MicroLeasing in Uganda ?

'A program design of the supply side of Microfinance'

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ABSTRACT – This paper will give recommendations for lending money to poor people on order to set up small bakeries in southern Uganda on the basis of microfinance principles. It is split up in a demand- and a supply side and this paper consists of the latter. Existing literature on microfinance is used to form a theoretical framework and experience of Ugandan Microfinance Institutions (MFIs) in Kampala as empirical evidence, both will be used to conclude what factors to consider when lending money to poor people and set up sustainable, small scale bakeries.

KEYWORDS: UGANDA, MICROFINANCE, LOAN, LEASING, OUTREACH, SUSTAINABILITY.

MANAGEMENT SUMMARY

This thesis has been written to assess in what way to lend money to poor people in Uganda in order to build small scale bakeries based on microfinance principles. The main question is: "Which of the theoretically and empirically researched factors should Bake For Life take into account when setting up a loan system in southern Uganda?" Several major choices have to be made in the end such as the use of group loans or individual loans and the use of lending money or leasing equipment. A theoretical framework has been built on which the interviews at local MFIs in Kampala, Uganda are based. These interviews form the empirical evidence and help making the right choices in the end. I have assessed what they find important and what problems they encountered. I conclude that grouplending works best if outreach is your goal, you can reach as many poor people as possible with grouplending since it circumvents the problem of collateral by its peer pressure within the groups. I furthermore conclude that Ugandan law presents problems with leasing because you cannot take away the leased equipment as collateral since it is owned by both parties after the first repayment. According to my research the best options for setting up the bakeries in Uganda is a group loan or individual lease together with training programmes beforehand and adequate monitoring afterwards.

"The world's seven richest men could wipe out global poverty. Their combined wealth is more than enough to provide the basic needs of the poorest quarter of the world's people."

(Data Snapshots on Microfinance – The Virtual Library on Microcredit)

INDEX

1. INTRODUCTION TO MICROFINANCE

According to the World Bank, more than 1 billion people on our planet still survive in extreme poverty on less than a dollar a day. Considering the quote on page four this is outrageous. Luckily there are incentives like the Millennium Development Goal of halving poverty by 2015, and one of the most promising tools to make this happen could be microfinance. For this paper I have spent 3 months in East Africa. I conducted research in Kampala, Uganda for two months and traveled my way through Rwanda, Kenya and Tanzania before and afterwards. In Kampala I got as much information about microfinance in Uganda as possible and interviewed microfinance institutions to use as examples for our plan of lending money to poor people for setting up sustainable, small scale bakeries. I experienced as much of the Ugandan life in Kampala as possible including its crippling-yet-wonderful chaos and two pretty extreme city-wide riots and witnessed besides Uganda's country-wide poverty also its beauty. You cannot take anything for granted as opposed to our western world since everything you do is more labor intensive, city-wide power outs are more rule than exception and for a single interview at least two or three visits are needed instead of a simple phone call. The one moment you are interviewing an MFI, the next you're off to lunch on the back of a kamikaze-bodaboda (motorbike) dodging the crazy Kampala traffic. Thinking I had seen all of this before and been traveling a fair bit in my life so far, one day I made my way to northern Uganda, bordering Sudan, where I visited one of many refugee (IDP) camps in the rebellious Lord's Resistance Army (LRA) territory where children are still abducted to be made child soldiers and a silent civil war is still going on. Here I witnessed microfinance at grass-root level amidst poverty I had not experienced before anywhere in the world. People that have absolutely nothing set up little shops and started tiny businesses from money they had all saved together. This very moment made me realize the great potential of microfinance and that it might indeed be one of the most promising tools to alleviate poverty, especially in the worst-off parts in the world.

'Live like you were to die tomorrow'
'Learn like you were to live forever'
-Gandhi

Behold, finally here before you are the fruits of my labor, enjoy!

1-1 Initial motive

Bake for Life is a foundation founded in 1999 with a mission to give young handicapped poor people in underdeveloped countries a chance by using donations to build small scale bakeries and train them to become a baker and support themselves. After they have been successfully educated they can either take over the existing bakery or start a new one with help of the foundation. Bake for life works in cooperation with the Dutch Liliane fund which is specialized in direct, small scale help to handicapped poor people in developing countries. Bake for Life opened its first bakery in Ghana in 2003 and a second in Uganda in 2006. A third, also in Uganda is being built right now. For building these bakeries the foundation needs between 60.000 and 150.000 Euro in donations.

Instead of these donations the basic idea of this research will be based on microfinance, or more specifically, the relatively new concept of Micro-Leasing; not lending money to spend, or donating a bakery, but instead lease necessary equipment, like an oven, to be repaid over a certain number of installments depending on the proceeds of the bakery, while the user becomes the owner a bit more with each installment until the bakery is paid off. The goal is to set up more, smaller scale bakeries in southern Uganda based on a microfinance lease model that can be replicated and used to build the bakeries in a sustainable way.

The overarching microfinance model to set up the bakeries will be split up in a supply- and demand side. The demand side is handled by my partner in crime; Renee Pater and consists of the market research and an assessment of necessary demand-side requirements like people, equipment and best locations to build the bakeries1, while this thesis will cover the supply side of the model; how to best lend/lease money to poor people according to existing microfinance institutions and theory.

1 Renee Pater "Local Economic Development through organizing the demand side of Microfinance - *A program design for micro baking in rural areas of Uganda"* Groningen, 2006.

1-2 Overview

This research paper will be organized as follows; first, the remainder of this chapter will be used to explain microfinance as a concept; its definition, and why and how it originated. After this the research questions and conceptual model are presented in the research methodology of chapter two. Chapter three handles important issues when lending money to poor people according to existing microfinance literature in the theoretical background which will lead to the empirical evidence I gathered from the interviews in Chapter four. New empirical findings I stumbled upon whilst researching are presented in Chapter five and the conclusions and recommendations about what factors bake for life should take into consideration when setting up the bakeries can be found in chapter six and the research will conclude with a discussion of its limitations in chapter seven.

1-3 Microfinance and its context

Most people have heard of the concept Microfinance, especially since 2005 was pronounced 'the international year of the microcredit and Muhammad Yunus won the 2006 Nobel peace prize for his efforts in the field. Yet people know little about what it really is, where it originated or the way it actually works.
Microfinance as a concept is not even that old, it started as microcredit, a term that is still being used interchangeably with microfinance, but has expanded beyond credit alone. Where microcredit is the provision of small loans to poor people, microfinance can also take the form of microcredit, but encompasses the whole spectrum of financial services that poor people usually have no access to, including savings, insurance and money transfer. "To most, microfinance means providing very poor families with very small loans (microcredit) to help them engage in productive activities or grow their tiny businesses. Over time, microfinance has come to include a broader range of services (credit, savings, insurance, and now also leasing) as we have come to realize that the poor and the very poor that lack access to traditional formal financial institutions require a variety of financial products." (Mixmarket.org)
In literature there are many explanations of the term microfinance, yet they all tend to converge around the same definition, for instance, Morduch (1999) defines microfinance as "providing financial services to low-income households" and that "almost all of the borrowers do so to finance self-employment activities", according to him, microfinance institutions "share a commitment to serving clients that have been excluded from the formal banking sector." Gutierrez-Nieto et al. (2005) agree with this by defining microfinance as "the provision of small loans to very poor people for self-employment projects that generate income". According to the ING report 'A billion to gain' (2005), offered to HRH Princess Maxima (who was elected ambassador of the year of the microcredit), microfinance is regarded as "an approach for reducing poverty in both developed and developing economies" and it defines the term as "the offering of any financial product to customers whose access to financial services is impeded by having a weak economic position". Altogether we can say that microfinance is providing poor people access to financial services so they can start a small business to escape from poverty. Microfinance is a viable solution to the alleviation of poverty and a promising

tool towards achieving the Millennium Development Goals, yet it is unfortunately not a panacea.

1-4 Microfinance Origins

On the 13th of October 2006, Muhammad Yunus and the Grameen bank in Bangladesh he founded, both won the Nobel peace prize 2006 for their efforts to 'create economic and social development from below'. According to the chairman of the Nobel prize committee "Lasting peace cannot be achieved unless large population groups find ways in which to break out of poverty. Microcredit is one such means. Development from below also serves to advance democracy and human rights." This brings us right at the heart and origin of Microfinance and the origin of the Grameen bank (Mjøs, 2006).

It all started during the Bangladesh famine of '74, Yunus loaned a total of $27 to 43 families so they could sell small items whilst avoiding predatory lending. He listened to poor people's needs and acted upon this. Examples are for instance a woman lending money to buy chickens and sell eggs, a woman buying a riksha so her husband can transport people, a 'phone company' where one woman in the village lends money to buy a mobile phone and villagers can pay to use this phone, or a woman lending money for her husband to start a small factory where others work and earn money for their families again. (Aardenburg, 2007)

Women are specifically targeted with these loans, since most of the time poor women are insubordinate to their male counterparts. By making loans only available to women, men are dependent on their women and have to ask them to get a loan. This gives them a certain amount of power and control, or in the least they have to communicate more with each other. According to Mjøs (2006) "Micro-credit has proved itself to be a liberating force in societies where women in particular have to struggle against repressive social and economic conditions. Economic growth and political democracy cannot achieve their full potential unless the female half of humanity on earth contributes on an equal footing with the male". On the large scale the Grameen Bank is operating now, this might actually change the role women play in these cultures. Yunus furthermore deliberately targets the rural areas, because he states that if he would start in the cities as well, cities might become too attractive for the rural population and they might want to move there in the vain hope of a better job and a better life. Now they have to make a choice between the city where they start with nothing or the countryside where they can get a loan to get started.

From all these ideas, the Grameen Bank originated and started as an independent bank in 1983. The goals of the Grameen Bank are to extend banking facilities to those without resources, based on the principal of development from below; "to stop the exploitation of the poor by money lenders; to create self employment opportunities for large unemployed rural populations; and, as the bank explains; to "reverse the age-old vicious circle of low income, low saving and low investment, into a virtuous circle of low income, injection of credit, investment, more income, more savings, more investment, more income." As of last year. Grameen Bank accounted for more than 1,5% of GDP in Bangladesh". (Bedell, 2006)

"Today Grameen Bank is owned by the rural poor it serves. Borrowers of the Bank own 90% of its shares, while the remaining 10% is owned by the government." As of May 2006, Grameen Bank has 6.61 million borrowers, of whom 97 percent are women. With 2226 branches it provides services in 71,371 villages (Grameen-info.org). Since its start, banks have used the Grameen bank as an example and a lot of best practices have come to surface. These will be analyzed in the theoretical framework.

2. RESEARCH METHODOLOGY

The goal of this research is to design a framework for Bake for Life on how to set up a sustainable system for lending or leasing money to poor people in order to set up small bakeries in Southern Uganda on the principle of microfinance. A literature survey to existing microfinance literature is conducted to build a theoretical framework, and since this part of the overall research is addressing the supply side of the model, experience of existing MFIs in Uganda will be used as empirical evidence. Factors that will be researched will be the outreach- sustainability paradox, different microfinance lending methods that address problems of collateral and the pros and cons of different ways of lending money to poor people.

Next, existing Ugandan microfinance institutions will be researched using semi-structured interviews for gathering qualitative data, how do they go about their business, what are their goals and how do they try to attain them, what problems did or do they encounter? In what way do they give loans to poor people? What are their demands and selection criteria? How do they collect the repayments? Why are, or aren't they self-sustaining? The answers to these questions will serve as examples and will form the empirical evidence. Both the theoretical framework and the empirical evidence will be used for the design of the loan/lease system for setting up a network of small bakeries in southern Uganda.

2-1 Research questions

Taking microfinance literature as starting point and existing Ugandan MFIs as an example, the main research question will be:

Which of the theoretically and empirically researched factors should Bake For Life take into account when setting up a loan system in southern Uganda?

By answering this question, it should be kept in mind that the intention of the Bake for Life model is to set up small bakeries in southern Uganda in order to increase employment and reduce hunger in a sustainable way. The main research question can be answered by breaking it down, and answering the following sub questions first:

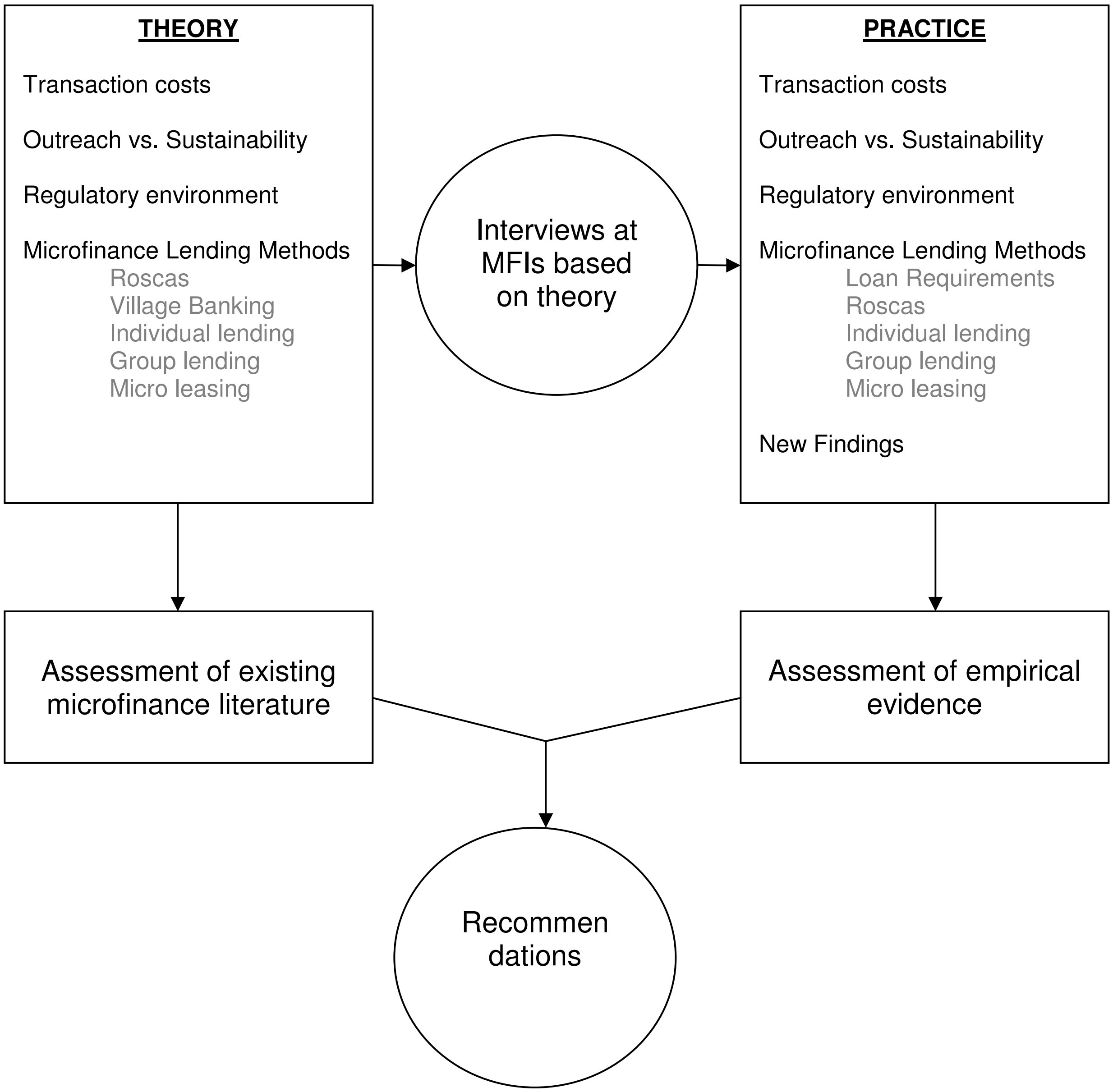
Sub questions:

1. **What are important factors when it comes to lending money to poor people according to existing microfinance literature?**
   Assessment of the available literature on microfinance and a selection of topics that prove to be important to consider for setting up a loan system based on microfinance principles.

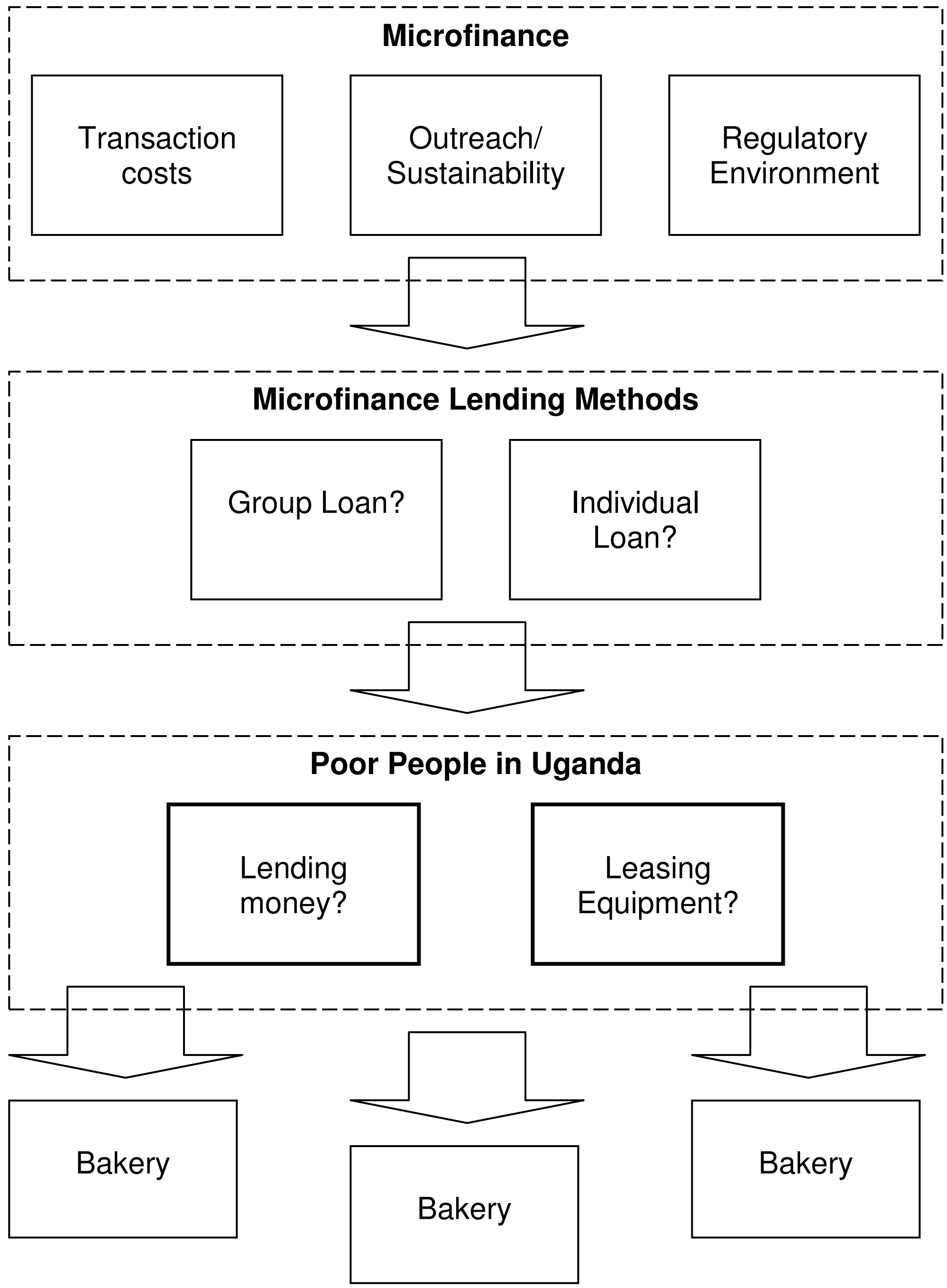
2. **What are important empirical factors to consider according to existing Ugandan Microfinance Institutions in Kampala?**
   Interviews at local MFIs asking questions based on the literature review to assess what factors they encountered and consider important. Semi-structured interviews will be used because of the open character of the questions that are used and to leave the interviewed person free in its answering and ample room for differing answers. The plan is to end up with 'prepared conversations' (half interview-half conversation).

3. **What is the potential of Micro<u>Leasing</u> to set up the bakeries?**
   Assess the possibility of MicroLeasing in which equipment is leased instead of money loaned and lenders own the equipment a little bit more after each repayment until they completely own it at the end.

2-2 Line of Reasoning



2-3 Conceptual Models



3. THEORETICAL FRAMEWORK

This theoretical framework will assess important factors to setting up a loan or lease system according to microfinance literature and tries to find an answer to the following sub question: *What are important factors when it comes to lending money to poor people according to existing microfinance literature?* Interview questions will be derived from this literature base to assess whether empirical evidence from Ugandan MFIs agrees with theory and to build the supply side of the bakery-model from both.

3-1 Introduction

Almost all microfinance practitioners agree that their goal is to improve the welfare of the poor, but they do not agree about how best to achieve this goal (Schreiner 2002). The nature of microfinance is complex and often little understood; the lack of knowledge on 'how' and 'at whom' the programs are aimed originates with the fact that many factors are not taken into consideration. The question 'through whom' to mobilize credit for the poor that have no access to it, is usually left out of the whole setup. "It is therefore important to construct programs by thinking in three dimensions, taking into account the diverse factors; environments, (economical, social and political), role players, and stakeholders" (Khawari, 2004). Our overarching research to both the supply and demand sides will handle all three of these dimensions, since this study covers the supply side of the bake for life model, it will research factors that are considered important not only according to the microfinance literature, but also according to the experience of existing Ugandan MFIs that form the supply side. Schreiner (2001) defines 'Access to loans' as "the ability and willingness to borrow and to repay at a price that covers the long-run cost of an efficient lender". By this definition, access to loans is the nexus of demand based on ability and willingness to repay and the nexus of supply based on low-cost ways to judge risk and to enforce repayment (Schreiner, 2001). One of the most influential factors to the price of a loan is transaction costs, which will be explained next.

3-2 Transaction Costs

"*Poor pay more for financial services because poor cost more to serve*"
(Schreiner, 2001)

Poor lenders demand very small loans for short terms, but cannot indicate and guarantee creditworthiness. Poor savers cost a lot to serve because they hold low balances and make frequent deposits and withdrawals (Schreiner, 2001). The main problem here is that it costs much more to offer many small loans than a few large ones and MFIs cannot cover their costs unless they can charge interest rates that are well above average bank loan rates. Their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding, and they cannot depend on governments and donors as reliable, long-term sources of funding. Furthermore, when governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit. Commercial banks that are forced to make small loans at rates that do not allow them to cover their costs and make some profit will develop ways to avoid mandatory allocations, or will lend and then ask the government to cover losses by claiming on loan guarantees". "At the same time, MFIs should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need to be". (CGAP, 1995, CGAP, 2004)

3-3 Outreach vs. Sustainability

"Experience around the world has shown that micro-entrepreneurs do not need subsidies and that MFIs cannot afford to subsidize borrowers. Low income entrepreneurs want rapid and continued access to financial services, rather than subsidies, since they often send the signal to borrowers that the money comes from government or donors who regard the poor as objects of charity, and borrowers see this as a signal not to repay. Few low income entrepreneurs end up benefiting from subsidized programs, because these programs fail before they reach significant numbers" (CGAP, 1995). "Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor people. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs, but cost recovery is not an end in itself; rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to reach more of the unbanked poor" (CGAP 2004).
According to Morduch (2000) "much of microfinance's enthusiasm rests on an enticing 'win-win' proposition: microfinance institutions that follow the principles of good banking will also be those that alleviate the most poverty". By eventually being independent from subsidies and achieving financial sustainability, microfinance institutions will be able to grow without the constraints imposed by donor budgets. "In the process, according to the argument, these institutions will be able to serve more poor people than can be served by programs fueled by subsidies. A key principle is that poor households demand access to credit, not 'cheap' credit. Thus, programs can charge high interest rates without compromising outreach. If the argument is right, much poverty alleviation can be achieved at no cost to governments and donors or perhaps even at a small profit (Morduch, 2000).

Two main streams can be identified within the microfinance literature, outreach and sustainability, or as Rhyne (1998) and Schreiner (2002) call it: a poverty approach and a sustainability approach.

The term outreach is typically used to refer to the effort by MFIs to offer loans and financial services to as many clients possible (breadth of outreach) and especially toward the poorest of the poor of these clients (depth of outreach) (Conning, 1999). The social value of the output of a microfinance organization can be summarized in terms of depth, worth to users, cost to users, breath, length, and scope (Schreiner 2002). Outreach is commonly proxied by the sex or poverty level of borrowers, the size or the terms of loan contracts, the price and transaction costs borne by users, the number of users, the financial and organizational strength of the lender, and the number of financial products offered, including deposits (Navajas et al. 2000, Schreiner 2002). The poverty approach assumes that great depth of outreach can compensate for narrow breadth, short length, and limited scope, while the self-sustainability approach assumes that wide breadth, long length, and sufficient scope can compensate for shallow depth (Schreiner, 2002).

The term sustainability is defined as "full cost recovery or profit making, and is associated with the aim of building microfinance institutions that can last into the future without continued reliance on government subsidies or donor funds" (Conning, 1999). According to Navajas et al. (2000) sustainability is permanence. "The social goal is not to have sustainable microfinance organizations but rather to maximize expected social value less social cost discounted through time. In principle, sustainability is neither necessary nor sufficient for social optimality. Sustainability is not an end in itself but rather a means to the end of improved social welfare (Rhyne, 1998). In practice however, sustainable organizations tend to improve welfare the most" (Navajas et al. 2000).

The initial goal of microfinance is the first, outreach, to lift as many (breath) of the poorest people (depth) from extreme poverty as possible by providing them access to financial services in a sustainable way. However, the latter, sustainability, has received much attention in contemporary microfinance literature, as more and more MFIs become self-sustainable and even profitable, and many of them adopt each others 'best practices' to reach self sustainability and profitability. The weight of official opinion seems to have steadily shifted toward valuing sustainability over outreach and the 'institutionist' or 'financial systems' approach that has become increasingly dominant at the World Bank and in much of the donor community, pushes microfinance providers to aggressively pursue sustainability through raising interest rates and lowering costs.

(Conning, 1999) This shift towards sustainability leads to a more commercialized microfinance market. "Microfinance has entered a new phase in which competition and other market forces are compelling microfinance institutions to adopt commercial approaches" (Woller 2002). The risk of this is so called 'mission drift', the de-emphasis of their social mission; to reach as many poor people as possible, in pursuit of higher financial returns. A logical hypothesis from this would be that MFIs scoring high on outreach would score low on sustainability since it is harder to be sustainable when serving the poorest people that are more expensive. By the same rationale a second hypothesis would be that the MFIs scoring high on sustainability do so because they have lower costs by not reaching the poorest people, thus score low on outreach, we have to see how this works in practice. Rhyne (1998) however argues that everyone involved in microfinance shares the same basic goal: "to provide credit and savings services to thousands or millions of poor people in a sustainable way. Everyone wants to reach the poor, and everyone believes sustainability is important". She states it is not an either-or debate but instead, it is about degrees of emphasis and what choices are made when trade-offs appear. Conning (1999) studied 72 MFIs and their problem to maximize the impact and outreach of their lending activities while remaining financially sustainable. According to him the tradeoffs between outreach and sustainability are shaped by monitoring and delegation costs that arise within a chain of agency relationships that are subject to moral hazard. He states that, all else equal, sustainable MFIs that target poorer borrowers must charge higher interest rates, have higher staff costs per dollar loaned, and are less leveraged. Rhyne (1998) compares this to a mathematical formula with the problem of dual-maximization of two goals: reaching the very poor and financial sustainability, if you maximize one, the other works as a constraint. However, "a mathematical concept leaves out the social, political and moral factors that drive us", thus she compares it to another image that pictures poverty and sustainability as two sides of a whole, "the yin and yang of microfinance" as she calls it, each incomplete without the other. "This view emphasizes that reaching the poor and sustainability are in large measure complementary, and particularly that sustainability serves outreach. Only by achieving a high degree of sustainability have microfinance programs gained access to the funding they need over time to serve significant numbers of their poverty-level clients. This image reveals that there is in fact only one objective: outreach. Sustainability is but the means to achieve it" (Rhyne 1998).

3-4 Regulatory Environments

"The international microfinance community is showing increasing interest in the issue of regulating and supervising MFIs. By far the majority of MFIs are still not subject to government regulation. Little practical experience has been gained and theoretical discussion is still at an early stage" (Staschen, 1999). According to Staschen (1999) regulation must pursue two prime objectives; consumer protection, effectively limiting the danger of opportunistic behavior by preventing excessive risk-taking, and avoiding an unwarranted run on a financial institution which could result in a system-wide bank panic. (Staschen, 1999). Interest in the regulation and supervision of microfinance institutions is mainly because unregulated MFIs also start to take deposits. Having become sustainable and seeking to expand their outreach, these unregulated MFIs are less likely to receive funding from donor agencies in the amount and timeframe needed to meet their desired levels of expansion (Vogel et al. 2000).

3-5 Microfinance Lending Methods

As mentioned before, the reason poor households are excluded from the formal banking system is their lack of collateral. Luckily the microfinance movement develops new contractual structures and organizational forms that reduce the risks and costs (such as adverse selection or moral hazard) of making un-collateralized and cheap loans (Khawari 2004). Examples of these structures are Group lending, Village Banking, Dynamic incentives and Micro-Leasing, and they are based on the benefits of Joint liability, Peer selection and Peer monitoring. One of the oldest examples of uncollateralized lending is the ROSCA.

Roscas

Almost every culture has developed some kind of informal financial system by which members of a group agree to pool their money and make regular contributions after which they give the money to members of the group on a rotating basis, by mutual agreement, by lottery or by need and emergency. These informal financial systems are called ROSCA's, or, ROtating Savings and Credit Associations (Waterfield 2001). These

ROSCA's can be found all over the world and go by different names in different regions and countries. Since these informal systems operate efficiently without any financial costs, it is surprising that little attention is paid to these lending techniques by NGOs around the world (Khawari, 2004). He explains: *"let's say there are 25 members who meet weekly and each contributes $2 to their ROSCA. At each meeting one of them is chosen via lottery and given the total amount of money collected, in this case $50. Once a member has received the amount, her/his name will not be entered into in the lottery again, though she/he will go on depositing her/his $2 every week. After 25 weeks when all the members have had their share of the fund, the ROSCA ends".* The first people that receive the pot are actually receiving interest free loans from the other group members, while the last members to receive the pot are no better off financially than if they had saved up their own money (Waterfield, 2001). The advantages of a ROSCA are that it socially bonds the members together, responds to their emergency needs and provides a discipline for savings. Risks however are that members might drop out after receiving the pot by which the others lose their whole contribution. It is this risk that makes ROSCAs carefully select their membership, and their success in doing so is an example for many group lending programs (Waterfield, 2001). The existence of ROSCA's can make everyone better off, but it hinges on three principles: "first, all participants wish to buy an indivisible, durable goods; second, they are impatient to do so; and third, ROSCA participation is enforced in that all participants that won the pot earlier keep contributing" (Aghion and Morduch, 2005). "A growing literature on ROSCAs concluded that peer review provided an excellent and efficient means of selecting trustworthy participants. That is, friends, neighbors, relatives, and long-time business associates are a better, or at least a more efficient means of providing a character reference than the traditional banking procedures. Second, ROSCAs showed that the poor could often be persuaded to repay their loans through peer pressure. Peers put more pressure and a different kind of pressure on borrowers than institution staff are willing and able to do. In addition, borrowers felt more obligated to repay when their companions were the ones to lose out rather than a faceless institution with unimaginably large resources" (Waterfield, 2001). However, downsides of ROSCAs are that members cannot receive their money when they need it most, due to the rotating nature of the system, and all loan amounts are exactly the same, regardless of their precise needs. This lack of flexibility leads to less opportunity, since a member with more ability to absorb and productively use credit will be unable to do so (Waterfield, 2001). Nonetheless, Khawari (2004) states ROSCAs are one of the most efficient forms of financial intermediation because they convert small savings into loans without any paperwork or storage costs, they are flexible and can be adjusted to any group size or kind. In Africa and Asia there have been efforts to establish microfinance programs based on ROSCAs.

Individual Lending

MFIs basically use two different contracts; the individual- and the group lending contract. When issuing either loan contract, the lender needs to find a solution to overcome the problems of adverse selection, moral hazard and enforcement of the contract. The first, adverse selection, occurs when lenders cannot distinguish between risky and safe borrowers in order to charge appropriate interest rates to both of them, the second, moral hazard, occurs due to the difficulty in monitoring the borrowers' actions, and the last, enforcement, and is necessary to avoid default (Aghion and Morduch, 2005). The main mechanism addressing all three problems is demanding collateral which covers the loan amount and the interest payment (Vigenina and Kritikos, 2005). This is the main difference between Group lending and individual lending, collateral and the screening and monitoring process. Under the group contract, loans are given to individuals, and instead of providing collateral they form joint-liability groups (see next paragraph). Under the individual contract, lenders demand collateral and use screening procedures, for which the central role is given to the loan officers; they have the responsibility for the entire lending process of screening, monitoring, and enforcement (Vigenina and Kritikos, 2005). The loan officer aims to generate as much information about the borrower's risk type and his repayment capacity as possible during the screening process, and makes detailed cash-flow based analyses of the applicant's household and business. Depending on their findings, they determine repayment conditions that fit the borrowers' repayment capacity, and depending on the profitability of the business and on the client's ability to show his creditworthiness, the loan terms vary per client (Vigenina and Kritikos, 2005). The main argument against the individual contract is that the collateral requirement makes it impossible to reach the real poor people since they have nothing to guarantee as collateral (Vigenina and Kritikos, 2005).

Group Lending

The 'discovery' of group lending opened up possibilities for microfinance especially for the problem of collateral when lending to poor people. It is by far the most celebrated microfinance innovation, and with good reason. Group lending showed how unconventional contracts can work and the shift in understanding led to other new ideas that borrowed as much from traditional moneylenders as from modern banking practices. Today, group lending is just one element that makes microfinance different from conventional banking (Aghion and Morduch, 2005). Early interest in microfinance focused on the group lending methods to solve the adverse selection and moral hazard problems (Tedeschi, 2005). To lessen adverse selection, members are jointly liable for each others' loans, so group members (who have better information than the lender) choose other members they believe most likely to repay. The risky borrowers have no choice than to group with other risky borrowers, easing the burden of default on the safe borrowers' shoulders. This process is called 'assortative matching'. Once groups are formed, each member has the incentive to monitor the others' behavior, reducing both moral hazard and the lender's monitoring costs (Aghion and Morduch, 2005, Tedeschi, 2005, Vigenina and Kritikos, 2005). The sanctions may be fairly subtle and induced by peer pressure from fellow villagers rather than by the direct actions of the programs. Sanctions may involve for example, the loss of a borrower's reputation in the community, social isolation, restrictions on access to inputs necessary for business, or, in rare cases, even the use of physical force (Aghion and Morduch, 2000). Another way of avoiding default is the use of dynamic incentives. When a borrower has continual credit needs, access to future loans can provide a strong reason to avoid default on a current loan or the unwillingness to repay a loan once a positive outcome is realized. Continual increases in loan size called progressive lending works as another incentive, for it encourages a borrower to repay over time (Tedeschi, 2005).

Micro Leasing

Leasing has only achieved widespread use in developed countries in the second half of the twentieth century, and while the concept remains hardly known in the majority of developing countries, it has proven to be an effective financing technique by overcoming barriers posed by interest rate ceilings and collateral requirements (Gallardo, 1997, Havers, 1999). While financial transfers would immediately increase the poor's disposable income and thus welfare, investments in the assets of the poor are clearly preferable as they durably enable the poor to better participate in and benefit from economic activities without making them dependent on welfare programs (Kappel et al. 2004).

Leasing is based on the proposition that profits are earned through the use of assets, rather than from the ownership of it, it can be an effective tool if an enabling macroeconomic market and a clearly established legal, regulatory and tax framework for leasing transactions exists (Gallardo, 1997). "Leasing is a contractual arrangement between two parties, by which you (the lessee) have the use of an asset (normally a piece of equipment) belonging to me (the lessor) in exchange for regular payments by you to me for a fixed period of time. It is this separation of ownership (by me) and use (by you) which is at the centre of leasing" (Havers, 1999). "The owner of the leased item expects the lessee to make lease payments by generating sufficient cash flow. This feature of leasing enables borrowers without credit history and collateral to access the use of capital equipment or other items" (Dowla, 1998). "Leasing represents a most effective financing technique for reaching those enterprises whose financial needs cannot be satisfied by traditional minimalist microfinance approaches. It has the potential to generate significant developmental impact by transforming marginal enterprises into sustainable businesses". (Gallardo, 1997).

Three main types of leasing exist: financial leasing, hire-purchase and operating lease. The first two, financial leasing and hire-purchase, both are an alternative to bank loan financing for equipment purchases. Financial leasing is also called full-payout leasing because payments during the lease term cover the entire lessor's costs; the lessee carries the risk of obsolescence and maintenance but has the right to purchase the asset in the end. Hire-purchase is a hybrid instrument which is typically used for retail or individual financing of motorcycles, refrigerators and other small items. The down payment is higher, but an increasingly higher percentage of ownership is transferred to the lessee with each lease payment until it owns the asset. Because of this it is less secure for the lessor (since the lessee owns part of the equipment), but it also avoids the risk of default since the lessee has a sufficiently large stake in the equipment. Finally, an operating lease is a contract for short term use of equipment (like car rentals) in which the lessor recovers its costs from multiple rentals and the final sale of the asset (Gallardo, 1997). “Although leasing interest rates are higher than those which are (in theory) available from commercial banks, they tend to be rather lower than those which are (genuinely) available from microfinance institutions”. (Havers, 1999).

Leasing has a number of advantages in comparison to conventional loans: It is easily accessible for small- and micro businesses since it doesn’t require detailed historical financial records or the provision of complex collateral security such as mortgages over land and buildings. The down-payment on a lease is lower than the stake in a bank loan. Leasing can fill the gap when medium and long-term bank finance is not available. It is furthermore characterized by low transaction costs because of its simple and quick procedures instead of the often time-consuming attendance at group meetings required by most microfinance institutions and the accessibility problems and corruption costs of trying to borrow from a bank. There are also tax breaks and even VAT advantages to leasing in some countries. Leasing should be attractive to donor agencies as well because if done properly, it is a profitable activity which has clear potential for achieving financial sustainability (Gallardo, 1997, Havers, 1999).

3-6 CONCLUSIONS FROM THEORY

This theoretical framework has explained how microfinance works, explored solutions to the problem of lending money to poor people, found ways to avoid the problem of collateral and shows how uncollateralized lending all started with the Rotating Savings and Credit Associations. The main conclusions from existing microfinance theory at this time are that an MFIs sustainability is just as important as its outreach while the first is a means to reach the latter, that microfinance is more expensive than regular lending in terms of interest rates because of its higher transaction costs, and that there are several methods of lending money to poor people without making use of collateral. The best practices from literature so far are the different ways around the problem of collateral; peer pressure that works as social collateral so the poorest people that have absolutely nothing to guarantee as collateral can still lend money. Especially micro-leasing sounds promising in theory and will definitely be assessed during the interviews. The interview questions are all based on these conclusions and findings from the theoretical framework

4. EMPIRICAL EVIDENCE FROM THE INTERVIEWS IN UGANDA

This empirical evidence is based on semi structured interviews[2] held at fourteen microfinance institutions in Kampala Uganda and tries to answer the following sub question: *What are the most important empirical factors to consider according to existing Ugandan Microfinance Institutions?* Together with the theoretical background, on which the interview questions are based, I hope to be able to give recommendations to Bake for Life or any other Institution that lends money to poor people in Uganda.

4-1 Introduction

Uganda is considered one of Africa's best reformers; it is performing better than many of its African counterparts even though the country is land-locked and has been confronted with many obstacles during its post-war period (Kappel, 2004). Uganda covers an area of almost 250.000km; it has around 28 million people and a population growth rate of 3,3%. People live to be around 50 years of age and literacy is around 70% (CIA-Factbook).

Economy Overview Uganda

For the past two decades the Ugandan government has taken action to rehabilitate and stabilize its economy and with the support of foreign countries and international agencies it is undertaking currency reform, raising producer prices on export crops, increasing prices of petroleum products, and improving civil service wages. Bringing inflation down and increasing production and export earnings were the main aims of these policy changes. The nineties were marked by continued investments in the rehabilitation of infrastructure, improved incentives for production and exports, reduced inflation, gradually improved domestic security and the return of Indian-Ugandan entrepreneurs who were exiled under Amin's rule. Recent growth from 2003 to 2006 reflects an upturn in Uganda's export markets. (CIA-Factbook)
Nowadays Uganda is generally seen as the country with the most vibrant and successful microfinance industry in Africa (Carlton et al. 2001). Microfinance is provided by over

2 For the interviews see appendices p.50>

1000 formal and semi-formal institutions, of which some have experienced strong growth and reaching a considerable number of clients, three of them are already serving between 25.000 and 45.000 clients and a number of microfinance providers are close to financial sustainability or already surpassed it. It is estimated however, that still only 10% of the rural population have access to financial services. The population below the 1$ poverty line did decrease from 56% in 1992 to 35% in 2002, but then increased again to 38% in 2004, due to the Northern Ugandan Insurgency (AMFIU 2006).

Uganda's financial sector has been divided in four 'Tiers'. Tier 1 consists of fifteen commercial banks, one of them also providing microfinance services (Centenary). Tier two consists of seven credit institutions, Tier three are four Microfinance Deposit taking Institutions (MDI's) and Tier four consists of about 15 larger MFIs and an unknown number (more than a thousand) of unregulated actors. The top five institutions have already surpassed, or are close to full financial sustainability, and "new providers continue to enter the market and join a relatively mature and professional industry" (Carlton et al. 2001).

For my research I interviewed 11 MFIs consisting of:

Tier 1	Centenary Bank ('s microfinance division)
Tier 2	CMF
Tier 3	Finca, U-trust, UML
Tier 4	Ugafode, Success, Med-Net, MCDT, Faulu and Acfode

I furthermore interviewed 3 Umbrella institutions:

Bank of Uganda	- The Central Bank
Amfiu	- Association of Microfinance Institutions of Uganda
Stromme Microfinance	- Wholesaler of funds to MFIs

The 11 MFIs were interviewed as examples for our plan of lending money to poor people to set up small bakeries, how they lend money, collect repayments and what problems do they encounter. The umbrella institutions were interviewed to get a clearer overview of microfinance in Uganda in general and the possibility of a more objective view on the MFIs in Kampala.

Introduction to the interviewed MFIs

ACFODE started in 1985 as a result of a conference discussing women issues in Nairobi whilst Ugandan women were denied. Four of them realized women needed a voice and Action for Development (Acfode) was born. ACFODE is an indigenous membership organization that guards women's interests. Members participate in planning and organization of activities and on top of gender equality issues, microfinance is part of its organization. ACFODE started in 1996 to empower women economically and is a non-profit organization.

AMFIU, the microfinance regulating body, started in 1996 by 5 MFIs that wanted their voice heard because MFIs were not recognized as a part of the financial system yet. Its main goal is to have MFIs contribution recognized, facilitate information sharing in the industry, set best practices and capacity building. AMFIU does not set rules and regulations but has codes of conduct to regulate the behavior of its members. There is no law in Uganda to disclose information, so high information asymmetries exist and transparency is selective, even banks are free to disclose whatever they want. AMFIUs main goal is to lobby at the Ugandan government to get these laws and constitutions in place.

Centenary was called centenary rural development bank. Its main aim is to uplift the standard of living for rural people through financial means.

CMF started as a mass market provider of financial services and its main difference is its local ownership.

Faulu started in Kenya and Faulu Uganda started as a branch of this. Started by "Food for the hungry" to give poor people access to financial services, it now has 21 branches in Kenya and 8 in Uganda (of which 4 urban and 4 rural). They lend to the economically active poor. Faulu is currently in the process of becoming a tier 3 (deposit taking) institution. Now they are still borrowing money from commercial banks which they lend out again. A lot of money goes to the interest on those loans and if they are tier three they can legally take deposits and get fully sustainable.

FINCA A worldwide organization with 7 branches in Uganda. Providing empowering financial services within Uganda's low income earning communities under positive social interaction through committed and motivated staff, while maximizing stakeholder value.

MCDT started as part of 'Save the Children' which funds child projects by giving money to mothers for school fees. From this it changed to funding income generating activities, but because people still thought it was a charity organization MCDT was formed as a separate entity to make clear the money had to be repaid. MCDT targets the real poor with only group loans.

MED-NET is an affiliate of 'world vision Uganda' that mainly do Area Development Programs (ADP's) of which microfinance is a small part. Med-Net started operations in 1997 as a separate, sustainable part of world vision.

Stromme had a passion to help the poor founded on Christian principles, from all contributors a fund was created. Stromme also operates in Sudan and Rwanda and is still spreading. Most funding comes from the Norwegian government through the NGO NORAD.

Success originated in 2005 from the 'Uweso Ugandan women effort to save orphans' that started in 1986. Uweso is an aid organization based on charity that also began savings, it is still running as a charity based NGO and Success is sustainable nowadays.

Ugafode started as 'Evangelistic Enterprises' to help HIV-Aids affected families. A microfinance organization was set-up in 1994 to help these people in a sustainable way. The loan officers are Christians and they respond to client needs with flexible instead of fixed products.

UML, or; Micro Uganda Limited started 9 years ago out of a grad school to do it better than existing MFIs, then most microfinance was supply driven instead of demand driven, they state they are flexible and innovative and have better customer service.

U-TRUST started in 1984 as 'Ugandan women finance trust', a tier 4 organization to economically empower women, now they are tier 3 and widely spread with 21 branches nationwide and a network system with access everywhere through an intranet. They not only have a financial goal, but also a social mission; women needed permission of spouses everywhere but at U-trust. Therefore U-trust started winning the loyalty of women.

Results from the interviews:

4.2 Transaction Costs

Higher transaction costs are the main reason microfinance interest rates are often higher than commercial rates. Interest rates are the prices commercial banks and MFIs charge for their products (loans), so the interest rate has to cover all the MFIs costs; costs of borrowing, transport of loan officers to rural areas, training, defaulting lenders, salaries, inflation, taxes and most importantly; monitoring and administration costs and a margin. One of the interviewed MFIs in Kampala, U-trust, had a monthly interest rate of 2,5%, the rest all set it on 3% (36% per year) obviously higher than the commercial rates. Smaller MFIs usually look at what their neighboring MFI charges, however according to Stromme, a wholesaler of funds to MFIs, they do not have to look at their neighbors because every MFIs loan package and cost structure is different. There are a couple of leaders in the industry; Finca, Pride, Uganda Finance Trust and Faulu, but the interest rate is mainly based on the market.

4.3 Outreach vs. Sustainability

According to AMFIU, MFIs often pursue two objectives; they have a social mission, to offer financial services for the poor, and they also have to and want to become financially sustainable. Microfinance is a business, its clients have to pay prices that cover all the MFIs costs and ensure the future ability of the MFI to operate. This is what AMFIU calls 'the double bottom line' of the MFIs that demands sound practices in strategic focus, sustainability and outreach (AMFIU 2005). From the interviews I found there are big differences in outreach and sustainability of different MFIs. When I asked the MFIs to put themselves on the scales below I got the following outcome:

	Outreach		Sustainability
1		**1**	
2	CMF	**2**	
3		**3**	
4	Centenary, Med-Net	**4**	MCDT, Ugafode
5	MCDT , U-trust	**5**	Success
6	Ugafode	**6**	Med-Net
7	Faulu, UML	**7**	Acfode, Centenary,
8		**8**	
9		**9**	CMF
10	Acfode, Finca, Success	**10**	Faulu, Finca, UML, U-trust

When asked to rate themselves on outreach and sustainability by the poverty level of their clients and how dependent they are on donors and subsidies ACFODE stated it targets the poorest of the poor in rural areas that are not easily reached and put itself at 10 on outreach, MCDT handles the poorest people by only giving group loans but puts itself at 5 on outreach and Finca states they target the poorest people in rural areas of all MDI's and is the only MFI that states it scores highest on both outreach ánd sustainability, the combination all MFIs strive for. Other MFIs, whilst also serving the poor, concentrate more on sustainability. CMF for instance, is close to full sustainability but as you can see they do not score high on outreach and Faulu, Finca, U-trust and UML are already fully sustainable whilst not scoring extremely low on outreach.
The first hypothesis from theory was that MFIs scoring high on outreach would score low on sustainability since it is harder to be sustainable when serving the poorest people that are more expensive. By the same rationale the second hypothesis was that the MFIs scoring high on sustainability do so because they score low on outreach. From my results however I cannot conclude whether the first hypothesis is true or not. I did find some evidence for the second hypothesis, with the exception of MCDT, Ugafode and Acfode, all MFIs score higher on sustainability when they score low on Outreach. Centenary for instance scores 4 on outreach and 7 on sustainability and CMF even 2 on outreach and 9 on sustainability, this might point a little bit towards my second hypothesis, but the success story of Finca that scores highest on both contradicts this again, which makes it dangerous to state any hard conclusions about this.

4-4 Regulatory Environment in Uganda

The Ugandan government had long been dominating the financial sector (like most sectors in Uganda) by directly supplying services or intervening in pricing or quantity decisions, luckily, in the second half of the 1980s, transformation to a market system began, however, government intervention is also justified under a market economy. To avoid government malpractice a microfinance umbrella organization called 'The Association of Microfinance Institutions of Uganda' or 'AMFIU' was started in 1996 by 5 MFIs that wanted their voices heard and their contribution recognized, because back then MFIs were not recognized as part of the Ugandan financial system. AMFIU is a member based and member driven organization that is independent of- but works together with the Ugandan government and central bank. They don't set rules and regulations, but have codes of conduct to regulate the behavior of its members, facilitate information sharing in the industry, set best practices and build capacity. Nowadays AMFIU has grown to be the most important formal network representing the microfinance industry of Uganda. AMFIU permanently identifies issues that need to be discussed with the Ugandan government and the Bank of Uganda, gives input to political debates that (may) affect microfinance, informs politicians, regulators and the general public about the technicalities of microfinance and safeguards the image of microfinance as a powerful weapon in the fight against poverty in Uganda.

All interviewed MFIs are members of AMFIU and although AMFIU has no authority to regulate MFIs directly (only the central bank is licensed to do this), criteria like; at least 2 years of operation, general transparency, disclosure of information and being audited by external audit every year are required to be an AMFIU member. AMFIU furthermore rates MFIs and ensures that whoever is a member conforms to its best practices. Through these criteria for its members AMFIU contributes indirectly to a regulated Microfinance sector (which is still a small part of the total Ugandan microfinance sector). The Ugandan microfinance union further standardizes MFI activities and by its 'MFI deposit taking act' the central bank of Uganda handles regulations as soon as MFIs grow to be tier 3 and higher and able to legally take deposits.

MCDT, a tier 4 MFI and also part of AMFIU, states that a problem of current regulation is that as a tier 4 they are lacking the ability to collect savings, they are therefore thinking of changing into a 'Sacco' (savings and credit co-operative) to be able to collect savings from its members. They state investing to become a tier 3 MFI (and be able to take deposits from anyone, not just its members) would divert from their original mission. Success Microfinance stated it is true that there are several quite demanding requirements to growing from a tier 4 to a tier 3 MFI; a 500mln Ush deposit at the bank of Uganda is required, a 250mln Ush Management Information System has to be in place and a smooth branch network with readily available information from all branches is needed and every morning a report of the previous day has to be sent to the central bank of Uganda. It is obviously very hard to meet these requirements and grow to be tier 3 if you are not a profitable MFI.

According to AMFIU the main problems considering the regulation of the microfinance industry is that it is still not fully regulated, it is a dual economy with a regulated and unregulated part, interest rates are still very high due to high costs and inefficiencies, microfinance services offered are still narrow and despite the fact that still over 70% of Uganda is still dependent on agriculture, it is not financed as much. Further problems are that there is no law in Uganda to disclose information, so high information asymmetries exist and transparency is selective, even banks are free to disclose whatever they want. Therefore AMFIU's main goal is to lobby at the government to get these laws and constitutions in place. When interviewed, AMFIU stated its main contribution is to transform MFIs into licensed companies that are able to take deposits and bringing MFIs, the government and regulators together. Regulating the industry to make things work better is paramount.

4-5 Microfinance Lending Methods

Loan Requirements

Only two (MCDT and ACFODE) out of the eleven interviewed MFIs clearly stated they also give startup loans, MCDT has as requirements that 100% of the lenders has to be female and that the lenders have to be in the same geographical area as the office, but they do give startup loans. ACFODE initially only targeted existing micro-businesses but now also starts giving loans to people with no businesses after they have shown potential during their training. Their field officer collects loan applications at group meetings, brings them to ACFODE where a loan appraisal committee checks the viability.

The rest of the MFIs all target existing micro businesses and require that potential lenders are engaged in at least some kind of economic activity with a cash flow, or have had a viable business or income generating activity for at least between 6 and 12 months. All MFIs require collateral for individual loans, most not for group loans. A guarantor (underwriter) is needed to get a loan at Success, Finca, Med-Net and UML, at ACFODE only for group loans and at U-trust even two. At U-trust lenders also need to open a savings account and, like MCDT, be resident in the area of the office. Furthermore at Acfode, Centenary and CMF the credit history of the lender is checked. Centenary requires a year of experience in the business or if it is agricultural, the lender has to have practiced it for at least 2 seasons. All this to make sure people are able to repay their loans and to avoid potential defaulters. Some MFIs, like Centenary, mentioned these criteria are flexible however, as long as the project is considered viable, some criteria may not be needed.

Roscas

'Munno Mukabi' (ROSCA in Luganda, meaning 'friend in need')

After having read all there is to read about microfinance and the way group loans can avoid collateral because of the peer pressure and so on, the thing that was still unclear to me is how those loan-groups actually form. How does a group of (wo)men come together and start saving? Luckily during my interviews I finally got some answers to this question, but even better was that I saw it first hand when I got to know someone in Kampala who was doing research to former LRA child soldiers north of Gulu (Northern Uganda, close to Sudanese border) and invited me to visit one of the IDP refugee camps where he was conducting research because he had heard they were just starting microfinance programs there. Here I saw from grass-root level what had always been unclear to me in theory, and what I asked so much about in my interviews. It felt like the last piece of my puzzle fell in place.

- Welcome song upon arriving at the IDP Refugee Camp north of Gulu -

- Interviewing Micro-entrepreneurs in the IDP Refugee camp –

- Women selling dried fish at the market after lending $5 from the group –

A small group of about 5 or 6 people had been trained by an NGO and those people had to 'spread the word' so to speak, until the maximum group size (in this case 30) was reached and a new group could be started. These groups of 30 people set clear rules and fines in case of default and started saving the equivalent of $0,20 a week per person. When I arrived the first group had saved $50 in almost 2 months and a second group just started saving. From this pot of $50 group members could lend $5 and had to repay $6 within the next two months. I visited group-members in the camp that had lent the $5 to see what they did with it; One member used the money to expand his very tiny shop (the only one in the 12.000 people refugee camp), another member bought gasoline at the nearest village about an hour away and sold it with a tiny profit in the camp and some members bought dried fish to sell on the 'market' of the camp with a little profit. These groups were now waiting for screening and a monetary injection by an MFI. Now these extremely poor people can make a little bit of profit and progress in their lives and have something to do and to live for. This is how the groups form that MFIs target, I had witnessed firsthand the true impact microfinance can have on poverty I had never seen before.

- One of eight water pumps for 12.000 refugees –

Individual Lending

All individual loans need collateral and most also a guarantor, because of this it is not possible to reach the poorest of the poor with individual loans, however, sometimes successful lenders outgrow the group loans and have to take an individual loan. Centenary stated they take a wide range of collateral but that there is often no proof of ownership of a piece of land used as collateral so they have to check with clan leaders and the local council (local governmental chairman) of the village. 25% of the loan is collateral. Ugafode lenders can lend 60% of their collateral value, and Ugafode agrees with Centenary that land titles as collateral are not very clear since there are no papers or certificates as proof, most of the time they also seek help with the local council of the village, but land titles are often owned by more family members that are dependent on it. At Faulu individual lenders need collateral of even 70% and at Med Net lenders need, besides a guarantor; a current account, historical bank statements, sale records and an overview of house bills. U-trust even states repayment rates of individual loans are better than group loans (90% vs. 80%), and they are gradually phasing out their group lending. All in all individual lending is for the "well off" poor that can put something up as collateral.

Group Lending

Group loans are the best microfinance's' best 'invention' for it circumvents collateral. This is how it works at most Ugandan MFIs I interviewed: Group loans are usually set up as one big group that can range anywhere between 20 to 50 members and consists of smaller groups of 5 members each, these member do not loan as a group but get a loan each so they all have a similar incentive. Sometimes lenders also have to appoint leaders within their groups that manage the group. These smaller groups act as 'solidarity groups' as ACFODE and UGAFODE appropriately call them, meaning that when a lender within this group defaults, the group of five becomes responsible for repaying the loan. The bigger group of 20-50 is sort of a safety net in case the solidarity group also fails to repay the default, which actually rarely happens. These group loans make it possible for poor people to lend money without collateral because the peer pressure within the different groups works as a social collateral, effectively replacing the monetary collateral, for the MFI these group loans work by making sure the MFI will be repaid, even if a lender defaults. If individuals within one of the groups would be so successful that they outgrow the group they grow into a personal loan. Most of the time 1% of the loan amount is used by the MFI as insurance against death or injury of the lender or its family, either in-house or outsourced at an insurance company.

Micro Leasing

To answer the third sub question; *What is the potential of MicroLeasing to set up the bakeries?* I asked all MFIs MicroLeasing related questions in the interviews. However, when asked if they also make use of micro leasing only one MFI, UML responded positive, most other MFIs do respond that they are planning to use it somewhere in the near future. UML makes use of hire-purchase leasing with a 20% collateral and state the main advantage of leasing is the instant collateral you get, however, I had lunch with a former CEO of a very big Canadian leasing company, who told me that the reason almost no-one is making use of micro leasing yet, is that the instant collateral doesn't work in Uganda. With hire-purchase the person that leases the asset owns it a little bit more every time he pays a term, so from the moment he paid his first term he is co-owner of the asset. From that moment on though, reclaiming the asset as collateral is impossible by Ugandan law because it is owned by both parties.

4.6 Empirical conclusions from the Interviews

From the fourteen interviews a lot of the theoretical findings presented in the theoretical framework proved true, other findings did not and some findings were completely new and did not originate from the theoretical framework. Group lending indeed proved to be one of the best options when no collateral is available, the regulatory environment in Uganda tries to regulate the otherwise unregulated microfinance sector, microfinance interest rates are indeed higher because poor people cost more to serve and however not sufficiently proven in this research, FINCA serves as an example that the outreach / sustainability paradox does not seem to be a paradox but that it can indeed be managed to successfully serve both ends to a maximum. Some empirical findings from the interviews did not correspond or even contradicted theoretical findings, especially on the main subject of this research; MicroLeasing. The concept of micro leasing has a number of advantages and seems to work in theory, in practice however, at least in Uganda, it does not seem to work. As expected also new findings surfaced during the interviews, findings I had not thought of, or that were not explicit in the researched microfinance literature. These findings explain things that had remained uncertain from theory, for instance on the subject Roscas, or how lending groups actually start. In the next chapter more of these new findings are presented.

5. NEW EMPIRICAL FINDINGS

5-1 Gender preference

About half of the interviewed MFIs prefers lending to women by requiring a minimum percentage of at least 50% lending to women or require women in leadership positions in the lending groups. Groups at ACFODE and Success exist for at least 80% out of women and at MCDT even 100%**.** Reasons mainly heard when interviewing MFIs are that women are better repayers, have better credit history, are more focused on income generating activities and have the biggest impact in the household by spending money on school fees, family, sick kids etc. Even Faulu, a tier 4 MFI with no preference for lending to women, stated women do perform better and their portfolio at risk is better. UML however, stated that it is a misconception that women repay better. This, together with the fact that the interviewed MFIs that preferred female lenders over male lenders are not convincingly more or less successful, nor earn higher profits, have larger outreach or are more sustainable than their counterparts makes that there is not enough empirical data, decisive figures nor a convincing majority to come to any decisive conclusions about this issue at this time.

5.2 Support / Training / monitoring

One of the factors that makes microfinance more expensive than regular loans is the costs of support like training and monitoring because more effort has to be put in most of the microfinance loans. **ACFODE** states that lenders will default If you just lend money without capacity building. They give monthly training in business counseling, stock taking, bookkeeping, how to use the loans ('loan tracking') and how to separate loans from family. The loan appraisal committee checks the business plan and if it is not viable more training is given. ACFODE furthermore makes lenders start village banks that are not owned by ACFODE. A field officer attends monthly group meetings and does Quarterly visits. Centenary trains loan management and sometimes works together with NGOs that give more training. They furthermore stated the Ugandan government has 'extension workers' on the sub-county level that teach farmers on farm management. Centenary mainly targets these trained farmers. **Amfiu** however states bookkeeping training will only raise the price and thus the interest rate of the loan. The payback rate and the clients business growing are paramount. **UML** agrees with this, their only loan requirement is a viable business. They state bookkeeping is overrated and only monitor their clients every now and then. **FINCA** also doesn't give training in bookkeeping, their loan officers visit the business before the first payment and after that visits are not structural. **FAULU** does train its loan-groups before the loan, but groups pay for these themselves. They state operational costs are very high and group loans are so sensitive that they really need weekly monitoring. They state even public holidays distort the numbers, that's why they are checked every day because they see people default if not checked for a week. **CMF** only offers courses when they get someone to pay for it every once in a while. They monitor quarterly, and check after 3 days if a repayment doesn't come in. **MCDT** visits before they give the loan and only gives training in their rules and regulations and how to organize groups. Monitoring after giving the loan is by sampling. For every loan they receive a status report from the group. **Med-Net** offers training in bookkeeping and saving and if the business is not growing Med Net also offers business counseling and makes sure clients diversify. **Success** gives training before and during the loan period. Before they give training in bookkeeping, the importance of savings, loan utilization and identification of potential defaults. They look at each others' social status, business performance and give training in group formation. According to Success this results in a separation in safe groups and risky groups. After **Ugafode**'s group forming process orientation training is given where staff tell their clients what Ugafode stands for and the services it can offer them. Training is 1 hour per week for 4-5 weeks and after the loan officers finish the training, the field manager does a 'centre recognition test' to assess how effective and responsible the groups are. If proven successful, the group leader presents a loan request to the loan officer and the loan is given. After the loan is given they give training in bookkeeping. Ugafode occasionally visits borrowers to monitor them, but this happens more for individual loans and they don't do it at fixed times, so borrowers do not expect the checkup. Before giving the loan **U-trust** gives awareness training at a meeting to teach lenders how and why people default and it trains loan-groups in bookkeeping. They furthermore arrange 1 day per year to resensitize its clients with the new financial products and try to understand the clients' changing needs and problems and things U-trust should change. U-trust does not monitor, but is planning to. They state if you realize their business is not running well it is already too late because they cannot repay.

5.3 Multiple Lenders

One main subject that kept recurring in every one of the interviews was that one of the MFIs biggest problems when giving microfinance loans is the fact that none of the MFIs actually knows whether a lender has already got a loan at one of their competitors, which would make them less creditworthy and a less suitable candidate for a loan to say the least. Even worse, when lenders that have multiple loans default, something they often do, their collateral works on a first-come first-serve basis, so some MFIs can't even get the collateral back. Stromme states the main causes for these problems are that MFIs can't cross check, there is no national id system in Uganda and no central system for checking default. Success has found a way around this and stated that if they operate in an area where other MFIs are also active, they plan their trainings at the same time so they can see who has double loans because lenders can only attend one of the two meetings at a time. Centenary stated that in an urban setting multiple lending is a very big problem but that in rural areas it is easier to assess because clan leaders, chairmen and friends and neighbors are a viable source of information. U-trust asks their competitors and the guarantors of the lenders in rural areas whether they have given loans already. All these are handy solutions but far from optimal, luckily some MFIs already stated what the Central Bank confirmed in an interview; a 'credit reference bureau' to ascertain who has gotten a loan at an MFI is being set up, and in its final stages now. This would be a major improvement and should be implemented wherever microfinance is being practiced. Another problem according to the central bank are the unregulated tier 4 MFIs, it would be preferable, however impossible, to regulate the whole sector with their current capacity, because there are over 500 unregulated tier 4 institutions.

6. CONCLUSIONS & RECOMMENDATIONS

After having read quite extensive amounts of microfinance literature and having visited actual microfinance institutions in Uganda to interview them about issues I had wondered about in theory, an image can be formed about the organization of microfinance in Uganda, best practices can be extracted from data gathered and insights gained, recommendations can be given to Bake for Life or other institutions that lend money to poor people in Uganda and the main research question can be answered; *Which of the theoretically and empirically researched factors should Bake For Life take into account when setting up a loan system in southern Uganda?*

The first issue that has been of utmost importance is the fact that I had totally steered towards a plan of leasing equipment (say, an oven) instead of lending money to poor people. According to theory this would work, instead of handing poor people a lot of money to spend on whatever they need and want, they get an oven they can only use for economic activities that helps them in the long term. After each installment they own the oven a little more until they own it, which works as an incentive to keep working. This plan works great in theory but does not seem to work in practice, at least not in Uganda. According to Ugandan law if a lender would fail to pay its installments you cannot take away the oven as collateral after the lender has paid one or more installments, since the lender partly owns the equipment. Ugandan law would consider this stealing. An alternative that incorporates lending piece equipment should be found to circumvent this problem. An easy solution would be to still lend an oven but not make the lender own it a little more after each installment, as with a lease, but only at the end when the lender has repaid all installments, whether this is possible is an object for further study however.

As for training and monitoring, it is very important to train lenders beforehand and keep monitoring afterwards. I have heard numerous accounts of default due to lack of monitoring and most MFIs agree that despite being expensive this is of utmost importance. A lot of MFI's have weekly or monthly group meetings in which they monitor the businesses and collect the repayments.

As to the choice between group- and individual lending; for a monetary loan I would definitely recommend group lending over individual lending since it is the intention of

Bake For Life to reach the poorest of the poor and these people have nothing as collateral so cannot engage in individual lending. However, group lending costs are higher due to more extensive monitoring, training, group meetings and the like. Biggest advantage is the replacement of collateral by peer pressure since members are responsible for each others' loan. If individual lending is the preferred choice I would recommend lending based on leasing as explained above and use the equipment lent in this way as collateral to be able to still reach people that have nothing to use as collateral. However, more risk of default would be involved in this way of lending compared to the group lending methodology.

Most of the choices to make will depend on the Outreach-Sustainability paradox (Conning 1999 and Rhyne 1998) presented in Chapter 3-3. Is it more important to reach as many poor people as fast as possible at any cost? Or is it more important to reach less poor people but in a sustainable way and possibly longer term? If donations are abundant and money is not the problem I would opt for the first, a lot of microfinance institutions that could be sustainable keep their interest rates artificially low to reach the poorest people because they receive enough donations. The now famous Grameen Bank is the living example of this. Most of the time this is not the case however, donations might not be abundant or might work restrictive by giving requirements as to how to spend the donated money, which makes reaching less poor people in order to stay sustainable and independent of donations inevitable to stay in business for the long term.

All in all the most important issue when lending money in general is trust. One of the main problems I encountered in every interview I conducted was that MFIs do not know whether a lender has already taken a loan at another MFI. Multiple lending is certainly an issue to keep in the back of your head when issuing a loan.

7. DISCUSSION & LIMITATIONS

The main limitation of this research is obviously generalizability. Since all interviews were conducted in Uganda it is uncertain whether these results will hold across the national boundaries in other parts of the world. Another limitation could be that respondents gave socially acceptable answers instead of the true story to keep a positive profile about their company. There is no reason to believe this however, because in my opinion most respondents were as elaborate on the negative as the positive facts about their operations. Another limitation is the fact that this research is based on only 14 interviews, more is always better, but due to time and monetary restraints 14 was the maximum. For most interviews at least two or three visits at the MFI were necessary to get the appointment, promises were often broken and some MFIs (like PRIDE microfinance) even demanded money (100USD!) for an interview. Another limitation could be the fact that the interviews are snapshots, I did not follow the institutions for a couple of months after which I conducted another interview to discover certain trends or problems over time.

Issues for further research would be first and foremost the research of alternatives to hire/purchase leasing in Uganda in a way that it is permitted by Ugandan law to use the leased equipment as collateral. Another issue for further research is a gender study. My research has proven too limited to conclude whether women or men are preferred lenders. More research to this issue in Uganda could yield valuable insights. Also more attention should be given to hedging or other monetary techniques to mitigate forex risk. Only one of the interviewed MFIs used countermeasures against this risk. Especially in a country with inflation as unpredictable as in Uganda this is certainly a priority. One last issue that should certainly be addressed is multiple lenders, the fact that MFIs have no way of knowing whether a lender has got more loans is detrimental to the business and causes unnecessary defaults. Fingers crossed for the system the Ugandan Central Bank is currently working on to counteract this problem.

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