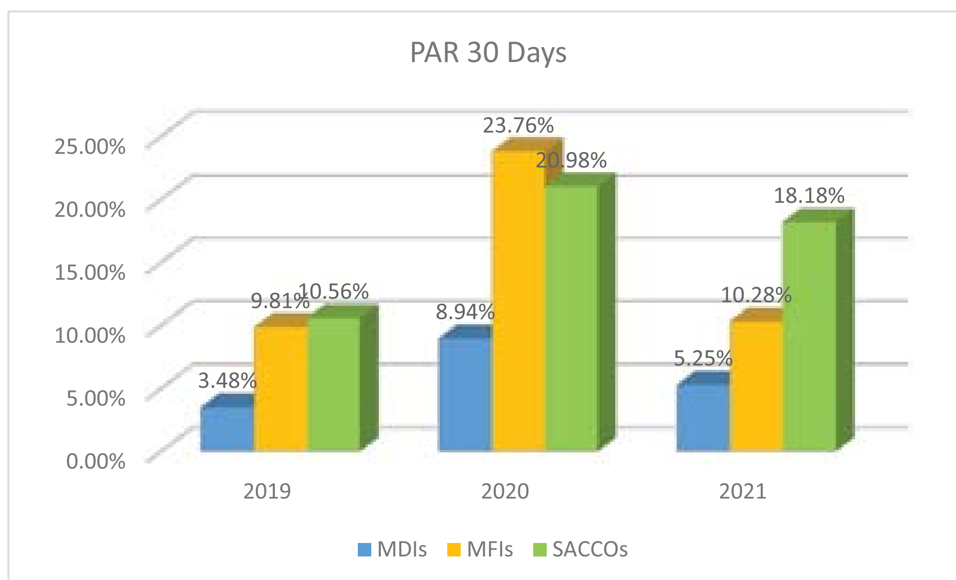
	2019	2020	2021
MDIs	336.04%	418.41%	260.54%
MFIs	91.40%	181.26%	248.03%
SACCOs	252.35%	126.87%	164.96%

4.9 Portfolio at Risk 30days.

This indicates the balance of loans outstanding that have a payment past due of 30 days as a percentage of Gross Loan Portfolio. The graph below indicates SACCOs with a higher PAR 30 days of 18.18%, followed by MFIs with 10.28% and MDIs with 5.25%.

For the 3 categories of financial institutions, the recommended PAR 30days should be ≥5%

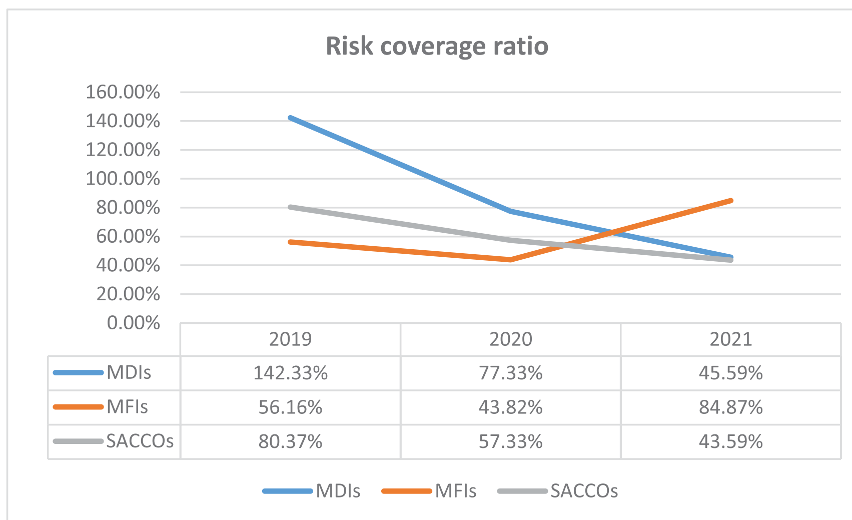
Chart 16: Portfolio at Risk 30 Days



4.10 Risk Coverage Ratio

The risk coverage ratio shows how much of the portfolio at risk is covered by the MFI loan loss reserve. A 100% and above ratio achievement is healthy for a financial institution. According to the graph below none of the financial institutions achieved the industry bench mark of 120% as MFIs had a risk coverage ratio of 84.87%, followed by MDIs with 45.59% and 43.59% for SACCOs respectively.

Chart 17: Risk Coverage

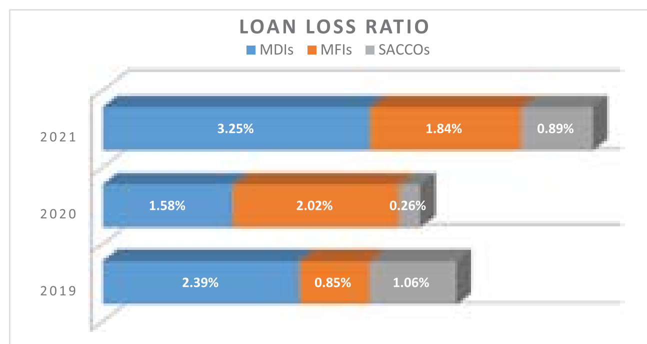


	2019	2020	2021
MDIs	142.33%	77.33%	45.59%
MFIs	56.16%	43.82%	84.87%
SACCOs	80.37%	57.33%	43.59%

4.11 Loan Loss Ratio

This ratio indicates the percentage of loans written off compared to the gross loan portfolio. According to the industry benchmark SACCOs and MFIs should operate below a loan loss rate of ≤ 1%. According to the graph, MDIs scored a loan loss ratio of 3.25%, 1.84% for MFIs and 0.89% for SACCOs.

Chart 18: Loan Loss



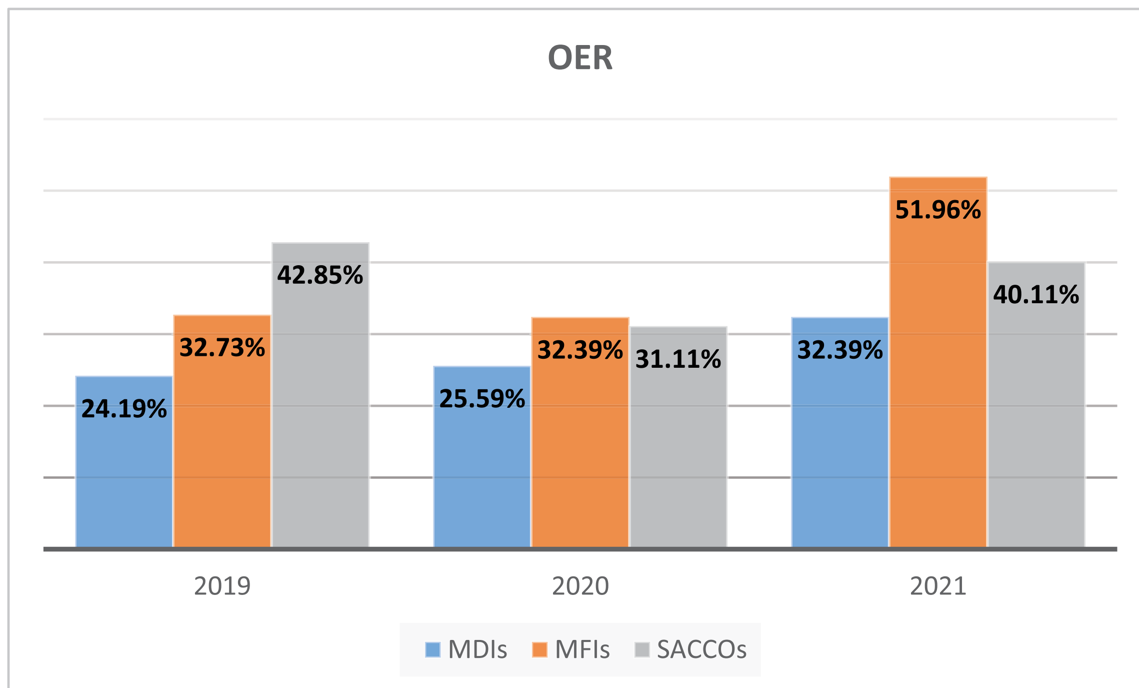
Efficiency and Productivity

4.12 Operating Expense Ratio

This ratio measures the operating expenses in relation to the institution's average portfolio which is its main income earning asset. In other words, it compares the organization's expenses in relation to the volume of the business at hand.

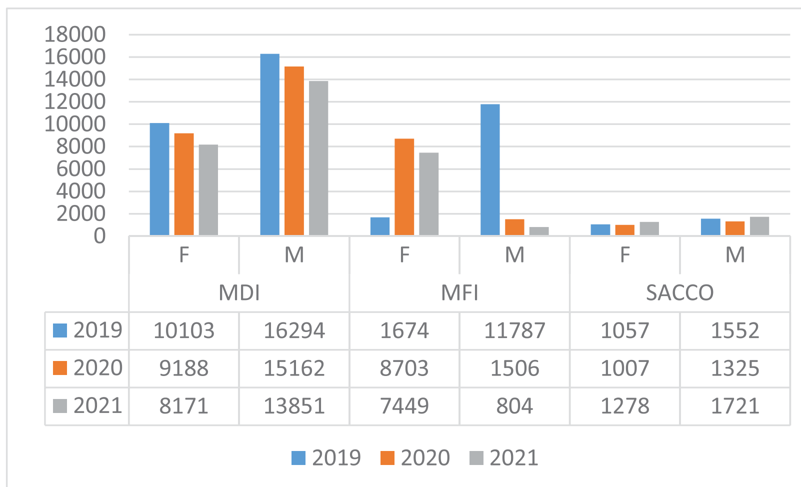
From the graph below MFIs scored an unhealth OER of 51.96% followed by SACCOs at 40.11% and then MDIs with a healthy ratio of 32.39%, against the industry benchmark of ≤ 60% for MDIs and ≤20% for MFIs and SACCOs.

Chart 19: Operating Expense Ratio



Other Outreach and Portfolio Quality Indicators

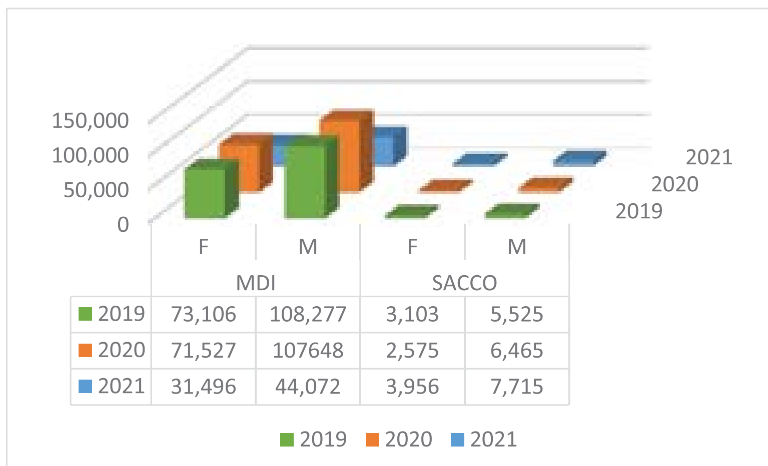
Chart 20: Average Number of borrowers by gender



	MDI		MFI		SACCO	
	F	M	F	M	F	M
2019	10103	16294	1674	11787	1057	1552
2020	9188	15162	8703	1506	1007	1325
2021	8171	13851	7449	804	1278	1721

From the graph above, MFIs have a higher number of female borrowers compared to MDIs and SACCOs.

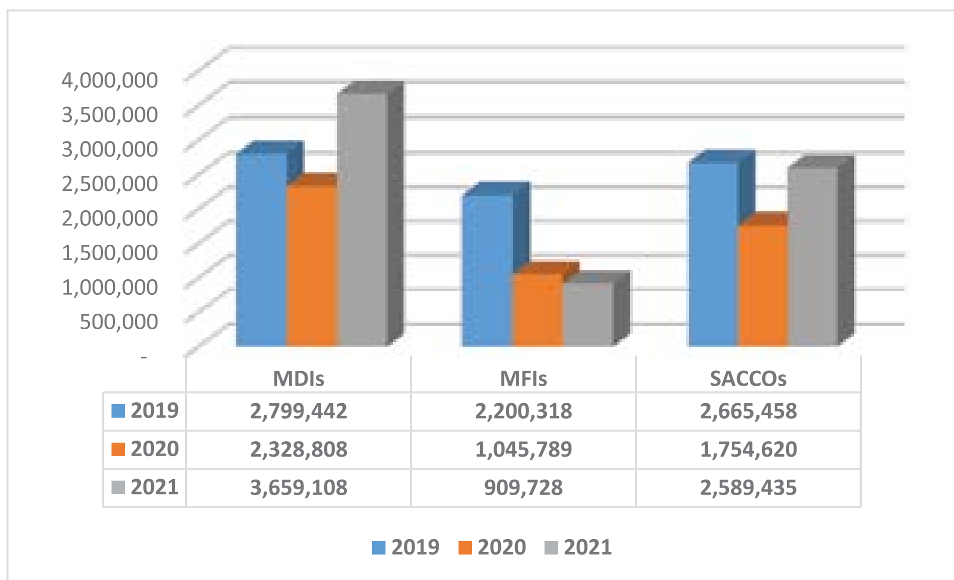
Chart 21: Average number of depositors by gender



	MDI		SACCO	
	F	M	F	M
2019	73,106	108,277	3,103	5,525
2020	71,527	107648	2,575	6,465
2021	31,496	44,072	3,956	7,715

According to the graph above both MDIs and SACCOs have more male depositors than female for the three years trend. The less number for female depositors implies that even if women are trying to save, there are still constraints that somehow limit them to scale up their savings to a tune competitive to that of male depositors.

Chart 22: Average Loan Size



	MDIs	MFIs	SACCOs
2019	2,799,442	2,200,318	2,665,458
2020	2,328,808	1,045,789	1,754,620
2021	3,659,108	909,728	2,589,435

As shown above, MDIs had the highest average loan size for three years, followed by the SACCOs and then the non-deposit taking institutions although the average seemed to rotate in the same range for the three categories of financial institutions.

Chart 23: Income Analysis

From the graph, financial institutions earn most from interest income on loans followed by fee income from loans and less from investments for MFIs and SACCOs. This implies that in order to earn more income, a financial institution needs to prioritise disbursements in addition to the other sources.

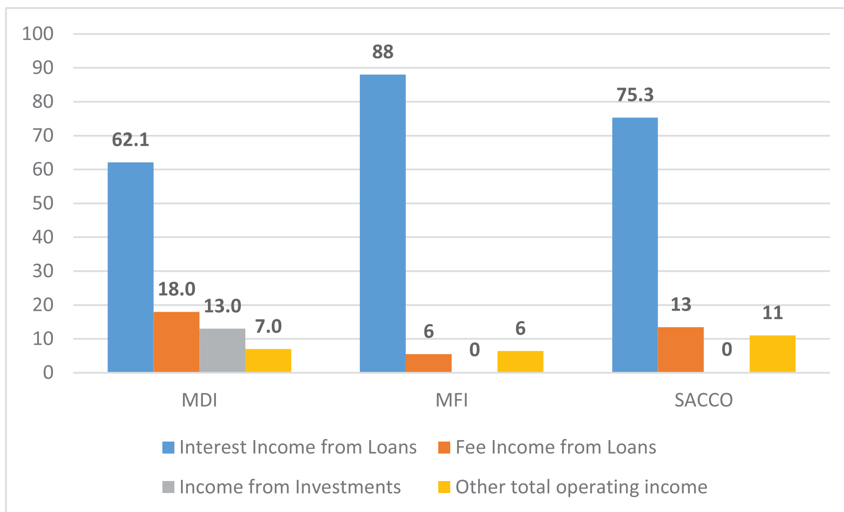


Chart 24: Expenditure Analysis

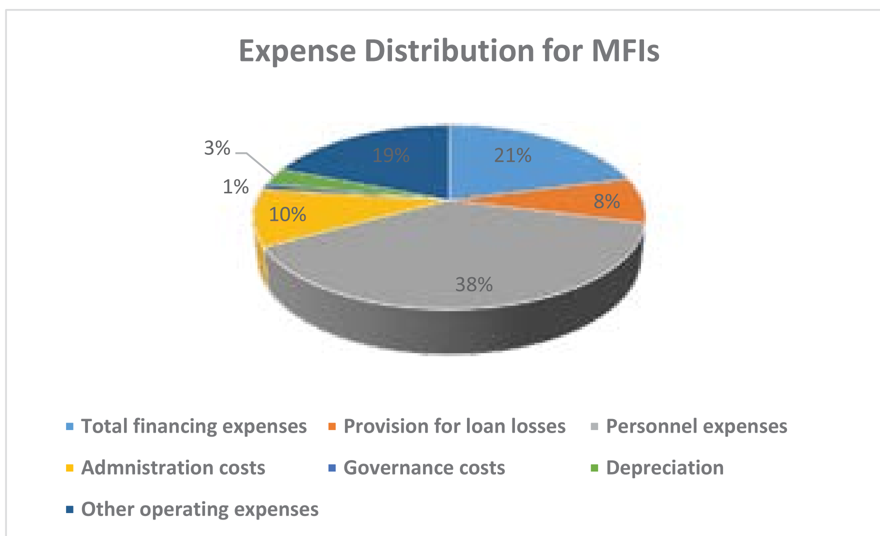


Chart 25: Expense Distribution for MDIs

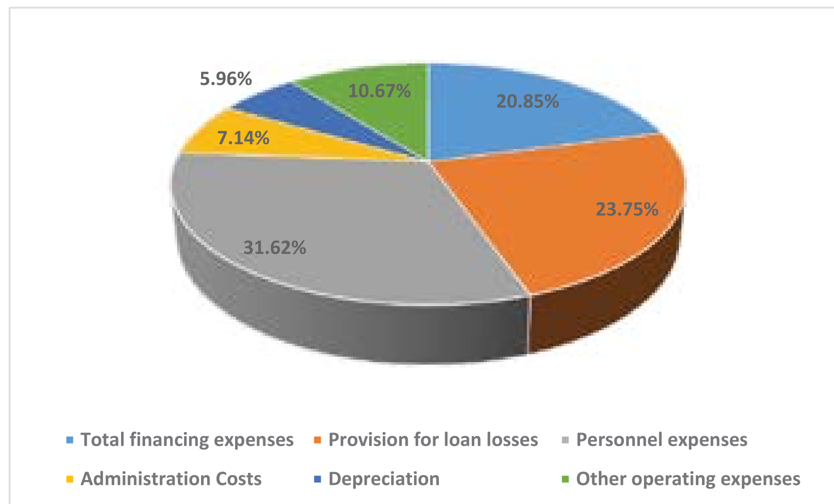
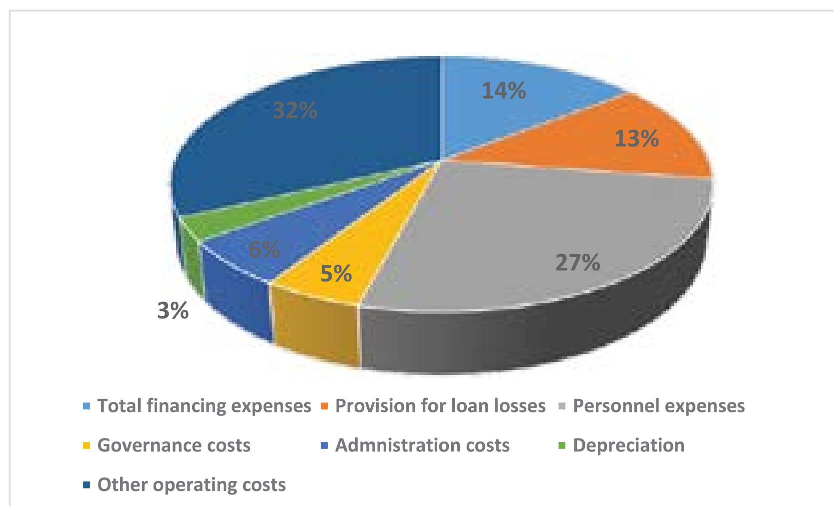


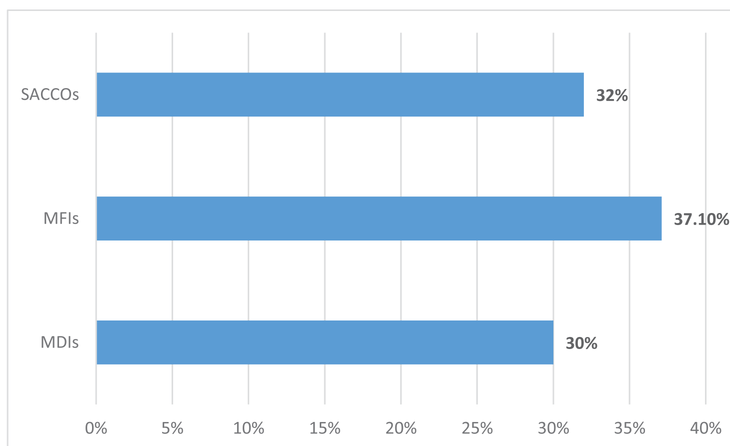
Chart 26: Expense Distribution for SACCOs



From the expenditure analysis, MDIs and MFIs incur more expenses on personnel than SACCOs who incur highest on operating costs. Financial expenses and provision for loan losses are other expenses where financial institutions spend their incomes. All financial institutions seemed to incur less costs on depreciation and governance.

Chart 27: Average Annual Interest rate

MDIs have an average interest rate of 30% compared to MFIs and SACCOs that have average interest rates of 37.1% and 32% respectively.



4.13 Recovering from the Effects of the Covid-19 Pandemic

According to the FSD Uganda survey August 2020, Savings and Credit Cooperative Societies (SACCOs), Village Savings and Loans Associations (VSLAs) and Microfinance Institutions (MFIs), which together form the backbone of Uganda's agricultural finance ecosystem, were worst affected by COVID-19, experiencing liquidity challenges due to reduced cash flows and accumulation of bad debt.

Survey respondents associated with SACCOs and MFIs all noted that since March 2020 lines of agricultural credit had 'significantly' reduced (30%-50%) or 'severely' (more than 80%) reduced. As a result, SMEs and smallholder farmers, the largest client base for these local-level financial institutions – experienced the greatest reduction in access to capital. MFIs, backed by some of their investors, responded to the crisis by offering a wide set of options ranging from no moratoria to blanket payment holidays.

The performance of restructured loans is a key element for potential solvency issues. Over the past year,

the loan portfolio under moratoria in Africa has fallen as more loans have been repaid and moratoria have ended. Looking at the Symbiotics portfolio, all clients are making some form of payment, around 64% are repaying their loans on time, and 36% are not fully meeting their full commitments.
Micro Save Consulting has come up with the following recommendations that can help financial institutions to survive which include;

i. Financial institutions need to understand their new operating environment if they wish to build survival strategies. They must assess the impact of the pandemic on the financial sector and their customers. This will help them prioritize strategic steps to support their recovery.

This assessment should address the impact of the crisis at an institutional level, including the following elements:

- o financial aspects like capital adequacy and funding structure, funding mix and financial instruments to mitigate various risks;
- o portfolio aspects such as asset quality, concentration and diversity;
- o risk management strategies;
- o aspects of human resources focused on redundancies, impact on staffing levels and the need to retrain staff members to perform other tasks.

ii. Build a crisis management unit to make quick and effective decisions. Institutions should build a crisis management unit to tackle challenges both during and after the pandemic. Ideally, the unit should have executive powers and it should be empowered to make proactive decisions. The unit should develop quick strategic and institutional responses to manage immediate and short-term risks.

iii. Develop a business continuity plan with scenario analysis to decide on immediate and short-term plans. The development of a business continuity plan across various time frames should be the next step. Financial institutions will need to revise their business plans in light of the emerging situation, build scenarios and refine their budgets accordingly. As part of this process, the institutions may need to optimize expenses, reduce costs and revise the prices of their products.

iv. Engage in internal and external communication to manage expectations and illuminate the way forward for all stakeholders. In the immediate term, financial institutions need to communicate well with their staff, customers, donors, investors and other stakeholders. They may focus on internal communications around restructuring staff members' roles, ensuring the safety and wellness of their staff, developing strategies for portfolio and risk management, and revising structures and job responsibilities. They may also amplify external communications around the impact of the pandemic on customers, staff and portfolios. These external communications may

include business continuity measures, portfolio and risk management measures, and guidance on the institutional response.

v. Consider portfolio management strategies, such as restarting operations, restructuring loans and managing emerging risks. Financial institutions may consider restarting operations in less infected areas to revive their portfolios. They may also consider portfolio planning and management through a mix of segmentation, risk analysis and stress-testing scenarios. As the pandemic affected most customers, institutions may need to restructure and refinance customers loans to enable their customers to use additional credit for business recovery. However, these institutions should use a segment-wise portfolio analysis, in which they identify which segments of their portfolio have been less impacted by the pandemic and therefore have greater potential for repayment. This can help them determine which customers are eligible for restructuring of loans.

vi. Source new funding to enhance recovery initiatives. Financial institutions will need new funding strategies to accelerate their path to recovery. In developing these strategies, they will need to reposition the institution to rebuild after the pandemic, and understand the current priorities of donors and investors. Institutions may also identify key government support programs for the financial sector, raising funds for the recovery phase by utilizing government programs as well as donor and investor capital.

vii. Digitize to recover and build resilience. Digital transformation offers the right combination of solutions or tools delivered digitally to provide a seamless user experience. Financial institutions should take advantage of the opportunity the crisis presents to digitize their business models and operations. An increasing number of financial institutions are now gearing up their efforts towards digital transformation and will quickly eat into the markets of analog financial institutions. However, financial institutions need to customize and contextualize their strategies for digital transformation. They may need to develop unique, individual and customized digital solutions that move past the current limitations of using physical touchpoints.

viii. Formulate and implement radically altered strategies, new product lines, and new revenue streams to build long-term resilience

In the next phase of post-COVID recovery, institutions will need to transform radically to build resilience based on their level of preparedness, the macro-economic conditions they operate in and the context. As part of these revival and resilience-building efforts, institutions may develop a new product mix, such as new credit lines and innovative savings schemes geared to insulate clients against future disasters. Further, they may build partnerships to offer products like wholesale lending credit lines to revive businesses.

ix. Enhance risk assessment and management to speed up the revival process. Financial institutions will need to enhance their approaches to risk management significantly, especially for credit portfolios. This can be done through the identification of existing and new risks, the assessment of the nature of these risks, and the validation of the existing risk management framework. Institutions may need to re-calibrate the indicators and triggers of all these risks in line with their shocks and impact on their portfolios. They might also need to refine the approaches to institutional risk management and mitigation measures.

x. Build staff capacities to operate in the new business environment in the post-pandemic world. Financial institutions can develop and disseminate content to better prepare their staff to work in the new, post-COVID business environment. These modules can comprise lessons in the form of interactive sessions that include experience sharing. Further, institutions may also enhance their employees' preparedness to manage shocks that may impact the business operations of clients in the future.

xi. Boost the skills and capacities of customers to help build resilience and nudge them to adopt digital products and alternative channels. Financial institutions need to ensure regular client engagement through the use of digital client management platforms. They may also help individuals and enterprises build skills and capacities through access to training modules. These modules can include lessons on digital capability and financial education for individuals, and business skills for entrepreneurs. Such skills and capacity-building measures may encourage clients to adopt digital products and alternative channels.

These measures can be used by financial institutions to align their business operations with the needs of their users, and to better utilize digitization to deliver customer-centric solutions. In addition, these measures would enable them to recover faster from the current social and economic crises, and to formulate a better response to future disruptions, thus being able to better support enterprises and boost their recovery and accelerating the recovery of the broader economy in emerging markets.

CHAPTER FIVE:

INDUSTRY STRESS TESTING

5.0 Stress testing exercise for the microfinance sector in UGANDA based on 31.12.2021 Data

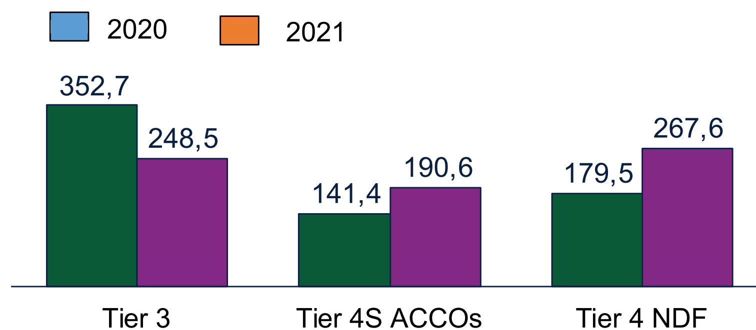
International Finance Corporation (IFC), a member of the World Bank Group, conducted s stress exercise on the data received by AMFIU through the PMT. The 2021 analysis shows some key changes in the portfolio structure, evidenced by a rebalancing of the activity between Tier 3, Tier 4 SACCOs and NDFs. In particular, the loan portfolio shrinked significantly for Tier 3 along with a decrease in the deposit base while the opposite happened for Tier 4 for both SACCOs and NDFs.
Profitability-wise, Tier 4 NDFs and SACCOs became much more profitable, whereas the net results decreased quite significantly for Tier 3.

The NPLs decreased for Tier 3 and increased for Tier 4. However, the level of risk has actually remained stable for Tier 3, the decrease being mainly driven by the portfolio size effect. For Tier 4, the increase in NPLs is associated with a decrease in the level of risk as the default rate decreased, and here also the increase in NPLs is size driven.

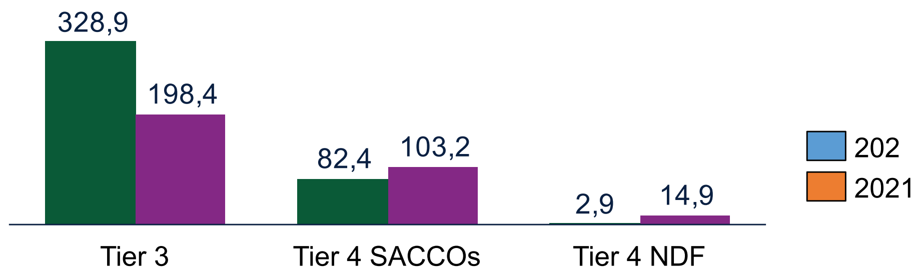
The stress test results show a stronger resilience for Tier 4 NDFs and SACCOs as compared to Tier 3, with the Tier 4 sector remaining profitable and being able to absorb the shock even after a significant increase in the provisions. That is not true for Tier 3.

While the capital position of all sectors remain solid and hence at an aggregated level, default risk should be well managed, the liquidity position should be an area of focus. This position remains positive for Tier 3, albeit it deteriorated quite significantly as compared to 2020, hence the trend in the coming months would deserve being monitored. For Tier 4 NDFs however, the liquidity risk is quite high driven by an aggressive loan portfolio growth and a refinancing structure relying on debt, hence much less stable than deposits.

Loan Portfolio Evolution

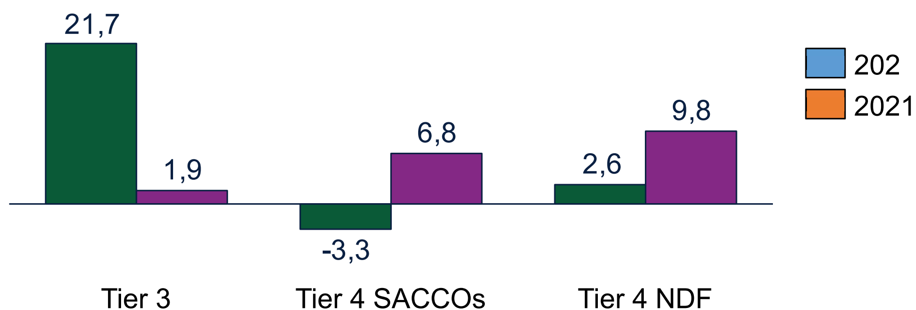


Deposit Evolution



NPLs Evolution

NPLs Evolution



Metrics - As of End of 2020	Tier 3	Tier 4	Total Sector
Evolution of loan portfolio	352,70	320,92	673,62
Evolution of deposits	328,93	85,22	414,15
Evolution debt instruments	66,61	102,56	169,16
Net results	21,70	-0,73	20,97
Return on assets	6,15%	-0,23%	3,11%
Net provisions	22,72	37,37	60,09
Non performing loans (NPLs)	32,12	59,26	91,38
% NPLs vs Total loans	9,11%	18,47%	13,57%
% NPLs vs healthy loans	10,02%	22,65%	15,69%
Provisioning rate	6,44%	11,64%	8,92%
Capital	184,10	146,48	330,58
Solvency ratio	57,4%	56,0%	56,8%

Metrics - As of End of 2021	Tier 3	Tier 4	Total Sector
Evolution of loan portfolio	248,51	458,15	706,65
Evolution of deposits	198,36	118,01	316,37
Evolution debt instruments	52,01	164,22	216,23
Net results	1,92	16,66	18,58
Return on assets	0,77%	3,64%	2,63%
Net provisions	21,88	35,94	57,82
Non performing loans (NPLs)	23,98	63,52	87,51
% NPLs vs Total loans	9,65%	13,87%	12,38%
% NPLs vs healthy loans	10,68%	16,10%	14,13%
Provisioning rate	8,80%	7,84%	8,18%
Capital	159,96	187,34	347,30
Solvency ratio	71,2%	47,5%	56,1%

Significant portfolio changes can be observed between 2020 and 2021, which ultimately will affect the stress testing results:
Loan portfolio decreased significantly for Tier 3 and increased materially for Tier 4, showing a shift in terms of loan origination activity. This seems to be driven by lower resources for Tier 3 and much higher ones for Tier 4, mainly through debt instruments.

Sharp decline in net results for Tier 3 and a material increase for Tier 4. Return on assets evidence such sharp decline in the profitability of Tier 3 institutions, whereas Tier 4 seems to have rebounded quite significantly.

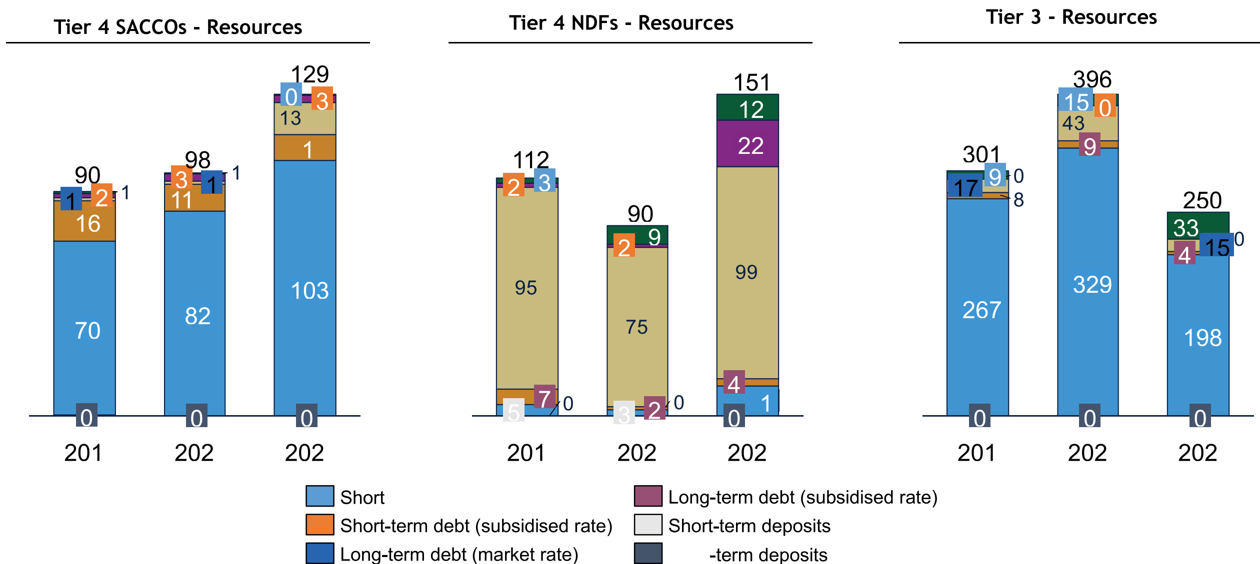
Provisioning rate has also seen some dramatic changes with an increase in Tier 3 provisioning rate and a sharp decline for Tier 4. This can be due to portfolio changes effect as the overall provisions have not changed significantly. In fact, the increase in the provisioning rate for Tier 3 might be explained by constant level of provisions despite sharp decline in NPLs. Whereas for Tier 4, provisions decreased despite an increase in NPLs, probably through more aggressive provisioning policy.

Default rate remained constant for Tier 3 but sharply decreased for Tier 4. It is to be seen if this is a structural improvement in the portfolio or if it is linked to a timing effect, whereas newly originated loans have not defaulted yet.
Solvency ratios improved for Tier 3, likely explained by changes in the asset portfolio (decrease) while the opposite can be said for Tier 4

Métriques	**Tier4 SACCOs**	**Tier4 NDF**
Evolution of loan portfolio	190,51	267,64
Evolution of deposits	103,15	14,87
Evolution debt instruments	26,80	137,42
Net results	6,83	9,83
Return on assets	3,58%	3,67%
Net provisions	14,88	21,06
Non performing loans (NPLs)	26,97	36,56
% NPLs vs Total loans	14,16%	13,66%
% NPLs vs healthy loans	16,49%	15,82%
Provisioning rate	7,81%	7,87%
Capital	91,49	95,85
Solvency ratio	55,9%	41,5%

Tier 4 SACCOs and Tier 4 NDFs have some similar patterns but with structural differences:
Loan portfolio is higher for NDFs which has a higher transformation rate as evidenced earlier. Funding comes mainly from debt instruments which can be associated with a higher cost of funding than voluntary savings.
Return on assets is almost at the same level between the two segments of the microfinance sector.
Provisioning rate is also quite identical with default rates being slightly higher for SACCOs as compared to NDFs.

Solvency is however higher for SACCOs as compared to NDFs. This can be explained by a higher transformation for NDFs, using a higher portion of the capital base to finance the loan portfolio.



Risk profile of the sector in UGANDA

The credit risk profile of the sector is characterized by a relatively high level of default rate, as the PAR30 portfolio represents around 14.1% (vs 15% in 2020) of the healthy loan portfolio. Tier 4 institutions have a higher credit risk profile with a default rate 60% higher than the one of Tier 3 institutions. However, as compared to 2020, Tier 4 default rate decreased significantly from 22.7% in 2020 to 16% in 2021.

The direct consequence of such risk profile is an improvement in the overall performance of Tier 4 in times of market shock as compared to 2020, especially considering the material improvements in the profitability. Hence, a larger loan portfolio which is less risky with higher returns would have positive effects on the stress test results. On the contrary, Tier 3 institutions have a similar level of PAR30 but with a much deteriorated profitability which will have more downside consequences in times of stress.

This level of risk, and the associated sensitivity, is more or less mitigated by two drivers: 1- a good level of profitability and 2-a high level of capital in the sector as whole.

- The first safety net is always linked to the capacity of the sector to generate profits as this generates a buffer to absorb losses and constitute reserves to offset an increased level of risk in the portfolio.
- The second safety net is linked to the capital / equity base as a highly capitalized sector, means that resources are available to cover unexpected losses that materialize in times of stress.

However, the default rate tends to be volatile, as evidenced by the historical analysis shown below. This is particularly true for Tier 4 institutions. A too high level of volatility is an indication of a high level of risk, and hence a high level of sensitivity to potential market shocks.

The liquidity profile of Tier 3 institutions is more likely to be stable as the main source of funding is linked to deposits, which are, more stable and more sticky. However, we would expect a deteriorated cash flow position for Tier 3 as per the lower returns. Similarly, SACCOs are expected to have a more stable liquidity profile than NDFs as per the funding structure.

Tier 4 institutions are comprised of institutions that are deposit taking and others that are not deposit taking and that rely on debt as a main source of funding. These institutions have a high loan to deposit ratio in particular for SACCOs (not relevant for NDFs) which indicates strong reliance on debt instruments which tend to be associated with roll-over risk. Short term deposits fell sharply for Tier 3 institutions, which in turn leads to a higher transformation rate.

It can also be seen that NDFs long term debt at market rate have increased sharply which can be associated with a higher cost of funding. The increase in short term debt can also be associated with a higher level of roll over risk.

The loan to deposits ratio has increased in 2021 after a downward historical trend which evidences a higher appetite for risks.

As a further evidence of a much lower liquidity risk profile for Tier 3 institutions as compared to Tier 4, two main points can be further elaborated on:

- First, Tier 3 institutions use less their resources to finance the loan portfolio growth. However,

the transformation rate increased significantly in 2021, while ressources decreased sharply. It is probably linked to run off of deposits and a reduced ability to raise liquidity. The decrease in deposits is either explained by higher consumptions or a shift of the depositor base to other institutions (like banks, but also Tier 4 SACCOs). The picture is a bit different for Tier 4, as not only all the ressources are used, but also, part of the equity base.

o Second, a lower credit risk profile for Tier 3, implies that collection of loans is higher which reduces liquidity pressure.

Portfolio and Balance sheet analysis of the Microfinance sector

The below analysis is about looking at the spot view as of 31/12/2021. This is the starting point of the ST exercise. The purpose is to understand of the portfolio structure as well as to define the risk profile « as of » date. This will allows defining appropriately relevant areas for the risk profile deformation.

Type	Direction	Poste	Type de données	Tier3	Tier4
BalanceSheet	Asset	Healthy Loans	Statique	214,5	366,4
BalanceSheet	Asset	Deposits in financial institutions	Statique	144,0	16,1
BalanceSheet	Asset	PAR 1-30D	Statique	10,0	28,2
BalanceSheet	Asset	PAR31D-90D	Statique	6,2	15,5
BalanceSheet	Asset	PAR91D-181D	Statique	17,8	48,0
BalanceSheet	Asset	under moratorium at the begining of the period - He	Statique	0,0	0,0
BalanceSheet	Asset	structured loans at the begining of the period - Healt	Statique	0,0	0,0
BalanceSheet	Asset	Loan loss reserve	Statique	-21,9	-35,9
BalanceSheet	Asset	Other Assets	Statique	77,3	123,9
BalanceSheet	Asset	Total Assets	Statique	447,9	562,2
BalanceSheet	Liabillity	Time deposits - <= 1y	Statique	116,7	21,9
BalanceSheet	Liabillity	Time deposits - > 1y	Statique	0,0	0,0
BalanceSheet	Liabillity	Voluntary savings	Statique	78,6	76,9
BalanceSheet	Liabillity	Compulsory savings	Statique	3,1	19,2
BalanceSheet	Liabillity	Short-term debt	Statique	33,2	37,5
BalanceSheet	Liabillity	Long-term debt	Statique	18,8	126,6
BalanceSheet	Liabillity	Loans from the central bank	Statique	0,0	0,1
BalanceSheet	Liabillity	Reserves	Statique	0,9	33,7
BalanceSheet	Liabillity	Capital	Statique	41,7	107,4
BalanceSheet	Liabillity	Donated equity and other capital	Statique	0,5	13,1
BalanceSheet	Liabillity	Retained surplus / (deficit)	Statique	116,9	33,1
BalanceSheet	Liabillity	Other Liabilities	Statique	37,6	101,3
BalanceSheet	Liabillity	Total Liabilities	Statique	447,9	570,9

The portfolio of healthy loans is now much higher for Tier 4 institutions (63% vs 45% in 2020) as compared to tier 3 (37% vs 55% in 2020). The portfolio at risk (> 30d) for the Tier 4 increased slightly in 2021 (UGX 63 vs 59B in 2020) and a decrease for Tier 3 (UGX 24B vs 32B in 2020).

The structure of the liabilities is comprised of time deposits, voluntarily deposits as well as debts with differences between the two perimeters

- o 11.5% (of total liabilities vs 20% in 2020) of time deposits for Tier 3 vs 2% for Tier 4 (stable) mainly with a time to maturity lower than 1 year.
- o 7.7% (of total liabilities vs 11%) of voluntary savings for Tier 3 vs 7.5% (vs 6%) for Tier 4 reinforcing a larger concentration of deposits for Tier 3.
- o 5.1% (of total liabilities vs 7%) of debt for Tier 3 vs 16% (vs 10%) for Tier 4, mainly concentrated on long-term debt.

A higher level of capital for Tier 4 institutions. At class level, capital represents 9.3% of class liabilities for Tier 3 vs 19% for Tier 4.
A strong resilience of the sector in terms of profitability. The net income for Tier 3 was of 1.6B in 2021 vs 16.7B for Tier 4.
The below analysis is about looking at the spot view as of 31/12/2021. This is the starting point of the ST exercise. The purpose is to understand of the portfolio structure as well as to define the risk profile « as of » date. This will allows defining appropriately relevant areas for the risk profile deformation.

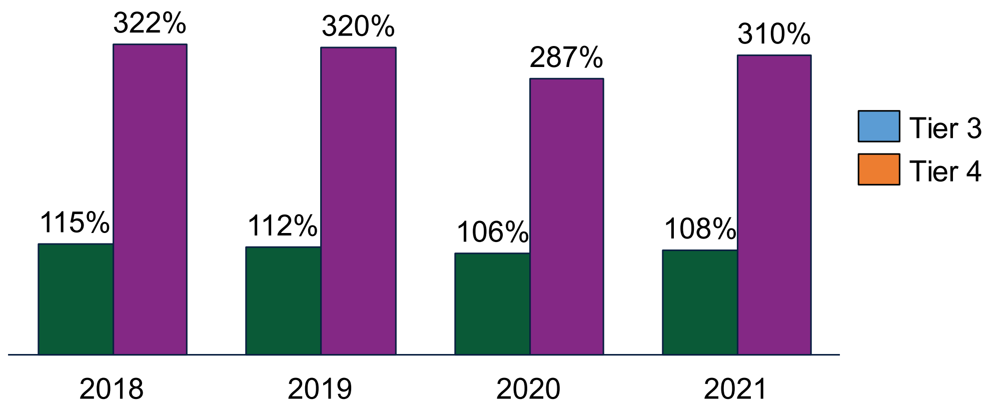
Type	Direction	Poste	Type de données	Tier4 SACCOs	Tier4 NDF
BalanceSheet	Asset	Healthy Loans	Statique	149,0	217,4
BalanceSheet	Asset	Deposits in financial institutions	Statique	10,3	5,8
BalanceSheet	Asset	PAR 1-30D	Statique	14,5	13,7
BalanceSheet	Asset	PAR31D-90D	Statique	7,3	8,2
BalanceSheet	Asset	PAR91D-181D	Statique	19,7	28,3
BalanceSheet	Asset	under moratorium at the begining of the period - He	Statique	0,0	0,0
BalanceSheet	Asset	structured loans at the begining of the period - Healt	Statique	0,0	0,0
BalanceSheet	Asset	Loan loss reserve	Statique	-14,9	-21,1
BalanceSheet	Asset	Other Assets	Statique	42,9	81,1
BalanceSheet	Asset	Total Assets	Statique	228,8	333,5
BalanceSheet	Liabillity	Time deposits - <= 1y	Statique	21,9	0,0
BalanceSheet	Liabillity	Time deposits - > 1y	Statique	0,0	0,0
BalanceSheet	Liabillity	Voluntary savings	Statique	76,9	0,0
BalanceSheet	Liabillity	Compulsory savings	Statique	4,3	14,9
BalanceSheet	Liabillity	Short-term debt	Statique	3,2	34,2
BalanceSheet	Liabillity	Long-term debt	Statique	23,4	103,2
BalanceSheet	Liabillity	Loans from the central bank	Statique	0,1	0,0
BalanceSheet	Liabillity	Reserves	Statique	15,2	18,6
BalanceSheet	Liabillity	Capital	Statique	53,4	53,9
BalanceSheet	Liabillity	Donated equity and other capital	Statique	3,8	9,3
BalanceSheet	Liabillity	Retained surplus / (deficit)	Statique	19,0	14,0
BalanceSheet	Liabillity	Other Liabilities	Statique	7,2	94,1
BalanceSheet	Liabillity	Total Liabilities	Statique	228,7	342,2

The portfolio of healthy loans represents 60% for NDFs vs 40% for SACCOs in the Tier 4 segment. The level of risk is close between the two, with a DR around 16%.
The structure of the liabilities is comprised of time deposits, voluntarily deposits as well as debts with differences between the two perimeters

- NDF are naturally funded through long term debt, whereas SACCOs have a more diverse funding base, with short term time deposits and long term debt, while the main funding source is voluntary savings.A higher level of capital for SACCOs which represents 23.4% of total assets vs 15.8% for NDFs. As a consequence, the risk profile of NDFs seems to be less on the conservative side, despite similar levels of portfolio at risk.

SACCOs return on equity is much higher than the ones of NDFs.

Activity analysis of the sector in UGANDA as of 31/12/2021

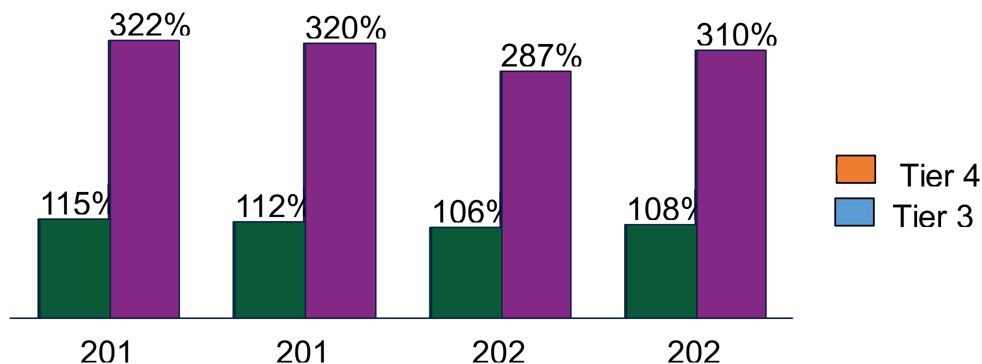


Loan to deposits analysis implies a de-risking for both segments up to 2020 while in 2021, more risk tolerance seems to be observed.

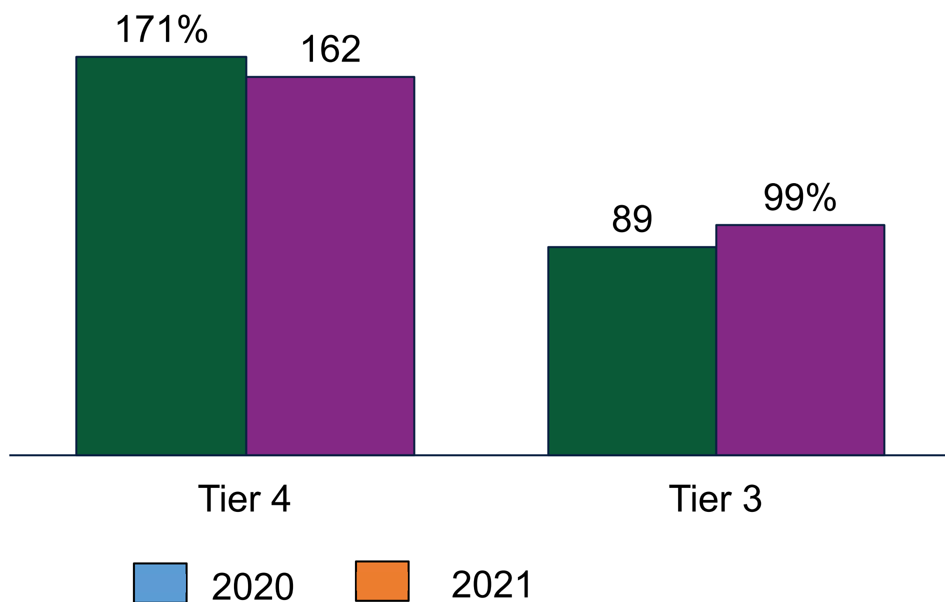
However, while the loan to deposit ratio is close to 1 for Tier 4 implying a lower liquidity risk, the Tier 4 institutions rely more on debt as a funding source.

Debt is usually considered less stable than deposits and hence relying on debt as main source of funding could mean a higher liquidity risk profile

Loan to deposits Historical evolution



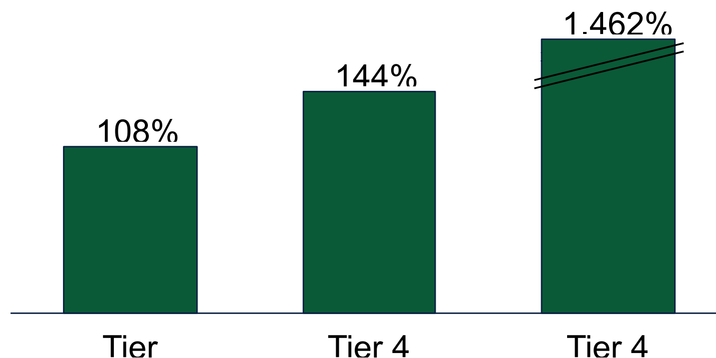
Activity analysis Transformation – Ratio of loans over resources



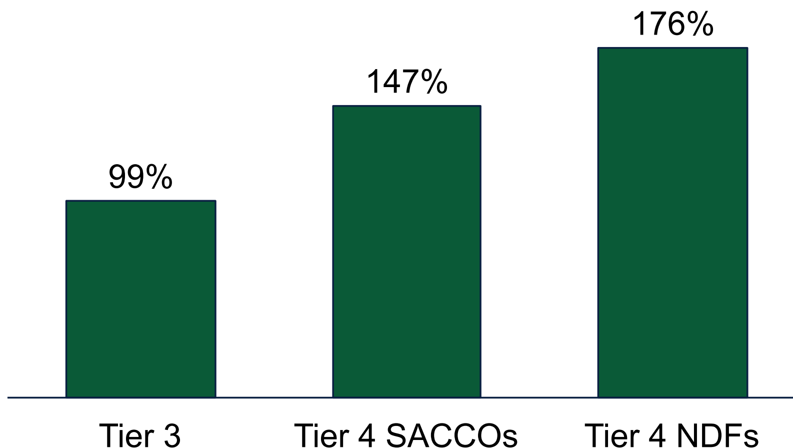
The transformation analysis demonstrates that Tier 3 institutions have a much more conservative approach when it comes to transforming resources into loans. It means that these institutions do not use all the resources to support the loan origination activity albeit this dynamic seems to have changed in 2021.

This also means that the liquidity position should be better for Tier 3 institutions
The activity profile of Tier 4 demonstrates that the loan origination activity is more « dynamic » evidencing a higher risk profile and also implying that part of the equity is used to support the loan activity.

Loan to deposits - Historical evolution



Activity analysis Transformation – Ratio of loans over resources



The transformation analysis demonstrates that NDFs have a much higher level of transformation implying a higher level of liquidity risk as compared to the SACCOs and Tier 3.

The activity profile of Tier 4 demonstrates that the loan origination activity is more « dynamic » evidencing a higher risk profile and also implying that part of the equity is used to support the loan activity.

GLOSSARY

Capital Adequacy

Capital Adequacy is the means of measuring the solvency level of MFIs which is an important indicator of risk bearing ability to the entities. It is the proportion of the capital/own fund held by an MFI against its total asset Capital to Total Assets Ratio of net worth to total assets.

Cost of Funds

This ratio measures the average cost of the company's borrowed funds. In comparing MFIs, the cost of funds ratio shows whether they have gained access to low cost funding sources such as savings.

Debt-Equity Ratio

Debt-Equity Ratio is the proportion of total debt borrowed to the total equity held at a given point of time.

Financial Inclusion

Financial Inclusion is the delivery of financial services at affordable costs to sections of disadvantaged and low income segments of society.

Operating Expense Ratio (OER)

Ratio of staff, travel, administration costs, other overheads and depreciation charges of the MFIs (non-financial costs) to the average loan portfolio during a year.

Operating Self Sufficiency

Shows the sufficiency of income (operating income and investment income) earned by MFIs to cover the cost like operating cost, loan provision and fiancé cost incurred for conducting the operations

Portfolio at Risk (PAR)

PAR indicates the proportion of outstanding amounts of all loan accounts having past due/arrears to the total outstanding loan. In general, PAR 60, i.e. the portfolio/part of the portfolio remaining unpaid 60 days and beyond crossing the due date, would be used as a measure to assess the portfolio quality.

Portfolio Yield
Measures how much the MFI received in interest and fees during the period relative to its average outstanding portfolio. Yield is the initial indicator of a loan portfolio's ability to generate revenue with which to cover financial and operating expenses.

Return on Asset (ROA)
Return on Asset (RoA) is the universally accepted profitability measure which in essence is the percentage net income earned out of total average asset deployed by MFIs during a given period say a year.

Return on Equity (RoE)
Return on Equity (RoE) is the net income earned out of average equity of MFIs held by MFIs during the given period.

Liquidity Ratio
The ability of a financial institution to meet near term demands for cash is determined by this ratio.

LIST OF PARTICIPATING INSTITUTIONS

INSITUTION	REGION	SACCO	MFI	MDI	CREDIT INSTITUTION
Advance SMART	CENTRAL		x		
Alut Kot SACCO	NORTH	x			
ASA Microfinance	CENTRAL		x		
Bagezza SACCO	WEST	x			
Brac Uganda	CENTRAL				x
Bunyaruguru SACCO	WEST	x			
Busiu SACCO	EAST	x			
Butuuro Peoples SACCO	WEST	x			
Community Devt Micro Credit Finance	CENTRAL		x		
Community Fund	CENTRAL		x		
Destiny Microfinance	CENTRAL		x		
East Africa Premier Investments (EAPIL)	CENTRAL		x		

EBO Financial Services	WEST	x			
ECLOF	CENTRAL		x		
EFC Limited	CENTRAL			x	
ENCOT	WEST		x		
Express SACCO	CENTRAL	x			
Finca Uganda Ltd	CENTRAL			x	
Five Talents Uganda	CENTRAL		x		
Franciscan Investment SACCO	CENTRAL	x			
Hofokam Ltd	WEST				
ISSIA SACCO Ltd	WEST	x			
Kagadi Women Trust	WEST		x		
Kati Youth Ventures	NORTH		x		
Kigarama Peoples	WEST				
kahunge SACCO	WEST	x			
Kashongi Farmers SACCO	WEST	x			
Kebisoni SACCO	WEST	x			
Kiboga Food Farmers	CENTRAL	x			
Kigarama farmers	WEST	x			
KIJURA SACCO	WEST	x			
Kitgum SACCO	NORTH	x			
Koboko United SACCO	NORTH	x			
Kolping Microfinance	WEST		x		
Kyamuhunga Peoples	WEST	x			
Letshego	CENTRAL		x		
Loro Oyam SACCO	NORTH	x			
Luzira Alliance SACCO	CENTRAL	x			
Lwengo Microfinance	CENTRAL		x		
Lyamujungu SACCO	WEST	x			
MAMIDECOT	CENTRAL	x			

Mateete SACCO	CENTRAL	x			
MCDT	CENTRAL	x			
Moyo SACCO	NORTH	x			
Mt. Otce SACCO	NORTH	x			
Mushanga SACCO	WEST	x			
Muhame Financial Services	WEST	x			
Mwizi SACCO	WEST	x			
Nile Microfinance Ltd	NORTH		x		
Nyakayojo Peoples SACCO	WEST	x			
Nyaravur Farmers SACCO	WEST NILE	x			
Omipa SACCO	WEST	x			
Pride Microfinance	CENTRAL			x	
Rubabo Peoples SACCO	WEST	x			
Rukiga SACCO	WEST	x			
RUFI	NORTH		x		
RUSCA	WEST	x			
Rushere SACCO	WEST	x			
Shuuku SACCO	WEST	x			
Talanta MF	NORTH		x		
Tujijenge Uganda	EAST		x		
UGAFODE Microfinance Ltd (MDI)	CENTRAL			x	
Uganda MicroCredit Foundation	CENTRAL		x		
Vision Fund	CENTRAL				
Y-Save SACCO	CENTRAL	x			
Offaka SACCO	NORTH	x			
Ikwera SACCO	NORTH	x			
Liberation Community Finance	CENTRAL		x		
Jennis Finance Company	CENTRAL		x		
Devine Microfinance Ltd	CENTRAL		x		

Mushanga SACCO	WEST	x			
Nazingo SACCO	CENTRAL	x			
Eleglance Microfinace	CENTRAL		x		
Palma Microfinance	CENTRAL		x		
Kihanga Mparo SACCO	WEST	x			
Hakashenyi SACCO	WEST	x			
Igara Buhweju SACCO	WEST	x			
SAO ZIROBWE	CENTRAL	x			
Wakiso Self Help SACCO	CENTRAL	x			
Glory Cooperative SACCO	CENTRAL				

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