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Centenary Rural Development Bank, Uganda: A Flagship of Rural Bank Reform in Africa

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**Centenary Rural Development Bank, Uganda:
A Flagship of Rural Bank Reform in Africa**

by

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Abstract

Centenary Rural Development Bank, Uganda: A Flagship of Rural Bank Reform in Africa

Centenary RDB is a commercial bank that provides deposit, credit and money transfer services indiscriminately to men and women of lower income. By insisting on loan recovery and cost coverage, it has reached more men and women in rural areas than any other institution in Uganda. With minimum deposits of \$6 and minimum loans of \$30, access barriers are low. 11 of its 16 branches, 73% of its deposits and 82% of its loans are in rural areas. Established by the Catholic Church of Uganda as a trust fund in 1983, it developed a **strength in savings mobilization** but performed poorly as a financial intermediary. In 1990, the political will to reform the fund evolved in the board, resulting in the fund's **transformation into a commercial bank** in 1993. With support from various donors including the German Savings Banks Foundation, the bank evolved into the most successful financial intermediary in Uganda. This has made the bank the **African flagship of rural and agricultural banking**, combining sustainability with outreach to the rural poor and demonstrating the feasibility of agricultural lending. With equity capital of \$6.8m and total assets of \$49.85m as of December 2001, it has mobilized \$39.9m from 280,00 depositors, provided \$14m in loans outstanding to 22,000 small borrowers, earned returns of 4% on average assets and 28% on equity, and, since 1999, finances its expansion from its profits. Centenary RDB has several stories to tell:

- one about the feasibility and impact of **rural and agricultural bank reform** - addressed to the community of agricultural development banks (AgDBs) in Africa and those who decide on their fate;
- another one about the **compatibility of institutional sustainability and outreach to both men and women** in rural areas - addressed to the community of microfinance institutions (MFIs) and their donors;
- a third one about the **feasibility of agricultural lending to men and women** - best told by the staff and clients at Mbale branch and addressed to financial institutions weary of risky agricultural lending.

Revised January 2002

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Summary¹

The woman-entrepreneur who financed diverse micro-enterprise start-ups through profits from farming and their expansion through credit: Nandina Zauma is 35, married and has four children, 13-20 years old. In 1983, she started with a small rice farm. To protect her savings from inflation, she put up a building for a mill in 1992, continued saving and installed a mill in 1996 – all self-financed from the proceeds of her farm. Since 1999, she received four loans from Centenary, each amounting to Ush 2 million (\$1,150). She first purchased a second mill, then expanded her produce trading operations, and finally bought two minibuses. During this 2½-year period, the total value of her business operations grew from Ush 6 million to 14 million (\$8,000). She has two full-time employees and several contract laborers.

Hard work, savings and credit: Connie Watuwa's business empire: Connie Watuwa is around 50, married and has six children. Born in a village, she moved to Mbale where business opportunities are unlimited. In 1971, she opened a restaurant with her husband. From the income, she saved money in a bank and opened a hardware store of her own in 1975. In 1986 she got a first loan from the now defunct Cooperative Bank for a lock-up store and, in 1991, a loan from the Uganda Women's Finance Trust for produce trading: buying rice at Ush 400/bag and selling it after 3 months at Ush 1000/bag. Despite the 150% gross profit margin in three months, she complains about UWFT's high interest rate. When Centenary opened a branch in Mbale in 1998, she became one of its first depositors. "Centenary is a greener pasture, it gives you no headaches", she said. Within two years, she received three loans: Ush 2 million, Ush 4 million and Ush 10 million. As all her payments were on time, she recently graduated to a so-called automatic loan of Ush 15 million at a substantially reduced interest rate. She invested the loans in a second lock-up store, a mattress store, and in an extension to the restaurant. She pays for her children's education at Makerere and Nairobi University. The total net worth of her business empire is now Ush 230 million (\$133,000). Her secret of success is hard work and credit: "I worked when I was pregnant up to my 9th month. I can work. All I need to expand is bigger loans."

Centenary is a *Tier-1* commercial bank that provides deposit, credit and money transfer services indiscriminately to men and women of lower income. By insisting on loan recovery and cost coverage, it has reached more men and women in rural areas than any other institution in Uganda. With minimum deposits of \$6 and minimum loans of \$30, access barriers are low. 11 of its 16 branches, 73% of its deposits and 82% of its loans are in rural areas. Established by the Catholic Church of Uganda as a trust fund in 1983, it developed a **strength in savings mobilization** but performed poorly as a financial intermediary. In 1990, the political will to reform the fund evolved in the board, resulting in the fund's **transformation into a commercial bank** in 1993. With support from various donors including technical assistance by the German Savings Banks Foundation implemented by IPC, the bank evolved into the most successful financial intermediary in Uganda. While continuing to mobilize deposits vigorously, IPC, a German consulting firm specialized on microbanking reform, introduced a **highly effective lending technology** based on:

¹ I gratefully acknowledge support of the study by the International Fund for Agricultural Development, Rome. Responsibility for the contents and any errors lies with the author.

- (a) the analysis of the total household as a complex IGA entity;
- (b) an incentives-driven repeat loan system, providing access to lower-interest *automatic loans*;
- (c) flexible but comprehensive loan security requirements; and
- (d) stringent enforcement of timely repayment, backed up by a system of computerized daily loan tracking, instant recovery action, customer incentives, and staff performance incentives at all levels of the bank.

This has made the bank the **African flagship of rural and agricultural banking**, combining sustainability with outreach to the rural poor and demonstrating the feasibility of agricultural lending. With an equity capital of \$6.84 million and total assets of \$49.85 million (*Dec. 2001*, up 35% over *Dec. 2000*), Centenary Rural Development Bank:

- mobilizes its own resources (\$ 39.9 million, up 34%) from 280,000 depositors (up 18%) , some 115,000 of them women;
- lends to 22,000 small borrowers (up 29%), some 7,000 to 8,000 of them women, at practically unlimited loan sizes (\$ 14 million loans outstanding, up 31%);
- has its loans repaid by both its male and female borrowers at a portfolio-at-risk rate of 2.1%;
- pilot-lends to 3,000 male and female smallholders (14.4% of the portfolio) at below-average arrears;
- earns returns of 4% on average assets and 28% on average equity during 2001;
- and, since 1999, finances its expansion from its profits.

Despite Centenary's impressive expansion of saver outreach and, to a far lesser extent, of borrower outreach, its single most important **weakness** has been its constricted lending. Given its financial technology and growing deposited resources, Centenary faces a vast rural market potential of up to 8.8 million rural people, among them 4.5 million women, most of them with multiple income-generating activities. Centenary covers little more than 3% of that market. Centenary could greatly benefit from *economies of scope* by extending credit to more of its depositors. Major **constraints** to a more rapid increase in borrower and saver outreach are a lack of capacity to train large numbers of new staff, inadequate premises, and limited management capacity. Capital inadequacy (*bridging equity*) is a lesser problem in Centenary compared to other institutions.

In terms of **gender**, Centenary has no bias, using its highly efficient financial technology to provide sustainable financial services to increasing numbers of male and female customers. Husband and wife may borrow simultaneously from Centenary, which is crucial to substantial impact and lasting poverty alleviation. 30-35% of its borrowers and 40% of its depositors are estimated to be women, a total of 115,000 (*Dec. 2001*). Their access to credit is not limited by any ceilings, opening the way to virtually unlimited growth and employment generation. However, in the absence of sex-differentiated information in its MIS, the bank misses the chance of developing specific strategies and products for women and men within the different culture areas of Uganda.

NGO/MFIs have rapidly expanded in Uganda over the past decade, providing start-up finance for microentrepreneurs, particularly women. Through **linkage banking**, Centenary could help solving their perennial problem of shortage of funds and, at the same time, its own problem of excess liquidity: either through wholesale refinancing or by enabling successful microentrepreneurs to graduate to the commercial banking services of Centenary. This would vastly increase and deepen Centenary's rural financial services, particularly to women.

Given its successful financial technology and the virtually unlimited size of the rural market, untapped in many areas, further **expansion of outreach to rural and agricultural areas** remains the Bank's biggest task. This is of particular importance to low-income people,

among them **microentrepreneurs, smallholders, women and the enterprising poor**. Convenient deposit services for small savings are normally not available in their proximity, but are of utmost importance to self-financed business growth and borrowing capacity. In this vein, major **challenges and opportunities** for Centenary include the following, centering on the **further expansion of outreach and deeper services for both women and men**:

(1) Bringing the bank to the people:

- Expanding into remoter areas through sub-branches and linkage banking
- Improving its branch services by expanding its staff and premises
- Expanding its small saver outreach through nearby deposit and collection services
- Expanding its small borrower outreach through sub-branches and through more balanced staff incentives for both, arrears prevention *and* disbursement.

(2) Bringing the bank closer to women:

- Including sex of customer in the bank's MIS
- Providing information differentiated by sex of customer to branches
- Monitoring discrepancies in outreach to women and men between branches
- Developing differential marketing strategies and products for women, men and youth as seen fit

(3) Bringing the bank to intermediaries:

- Lending wholesale to NGOs, MFIs and associations of farmers and microentrepreneurs
- Graduating clients of NGOs and SHGs to bigger loans, voluntary deposits and money transfer
- Monitoring linkages with women-only vs. mixed-clientele intermediaries

(4) Deepening financial services and impact:

- Offering tied savings-cum-credit products and cross-selling of financial products
- Strengthening microenterprises through business services by cooperating agencies

(5) Strengthening the delivery capacity of the bank:

- Expanding staff and staff training facilities
- Expanding and modernizing bank premises
- Modernizing the MIS, introducing a graphic user interface system
- Expanding management capacity

(6) Disseminating sustainable rural finance, agricultural lending and agricultural bank reform:

- Providing exposure training to MFIs and commercial banks in Uganda
- Providing exposure training to rural and agricultural banks in the wider region

(7) Harnessing donor support:

- Working out strategies of expansion and financial deepening jointly with donors
- Coordinating donor inputs through leading donor agencies with local presence
- Encouraging co-financing by financial and technical assistance agencies
- Revising the *Business Plan* as a living document in cooperation with major donors.

Donor support to Centenary for spreading its highly successful rural and agricultural financial technology and deepening its impact is recommended in the following fields:

- (1) development of strategies of expansion including new products at national level
- (2) capital adequacy bridging
- (3) cooperation with NGOs and MFIs (*linkage banking*) at national and local level
- (4) expansion into underbanked areas with a potential for sustainable banking
- (5) management and staff training
- (6) national and regional exposure programs for agricultural banks and rural MFIs

1. Centenary Rural Development Bank: a commercial bank for the poor

Centenary Rural Development Bank Ltd.², variously referred to as Centenary, CERUDEB or CRDB, has several stories to tell:

- (1) one about the feasibility and impact of **rural and agricultural bank reform** - addressed to the community of agricultural development banks (AgDBs) in Africa and those who decide on their fate;
- (2) another one about the **compatibility of institutional sustainability and outreach to both men and women** in rural areas - addressed to the community of microfinance institutions (MFIs) and their donors;
- (3) a third one about the **feasibility of agricultural lending to men and women** - best told by the staff and clients at Mbale branch and addressed to financial institutions weary of risky agricultural lending.

The big story behind all is addressed to the rural as well as urban people in Uganda: in terms of **access of both men and women to adequate financial services and impact** of these services on their life and business.

In terms of **gender**, it is a universal bank: it discriminates neither against women nor men. Both sexes have equal access to its services. About 30-35% of its borrowers and a somewhat higher proportion of depositors – perhaps 40% - are estimated to be women. Like all commercial banks, Centenary does not break down its customer information by sex, thereby missing a simple and inexpensive tool of market research. Given the success of its financial technology, the bank has not been inclined to pay particular attention to the gender issue. Women have benefited from Centenary's emphasis on sustainable banking, which has enabled the bank to increase its overall outreach and provide individual loans on a scale limited by opportunity and collateral rather than ceilings and standard loan sizes. However, in the future, differential information on male and female customers would enable the bank to monitor discrepancies in gender-specific outreach between branches and to develop differentiated strategies and products according to culture areas in Uganda.

Centenary is a commercial bank that offers economically disadvantaged people in Uganda a full range of financial services, comprising savings, credit and money transfer. Upon the initiative of the Uganda National Council of Lay Apostolate, it was registered in 1983 as the Centenary Rural Development Trust and started its financial operations in 1985. The Catholic Church holds a 51% majority through various church agencies including the Uganda Catholic Secretariat. Other shareholders include the Development Finance Company of Uganda (15%), the Hivos-Tridos Fund from The Netherlands (15%), and SIDI from France (10%). Since its inception, Centenary has held on to its **mission**:

To provide appropriate financial services, especially microfinance, to all people in Uganda, particularly in rural areas.

² Entebbe Road # 7, P.O.Box 1892, Kampala. Tel. +256 41 232136, Fax 346857;

2. From trust fund to commercial bank: The reform of Centenary

Centenary is a reformed bank. Unlike Cooperative Bank, a government-owned agricultural development bank which was closed in May 1999, Centenary mobilizes its own resources, provides a full range of financial services to all segments of the population including rural women and the poor, has its loans repaid, and finances its rapid expansion from its profits. This makes it a **model case** in terms of the IFAD Rural Finance Policy.

The comparison with the Cooperative Bank is a telling one. Not only have they shared the same market. Upon its collapse, Centenary took over 10 of its branches. Where Cooperative Bank lost money and customers, Centenary now gains both, money and customers.

The political will to reform the Trust into a commercial bank, which is the most difficult part of rural and agricultural bank reform, was initiated in 1990 by one of the founding members of the Trust. He succeeded in convincing a board of nonprofessionals with a religious commitment to seek the assistance of the German Savings Banks Foundation, an affiliate of the German Savings Banks Association (DSGV), which has been supporting the reform of savings banks and similar institutions since the mid-80s.

The actual reform process began in 1993 with the arrival of IPC, a German consulting firm specialized on the establishment and reform of rural and urban microbusiness banks. Unfortunately, no records of the reform process, its stages and pitfalls were left in the Bank when IPC pulled out in 1998. The case study of the reform process in all its details is yet to be written. The first step of reform was the Trust's **transformation into a commercial bank** in 1993, an institution under the banking law and under central bank supervision.

Ownership was diversified, bringing in foreign and other domestic shareholders, while leaving a majority holding with organizations of the Catholic Church. Centenary is not traded at the Uganda Stock Exchange; there are as yet no real private sector shareholders with predominantly commercial interests. While this has come under criticism on governance grounds, there is no evidence that the Bank, within the framework of its mission, could have performed much better under stronger private influence. The main emphasis of the reformers, IPC and the German Savings Banks Association, was on management restructuring and the lending technology. Changes in **governance** took place at all levels: a new chief executive came in; board members were retired; branch managers and loan officers were replaced; additional loan officers were hired; and all staff were systematically retrained. Whether a shift in majority ownership from Church to private investors would have entailed a *mission drift* is a matter of speculation.

The Trust had been quite successful with savings mobilization; and the new management continued to emphasize deposit mobilization, both as a source of loanable funds and as a service to customers. But the Trust had no system of lending: loan products were inadequate; the lending volume was low; and arrears were high. The management, together with IPC, then put a **new system of individual microlending** into place, described in detail in a *Loan Policy and Procedures Manual*. It is guided by four principles:

- *Analysis of the household*: Centenary lends to individuals, but examines the household as an economic unit: its assets and liabilities, and its income and expenditure together with its seasonal or other cashflow. Within that framework, it then examines the feasibility of the business, putting more emphasis on the ability to repay than on collateral.
- *Graduation principle*: Loans start small, at Shs one million (\$580) or less, and for a short term, usually six months. If repayment performance is 100% satisfactory, the customer may qualify for repeat loans of increasing size and loan periods, eventually for loan periods up to one year. The customers learn that the Bank is rigid on timely repayment and loan security. As a result, they are cautious in their loan applications

and conscientious in their obligations. After three successful loan cycles of an average of 6 months, they *graduate to automatic loans* at a substantial interest rate reduction, cutting the effective rate of 48% p.a. almost into half.

- *Loan security requirements:* The Bank is flexible concerning formal and nonformal collateral, combining fixed assets and guarantors according to the situation of their customers. Low-income customers may provide personal guarantors; land without a title; movable items like livestock, household items including nondurables, and business equipment). The guarantors, who are concerned about repayment, provide additional information, eg, on collateral or indebtedness.
- *Computerized monitoring & control,* with a software package originally supplied by IPC, is crucial for loan follow-up, staff performance analysis and incentives, and provisioning.

A major emphasis was placed on **incentives** at branch, staff and customer level:

- Converting branches into profit centers
- Introducing individual staff performance rating on position-specific scales, tied more to repayment (75% of the score) than disbursement, with incentive payments up to 45% of one's salary (all spelled out in a *Human Resource Manual*)
- Rewarding customers who meet all their obligations on time, graded on a 1-5 scale, with repeat loans of increasing size and maturity and, after the third loan, a reduction in the interest rate by almost 50%; at the same dropping defaulters from the list of eligible borrowers.

Arrears management and loan loss prevention are crucial factors in lending. They have an impact on the interest rate charged to cover all costs, outreach, and the bank's profit. Arrears and loan loss rates are closely related. High arrears rates reflect carelessness in loan examination or leniency in enforcement on the part of the lender; and negligence on the part of the borrower. Invariably, they lead to high loan losses. They are detrimental to the bank and to the customer. They make the bank reluctant to lend, lower its profit rate and slow down financial intermediation. As a result, customers have less access to loans, are more thoroughly scrutinized, have their loan sizes and loan periods cut down, and pay higher interest rates. At the same time, the costs of arrears management and the incentives for loan recovery must be kept within limits, lest disbursement and outreach are constrained.

Centenary measures arrears in terms of the *portfolio-at-risk rate*, which is calculated as the outstanding balance of loans with late payments over loans outstanding - one of the most stringent measures. In December 2000, the portfolio-at-risk rate in Centenary was 2.97% - a remarkably low figure. Yet, sustained efforts brought the rate further down to around 2% (1.9% in June and 2.1% in December 2001). How did Centenary do it, a national bank with a diversified portfolio predominantly in rural areas, including agricultural loans?

The single most important element in its financial technology is **a system of daily loan tracking backed by staff and customer incentives**. Functionally tied to the incentive system, it is one of the most impressive features of Centenary. The system is methodically designed to bring down arrears at four levels: the customer, the loan officer, the branch, and the Bank. It has the following operational elements:

- (a) *Daily tracking:* There are five loan officers in every branch, one of which acts as a head loan officer. At the end of each day, every loan officer knows which customers have missed a payment.
- (b) *MIS on-line:* At the end of the day that a payment fell due, the information is entered on-line into a data base.
- (c) *Immediate action:* (c-1) The very next day, action is taken: reminding the delinquent first orally, then in writing within a week, documenting the results of the investigation; after one month, the total amount falls due; and legal action is initiated. (c-2) If there are reasons to suspect irregularities, the head loan officer may bypass the loan officer

and approach the customer directly. (c-3) Rescheduling, a common practice in Agricultural Development Banks, has proven to be a loophole for both the customer and the loan officer and has been dropped, except in special cases.

- (d) *Branch control*: The head loan officer receives the MIS data and brings the information to the attention of the branch manager, who checks the performance of each loan officer.
- (e) *Head office control*: The next morning, the General Manager of the Supervision Department at the head office receives the information. He checks the repayment performance in each branch and then reports to the Chief Executive of the Bank. A report from the branch manager may be requested; and a special analysis of branch problems, including fraud detection, and subsequent action may be initiated as seen fit.
- (f) *Instant communication*: There is a direct telephone line of the Supervision Department to the branches to discuss any problems at the loan officer or branch level and initiate remedial action.
- (g) *Staff incentives*: Staff members receive substantial individual performance incentives, among which the repayment performance of their customers has the biggest weight, accounting for 75% of the total score. The incentives of the head loan officer are tied to both his individual collection performance and that of the loan officers under his responsibility. The incentives of the branch manager are tied to branch performance including arrears.
- (h) *Customer incentives and penalties*: Customers who pay on time have access to bigger repeat loans and receive, after two successful loan cycles, a substantial lowering of the interest rate up to 50%. Defaulters are dropped from the list of eligible borrowers; those who are late in repaying fall back on the scale of eligibility for increasing loan sizes.

The key elements of the system thus are: instant information³, direct control at all bank levels, immediate action, staff incentives, and customer incentives. The system brings out problems at the level of loan officers and branches and serves as an early warning mechanism for unsatisfactory performance and fraud.

The results of the reform process are impressive (*Dec. 2001 data*), providing strong evidence that rural bank reform is feasible in Africa:

- The bank mobilizes its own resources from some 280,000 depositors;
- It lends to 22,000 small borrowers;
- It has its loans repaid, with a portfolio-in-arrears rate around 2%;
- On a pilot basis, it lends to 3,000 smallholders, with lower-than-average arrears;
- It is highly profitable, with returns of 4% on average assets and 28% on average equity during 2001;
- It finances its expansion from its profits.

Total assets grew from Ush 63.5 billion (\$37 million) in Dec. 2000 to Ush 86.2 billion (\$50 million) in Dec. 2001, total equity from Ush 7.8 billion (\$4.5 million) to Ush 11.8 billion (\$6.8 million) – increases of 35% and 51%, respectively, after a doubling of these figures between 1998 and 2000.

³ The end-2001 data reported below were received by the author on 17 January 2002.

Table 1: Key balance sheet and performance data, 1998-2001⁴

	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001
Asset structure:				
Liquid assets	37%	56%	57%	
Advances	46%	33%	29%	28%
Other assets	17%	11%	14%	
Total %	100%	100%	100%	
Total assets in million Ush	24,974	47,808	63,477	86,234
Growth of loan portfolio in %	17%	38%	14%	31%
Lending ratio (loans/deposits)	57%	39%	35%	35%
Capital & liability structure:				
Deposits	80%	85%	81%	
Other liabilities	11%	7%	6%	
Equity	8%	8%	12%	
Total	99%	100%	99%	
Total liabilities in million Ush	22,963	44,021	55,658	74,405
Total capital in million Ush	2,011	3,787	7,819	11,829
Growth of deposits	43%	102%	27%	34%
Leverage (liabilities/equity)	12.4	12.6	8.1	6.2
Performance rates:				
Operational sustainability	129%	128%	133%	
Financial sustainability	110%	114%	124%	
Growth of income	34%	61%	45%	
Growth of expenses	29%	55%	33%	
ROA (return on av. assets)	4%	4%	6%	
ROE (return on av. equity)	49%	49%	53%	
Portfolio-in-arrears rate:			2.97%	2.11%

⁴ Full balance sheet data for 2001 were not available at the latest date of revision, 17 January 2002.

3. Financial services and outreach

The **market** for rural microfinancial services comprises an estimated 4 million households engaged in agriculture, which is 85% of the population, and an estimated 800,000 non-farm small and microenterprises. Their demand for financial services is largely unmet. While Centenary is the major provider of deposit and credit services, it meets but a fraction of that demand. For all practical purposes, its market is unlimited, constrained only by the Bank's ability to expand its branch network and train new staff.

Vigorous deposit mobilization: By far the biggest demand, particularly by the poor, is for savings deposit services. They enable a household or individual to accumulate wealth, self-finance investments and working capital, safeguard against uneven income streams and protect against emergencies. Centenary has responded positively to that demand. Its strength in terms of outreach and self-financing capacity lies in deposit mobilization. Centenary offers the following **deposit products**:

- *Passbook savings* are the Bank's most popular product. They earn 2% interest p.a. with a minimum deposit of Ush 10,000 (\$6) and up to 23 free withdrawals per month.
- *Current accounts* or checking services require minimum deposits of Ush 100,000 for individuals, Ush 200,000 for associations and Ush 300,000 for businesses. No interest is paid
- *Fixed deposits* of 3 and 6 months offer yields up to 12% p.a., varying by term and amount.

Total deposits amounted to Ush 51.6 billion by December 2000, an increase of 27% over December 1999; Ush 58.4 billion (\$33.5 million) by mid-2001, an increase of 13% during half a year; and Ush 68.95 billion (\$39.9 million) by December 2001 – an increase of 34% over the preceding year.

Table 2: Deposit balances and deposit growth rates, 2000-2001

<i>Product</i>	<i>Dec. 2000</i>	<i>June 2001</i>	<i>Dec. 2001</i>
Passbook savings	32.81 64%	37.71 65%	
Current accounts	14.73 29%	16.69 29%	
Fixed deposits	2.99 6%	3.18 5%	
Foreign accounts	1.05 0%	0.80 1%	
<i>Total (billion Ush)</i>	<i>51.58</i>	<i>58.39</i>	<i>68.95</i>
<i>Annual growth rate</i>	<i>27%</i>		<i>34%</i>

Rapidly increasing but still restricted lending: Loans outstanding amounted Ush 18.40 billion by December 2000, an increase of 14% over December 1999; and Ush 24.13 billion (\$ 14.0 million) by December 2001, a substantially larger increase of 31% over the preceding year. Thus, the deposits collected by Centenary are only partially intermediated and transformed into loans – stagnating currently at a lending ratio of 35%. This is detrimental to the entrepreneurial opportunities of the enterprising poor and non-poor, holding back rural development and the creation of employment for the poor. In terms of its mission and growth potential, this is Centenary's single most important weakness.

Centenary's lending rate (loans/savings) dropped from 57% in 1998 to 39% in 1999 and 35% in 2000 and stayed there up to December 2001. The initial drop was due to a general banking crisis in Uganda, which led to the closure of several banks and caused the remaining ones, including Centenary, to reduce their lending, while they continued to mobilize deposits vigorously. In a successful effort to fight inflation, the central bank took the excess liquidity off the market by offering Treasury Bills at excessive rates up to 31%, with real returns up to 25%. This in turn made it more lucrative for banks to invest in T-Bills than

in risky loans to customers. For several years, banks have thus failed to expand their lending business. Centenary put all its emphasis on deposit mobilization and loan recovery, rather than borrower outreach. TB rates dropped to 6%-8% in July 2001, but continued to fluctuate widely.⁵ This may serve as a warning to banks not to rely too heavily on easy but volatile earnings from investments in T-Bills. Banks, including Centenary, are unable to quickly respond to changes in the market situation and expand their lending. This would require additional staff, which needs to be trained thoroughly, and new loan products, eg, tied savings-cum-credit products for the financing of investments, housing, and educational expenses. Centenary offers the following **credit products**:

- *Business loans*, with a maturity up to one year are the Bank's most popular credit product. First borrowers pay 22% interest p.a., a 2% acceptance commission up-front; a monitoring fee of 2% p.m., and charge of Ush 45,000 for the loan application form. The effective interest rate for first borrowers averages 48% effective p.a. and declines to 30% p.a. after three loans and satisfactory repayment performance. This compares very favorably to the commercial bank prime rate of 25-26% in 2000.
- *Investment loans*, with a maturity up to two years, are a new product
- *Agricultural loans to smallholders* with less than 2 ha of land, provided by specially trained loan officers, were introduced on a pilot basis in 1998, with support by DFID.
- *Agricultural loans to commercial farmers*

Table 3: Loans outstanding and portfolio growth rates, 2000-2001

<i>Product</i>	<i>Dec. 2000</i>		<i>June 2001</i>		<i>Dec. 2001</i>
	<i>Amount</i>	<i>%</i>	<i>Amount</i>	<i>%</i>	<i>Amount</i>
Business loans:	16.17	85.5	17.93	88.5	
<i>Commerce</i>			15.40	76.0	
<i>Service</i>			1.28	6.3	
<i>Industry</i>			1.25	6.2	
Investment loans	0.05	2.7			
Agricultural loans	2.18	11.8	2.32	11.5	
<i>Smallholders</i>	1.93	10.4			
<i>Commercial farmers</i>	0.25	1.4			
<i>Total percent</i>		100.0		100.0	
<i>Total (billion Ush)</i>	18.40		20.25		24.13
<i>Annual growth rate</i>	14%				31%

Outreach: Total **saver outreach** was 237,000 accounts as of end-2000 and 280,00 as of December 2001. The increase was 21% during 2000 and 18% during 2001.

Table 4: Number and growth rate of deposit accounts, 2000-2001

<i>Product</i>	<i>Dec. 2000</i>	<i>June 2001</i>	<i>Dec. 2001</i>
Passbook savings	214,289	229,307	
Current accounts	22,105	22,784	
Fixed deposits	350	446	
Foreign accounts	68	74	
<i>Total</i>	236,812	252,611	280.458
<i>Annual growth rate</i>	21%		18%

⁵ Results of the TB auction on 15 August: 91 days 14.2%; 182 days 17.2%; 273 days 24.9%; 364 days 27.5%. Rediscount rate: 15.4%

Total **borrower outreach** was 18,411 in December 2000 and 21,815 in December 2001 – an increase of 29%. The borrower-to-saver ratio was 1:12.9 both in 2000 and 2001 – pointing to a strong demand for savings deposit services, but also to inadequate borrower outreach, limited by staff capacity, not lack of funds.

Table 5: Number of borrowers and borrower growth rates, 2000-2001

<i>Product</i>	<i>Dec. 2000</i>	<i>June 2001</i>	<i>Dec. 2001</i>
Business loans	14,102		
Investment loans	18		
Agricultural loans:			
Smallholders	2,734		
Commercial farmers	61		
<i>Total number</i>	<i>16,915</i>	<i>20,259</i>	<i>21,815</i>
<i>Annual growth rate</i>	<i>21%</i>		<i>29%</i>

Outreach to women: It is estimated that 30-35% of Centenary's borrowers and 40% of its savers are women, totaling, in absolute numbers, a female clientele of about 115,000. Given the high rate of repayment, Centenary has seen little reason to analyze female and male rates of participation and of repayment. However, by excluding sex of customer from its MIS, it has missed the chance to monitor discrepancies in outreach to men and women between branches and develop sex-differentiated strategies and products. In recent years, management has been busy with improving its financial technology and driving up repayment. Now that these fundamental problems are solved, the Bank should be ready to move into differential marketing strategies and institutional linkages which would further deepen its services to women. But we should add that the case studies (chapter 4) have not revealed any qualitative weakness of services to women.

4. Sustainability and outreach in agricultural lending: experience at Mbale

4.1 Agricultural lending at Centenary

In mid-1998, Centenary introduced agricultural lending in a pilot test in all its ten branches and subsequently extended it to the newly acquired branches. Its approach was prudent and gradual. In each branch, areas of operation were determined by a team of loan officers on the basis of the commercial potential of the crops grown, soil quality, rain fall, accessibility, and cultural factors of entrepreneurial and financial behavior.

Mbale was selected as the lead branch of agricultural lending. The ground had been well prepared by the USAID-supported IDEA project, which provided technical assistance to farmers in the commercialization of their products. The loan officers divided the area into low lands (with rice, maize, cassava, millet, sorghum and, bananas as well as coffee and cotton as major cash crops) and high lands (with potatoes, bananas, vegetables, citrus fruit and coffee as major cash crops). They identified about 20 areas, each with some eight villages and 400 households on average. With the assistance of local leaders, the loan officers held *customer education training sessions* in the local language on all relevant aspects of banking, which were deepened in *loan sessions* at the time of disbursement. Particular emphasis was placed on the importance of timely repayment and the associated incentives. Through the interaction at local level, *contact clients*, motivated by the prospect of faster graduation to bigger loans, were found who helped expanding.

Within three years, the number of agricultural loans outstanding in the Bank reached 3,000 and the portfolio outstanding Ush 2,9 billion, this is 13% of all active borrowers and 14.5% of the portfolio outstanding (June 2001).⁶ In a country with 83% of the population in agriculture, the potential for growth is virtually unlimited. However, at present it is Centenary's policy to limit its agricultural lending to 25% of its portfolio. The Mbale branch is the Bank's experimental station in agricultural lending. It accounts for 59% of all agricultural borrowers and 49% of the agricultural portfolio (June 2001). Other branches with at least 150 agricultural borrowers are Lira, Kampala, Mityana and Mbarara, in that order.

Table 6: Agricultural lending in Centenary and the Mbale branch, Dec. 1998 – June 2001

	Centenary		Mbale branch	
	Number	Amount in bn	Number	Amount in bn
Dec. 1998	1,091	0.96		
Dec. 1999	2,095	1.66	908	0.51
Dec. 2000	2,553	2.00	1,341	0.86
June 2001	2,943	2.31	1,732	1.14

4.2 Overview of the Centenary branch at Mbale

The branch of Centenary in Mbale, a small town with five banks and several NGOs, opened in July 1998 and has now been in operation for three years. It differs from other branches in that its main business is agricultural lending: 65% of its customers, and 56% of the volume of loans outstanding, are in agriculture. The branch has a staff of 28, among them 13 loan officers. The branch experienced its most rapid growth during its first year of operation, with a saver outreach of 7,641 and a borrower outreach of 1,606 by end-1999. It now serves 13,853 depositors and 2,646 borrowers with loans outstanding (June 2001). Other services include money transfer. The volume of deposits is Ush 1.67 billion; the volume of loans outstanding Ush 2.01 billion. In terms of repayment, the Mbale branch is among the best performers. Its arrears ratio is a mere 1.51 % (June 2001; July: 1.43%). Contrary to all

⁶ Centenary does not report cumulative figures, which are deceptive and meaningless.

expectations and experience elsewhere, it is lower in agriculture (1.20%) than in small enterprise lending (1.60% - July 2001 figures). Its staff has earned maximum performance incentives throughout its three years. The branch is audited bi-monthly by internal auditors from the head office and annually by external auditors and by BoU inspectors.

Table 7 : Deposits, loans and arrears rates, Mbale branch, Dec. 1999 – June 2001

	<i>Deposits</i>		<i>Loans</i>		<i>Arrears rate</i>
	<i>No of accounts</i>	<i>Amount in bn</i>	<i>No of accounts</i>	<i>Amount in bn</i>	<i>%</i>
Dec. 1999	7,641	1.54	1,606	1.09	3.39
Dec. 2000	11,824	1.66	2,063	1.57	1.82
June 2001	13,853	1.67	2,646	2.01	1.51

Despite its large number of depositors (93% of them passbook savers) and a borrower-to-depositor ratio of 1:5, the branch is a deficit unit, with loans outstanding exceeding deposits. Loanable funds are transferred by the head office from its vast excess liquidity in other branches. There appears to be a considerable untapped deposit potential. Payments are accepted only in the branch office; no decentralized collection services are offered. This prevents most rural people from depositing and accumulating their small savings in a safe place. The branch does not analyze outreach and repayment performance by sex of customer.

Table 8: Types of Deposits, Mbale branch, in percent, Dec. 2000 and June 2001

Type of deposit	Dec. 2000		June 2001	
	No.	Amount	No.	Amount
Passbook savings	92.1%	63.8%	92.9%	70.8%
Current accounts	7.8%	30.3%	6.9%	22.9%
Fixed deposits	0.1	5.8%	0.1%	6.2%
Total percent	100.0	99.9%	99.9%	99.9%
Total no. of accounts	11,824		13,853	
Amount in million Ush		1,657.2		1,665.2

The branch operates profitably, with an operational sustainability rate of 157 % (*income over expenditure*). It reached its break-even point within 8 months, in February 1999. How did the branch accomplish sustainability and outreach in such a short period of time, and with its main business in agriculture? There are three major factors:

- Prudent staff selection and specialization on agricultural lending;
- holistic loan appraisal;
- rigorous enforcement of repayment supported by a computerized system of instant arrears information, combined with powerful staff and customer incentives.

4.3 Staff selection and specialization

The Mbale branch was the first among the Centenary branches to introduce agricultural lending, starting in August 1998. Four new loan officers, among them the present head of loans, were trained by IPC consultants in July before joining the bank and hired in August. About 100 people had applied; 16 applicants with agricultural experience took the aptitude test; 12 were interviewed; 8 underwent the IPC training concluded by a written examination; 4 were selected. By mid-2001, their number had increased to 8.

By September, the first 100 customers had received an agricultural loan. Their number grew to 300 by December 1999; 1,186 by December 2000; 1,729 by June 2001; and 1,801 by July 2001.

In response to the rapid expansion in agricultural lending, the loans department has differentiated its lending in two sections: agricultural and small & microenterprise lending. There are now eight loan officers specialized on agricultural lending at a rate of 75%; plus 25% on small enterprise lending. Five loan officers are fully specialized on commercial loans. On average, there are some 25 agricultural and some 20 small enterprise loan decisions per day. The case load per loan officer was 330 in June 2001 and 345 in July. It might be substantially increased by a more balanced emphasis on incentives for repayment as well as disbursement.

4.4 Holistic loan appraisal

Before entering into agricultural lending, the bank, with technical assistance from IPC, analyzed the mistakes of other institutions in agricultural lending. It found that arrears tracking was inadequate; and collateral was appraised inappropriately, with excessive emphasis placed on land and asset size rather than asset quality and salability.

The bank prepared an agricultural credit scheme that differs radically from other banks: the Credit Management System (CMS). It takes a holistic approach to credit analysis by designing a credit package based on the repayment capacity of each individual household, with loan sizes varying from Ush 100,000 to 5 million and above. There is no standardization. The results are entered into the Credit Management System, a computer software package originally introduced by IPC but now replaced by an American system. The CMS produces an agricultural loans analysis spreadsheet, which includes a cashflow analysis. Installments must not exceed 50% of the monthly surplus.

The bank also examines the deposit accounts of the applicants, but does not require savings as collateral. In commercial loans, a loan applicant must have had a current account for at least 2-3 months.

In its analysis of collateral, the Bank examines the value of field and horticultural crops and allows for loan sizes up to 50% of this so-called inventory and up to 60% of inventory as collateral. Acceptable collateral includes land, cows, goats and household property such as radios, bicycles, tables and chairs. The value of collateral should be at least 150% of the loan amount.

The branch manager (in his absence the head loan officer) meets with his loan officers every morning and discusses lending decisions: the creditworthiness of the customer, the business, loan size and loan security. As loan applications are screened beforehand by the loan officer, there are only few rejections at the loans committee meeting. The results are entered into the CMS. On the Monday morning of our first visit, there were 20 agricultural loan applications and a backlog of 4 commercial applications. The results are presented in a loans committee summary, which shows all the information on the application form entered by two computer operators.

At the beginning of each month, there is a loan department meeting to discuss issues and remedies pertaining to the operations and the performance of the department and of individual loan officers.

By end-July 2001, there were 2,758 loans outstanding in the branch: 1,801 agricultural loans outstanding and 957 commercial loans. Their volume was Ush 1.19bn in agricultural and Ush 0.94bn in commercial loans. The Bank does not inflate its statistics by producing cumulative data on the number of loans ever disbursed. The portfolio-at-risk rate was 1.43% for the branch. Surprisingly, at 1.20%, the rate was lower in agricultural loans than in commercial loans at 1.60%.

Table 9: Loans outstanding and arrears, July 2001

Sector	Number	Amount in bn Ush	Portfolio-at-risk rate
Agriculture	1,801	1.19	1.20%
Commerce	957	0.94	1.60%
Total	2,758	2.13	1.43%

4.5 Loan enforcement

The Bank uses four instruments to achieve high repayment rates: incentives to repay on time; instant arrears information and delinquency tracking; immediate action to enforce repayment; and rigorous recovery in case of defaulting

A powerful **incentive** is built into timely repayment: As processing speed and loan appraisal costs decline rapidly for repeat loans, a customer qualifies after three satisfactory loan cycles for an *automatic loan* that may be granted within a day; the increment in loan size is 25% instead of 15%; and the monthly interest rate drops from 2.0% to 0.5% (fees and commissions remain constant), bringing down the effective rate from 48% to 30%.

Clients are **rated** on the basis of their repayment performance on a scale of 1 (repayment within three days) to 5 (repayment after two weeks). Willful defaulters and delinquents with a rating of 5 are not eligible for a new loan. With a rating of 3, the volume of the follow-up loan is being reduced. With a rating of 2: the same loan amount may be granted again. With a rating of 1, the loan may be increased by 15% annually or more if justified.

The loan officers have **daily information** on arrears and discuss this on a daily basis. In the afternoon of each day, they receive a list of those who paid their dues and, at any time thereafter, the list of delinquents and arrears. After one day, each loan officer follows up his delinquents and provides the information twice a week to the Recovery Committee, comprised of the branch manager, the head loan officer and the loan officers. Simple cases are presented but handled the individual loan officers; more difficult cases are handled jointly, particularly when enforcement action is to be taken.

Recovery action is in the hands of a specialized recovery team of five as a group, comprising the head of loans and four loans officer. In extreme cases, they may request the assistance of the police. The recovery team goes into action for loans overdue 30 days and longer; these were 60 delinquents out of 96 in July 2001.

Collateral can be seized by the loan officers or the recovery team on the spot in collaboration with the chairperson of the Local Council (LC) of each village. Seizure of collateral is either on the basis of a land title or, in the case of land possession without a title, in cooperation with LC chairperson. He writes a letter confirming possession of land and signs the mortgage agreement. The latter includes the land and the movable property on it, such as cows, crops and household items, all listed on the mortgage form. In the absence of land, movable collateral is entered into a chattel mortgage form signed only by the client. All the information is entered into the IMS.

In the case of fraud committed by management or staff, rigorous action is taken, up to imprisonment.

4.6 Challenges and opportunities

The main challenge to the Bank in Mbale is **expansion of outreach**, comprising borrower and saver outreach. The bank lends mostly within a radius of 30 miles from Mbale up to a maximum of 45 miles, but accepts deposits and repayments only within the branch premises in Mbale. Accordingly, transaction costs are shifted from the bank to customers, which is inefficient in economic terms. This makes depositing of small savings unviable and deprives

the customers in villages of the opportunity to accumulate savings and increase their self-financing capacity. This also explains why the branch is a deficit unit, with loans outstanding exceeding deposits by 20%. Three strategies for the expansion of outreach may be examined: (1) branching out, (2) wholesale operations through local intermediaries (*linkage banking*), and (3) cooperation with NGOs in terms of client graduation.

(1) Branching out

Tororo and Kapchorwa are two centers where Centenary has a sizeable number of customers. Convenient deposit facilities are essential for the self-financing and borrowing capacity, which are both interrelated, and for accumulating resources for installment payments, deductible directly from a current account. Conversely, bank staff considers increases in the self-financing capacity of borrowers an important aspect of the impact of their loans. There are ample business opportunities in the area, which could be activated through local financial deepening. An interim solution has been found through collection accounts in the name of Centenary at other banks, where customers can deposit their savings. In Tororo, Shs 30 million are being deposited monthly in a collection account with UCB. A solution for expansion of outreach and financial deepening is branching out, either by establishing branches or agencies, which are much smaller and more widely dispersed. The Bank has already approved the establishment of a branch in Tororo. Alternatively, it might consider establishing two or more agencies, thus bringing the bank closer to the people. Given the level of on-going bank activities in the area, it is expected that agencies should break even after 4-5 months.

The Bank might also consider introducing **doorstep deposit collection services** by agents or bank staff, possibly against payment of a fee by the customers. Such services are popular in West Africa and parts of Asia.

(2) Wholesale operations through intermediaries (*linkage banking*)

Two types of linkage banking may be appropriate for Centenary to expand their outreach at low transaction costs: (a) indirect wholesale lending through NGOs and MFIs as legal borrowers; and (b) direct lending to members through their self-help groups and associations as facilitators. Centenary is in the position of providing wholesale loans to NGOs and MFIs, who use these funds for loans to groups or individuals. Among the clients of Centenary is FINCA in Kampala, which has obtained a loan of Ush 200 million. Negotiations are on the way with PRIDE. In Mbale, among the potential wholesale borrowers are FOCCAS, PRIDE and UWFT. Centenary would be a most appropriate partner than other banks as it would also provide loans to graduating members.

The Commercial Farmers of Kapchorwa, an organization of 250 members, which has received support from USAID, acts as an agent of Centenary, organizing loan applications and transmitting payments collected through their group structure. All 250 members have loans from Centenary, ranging from Ush 1 million to Ush 9.5 million; the average is Ush 1.5 million. Another example is a group of 100 Luhongwe Tenant Farmers, all under one landlord. All members have received loans from Ush 100,000 to Ush 1 million, averaging Ush 300,000. The group also has a task force which monitors repayments. It also acts as a financial intermediary with its own loan fund kept in a bank account. In both organizations, there has been no delinquency. The Bank is prepared to extent its operations with such groups and carry out the promotional work through its own staff, rather than NGOs. In the Mbale district, the branch prefers an average group size of about 100 members, comprising some 5 villages. In other areas, it might be more appropriate for cultural reasons to organize groups at village level.

(3) Cooperation with NGOs in terms of client graduation: Many NGOs act as financial intermediaries, collecting compulsory savings as partial collateral and providing loans to groups and their members or to individuals. They are involved in the establishment and maintenance of groups and in financial intermediation. Their target group are mostly people, many of them start-ups. who would not qualify for bank loans. Loan sizes are usually small,

Ush 50,000-300,000 through groups and, in case of individual lending, up to about Ush 2 million. Many members have investment opportunities which exceed these limits and complain about small loan sizes. In Mbale District, organizations like FOKKAS and PRIDE provide loans through groups up a ceiling which roughly is Centenary's floor. Because of limited loan sizes, some clients have switched to Centenary. In 1998, UWFT has graduated about 100 clients to Centenary. Since then, smaller numbers of clients have informally passed on to Centenary. FOKKAS has 400 groups in the area with 35-50 members each, many of which could use larger loans and enter into Centenary's cycle of repeat loans of increasing size. On the whole there is a large untapped market which needs to be organized through graduation agreements between Centenary and the NGOs. Negotiations would have to be held both at branch and head office levels.

Centenary has also suggested a credit rating agreement with the NGOs, exchanging credit information. These are initiatives which need to be followed up at branch level.

5. The customers of Centenary

Financing self-made women and men: Without exception, the customers of Centenary visited in both rural and urban areas are self-made. They have self-financed their start-up from their own personal resources. Financial contributions from spouses or other relatives seem to be rare, the frequently cited contributions from friends or neighbors nonexistent. Savings accounts at different financial institutions usually played an important role in early capital accumulation. Once they had access to a loan from Centenary, their business operations grew rapidly. Husbands and wives have separate economic activities; there was no instance of joint business operations.

Diversified microbusiness activities: Business operations are highly diversified. Male or female borrowers usually combine 4-6 different activities; the non-borrowing spouse is usually less active and has only one or two income-generating activities. Opportunities for new businesses and for business expansion are pervasive. The crucial factor during the start-up phase is the willingness and ability to accumulate savings. Rapid growth of business operations is usually financed through consecutive loans from Centenary – hardly ever from any other institution.

Equal opportunities for women and men: Centenary's women borrowers have large numbers of children and combine this with large numbers of business activities. Opportunities seem to be equal for men and women, both in terms of starting a business and in terms of access to financial services. Husband and wife may borrow simultaneously from Centenary, with positive effects on family income, occasional business cooperation between spouses, and no adverse effect on repayment. There were no complaints from either women or men about discrimination or inequalities. Neither large families nor early marriage seem to be a hindrance to the entrepreneurship of women.

No complaints about loan terms: There were no complaints about the quality of service or the interest rate. A few exceptionally successful business women and men felt constrained by lending limits in the tens of millions of Ush, but admitted that the limiting factor was inadequate collateral for large-size loans. There was no doubt in their minds that for the financing of either farm enterprises or small and microbusinesses, there is no alternative to Centenary. Several men and women had held deposit accounts with other banks; they all switched to Centenary because of access to loans – limited only by their ability to secure, invest and repay their loans.

Compared to NGOs, no limits to growth: Centenary provides loans to very small businesses in rural areas, the sizes and terms of which overlap with those of NGOs. Centenary differs from MFIs run by NGOs in two respects: it provides agricultural loans – and does well at it! -, which virtually none of the NGOs does. And for all practical purposes, its loan sizes are unlimited, except by collateral constraints. This is clearly shown in the progression in the scale of loans from villages to Mbale as a rural town and ultimately to Kampala, where many of the successful women-entrepreneurs originate from villages: definitely a **progression out of poverty**.

The potential for linkage banking: NGOs in Uganda have provided start-up finance for microentrepreneurs, particularly among women, and have created avenues for graduating from standardized group loans to more flexible larger-size individual loans – up to a ceiling. This has been an important learning experience for new microentrepreneurs. Linking NGOs to Centenary could open up new avenues for microenterprise growth and employment generation, in two ways: either by access of NGOs to Centenary as a wholesale and refinancing institution; or by enabling successful microentrepreneurs to graduate to the commercial banking services of Centenary.

5.1 Rural customers of the Mbale Centenary branch

Area development and employment generation through individual loans: In Bunyole County, Tororo district, Centenary has disbursed about 300 loans, generating a critical mass of farm and non-farm activities which put a cycle of growth into motion. In Nabiganda village, Tororo district, Centenary has financed rice fields and microenterprise activities on a large scale. As a result, there has been a general increase in income and employment throughout the area. Eg, the number of rice mills in Nabiganda village has increased from two to six. Before Centenary financed rice mills in the district, the rice had to be milled in Mbale. The traders now buy the rice in the villages at value added. We visited one of the mills, a rice and cassava mill. Its expansion had been financed since 1999 through four consecutive loans from Centenary: Ush 600,000; 800,000; 1.5 million; and 1.0 million. During this two-year period, the value of assets has increased from 2.2 million to 6.0 million: 4.5 million in machinery and 1.5 million in the building. The mill generates a daily income of Ush 70,000 and gives employment to five workers.

Credit for agricultural expansion: On land owned and prepared for irrigated rice cultivation by the government, Centenary has given numerous working capital loans to tenants. Tenancy contracts, which are alienable, are accepted as collateral. One of the tenants is Kifude Abdu, 68 years old. He has two wives, Nula (55) and Madina (58), and 15 children. He received a loan of Ush 1 million from Centenary to double his rice fields from 4.5 acres to 9.5 acres.

Repeat loans for vertically integrated activities: *Were Kalifani* is a rice farmer and rice trader, 45 years old, married, with 8 children. He had four loans from Centenary since 1998: Ush 300,000; 550,000; 800,000; and 2 million. He used the loans as working capital on his 2-ha rice farm, for trading, and for the purchase of a rice mill. He employs workers and contract laborers. Since 1998, the value of his assets has increased from 3 to 7 million.

The successful woman-entrepreneur who financed diverse microenterprise start-ups through profits from farming: *Nandina Zauma* is 35, married, and has four children 13-20 years old. She went to primary school up to grade VII. She runs four business operations of her own: a one-acre rice farm; a grain mill; agricultural produce trading; and two minibuses. In 1983, she started with a small rice farm. To protect her savings from inflation, she put up a building for a mill in 1992, continued saving and was finally able, in 1996, to install the first mill – all self-financed from the proceeds of her farm. Whatever Nandina does, she does well. Examining her household economics and business record in early 1999, Centenary had no reservation against financing the further expansion of her business operations. Since then, she received four loans from Centenary, each amounting to Ush 2 million. She first purchased a second mill, then expanded her produce trading operations, and finally bought two minibuses. During this 2 ½ year period, the total value of her business operations grew from Ush 6 million to 14 million. She has two full-time employees and several contract laborers on her farm. Her husband has his own business as a subcontractor, clearing road sides from greenery for the government.

The unsuccessful woman-entrepreneur who failed to master diversity: *Dorothy Salira* is 43, married, and has six children. She lives on a farm 7 km from Mbale, where she has been involved in a multitude of activities. But it seems that whatever she did, she did poorly: crop farming, coffee seedlings, animal husbandry, a maize mill, feed mixing, a piggery, poultry farming, and gastronomy. There is a fish pond on her property, which dried out; and there are four incubators, two of them not in working order. In 1992, she defaulted on a Ush 2 million loan from the Uganda Women's Finance Trust for a restaurant in an inappropriate location that failed. She has applied for a loan from Centenary; but there is little chance that she will be found creditworthy.

The diverse farm and non-farm activities of Musana Ali Koire and Robinah Koire:

Musana Ali Koire and his wife *Robinah* are in their early thirties and have five children. *Musana Ali* has 4 ha of rice fields, a grain mill and a grain store. Since 1999, he had three loans from Centenary for investments and working capital: Ush 1.5 million to purchase a rice huller; Ush 2.0 million for working capital; and Ush 2.0 million for another rice huller. He has five employees and 6 contract workers. From mid-1999 to mid-2001, his assets have increased from 8 million to 10 million. He is satisfied with both the service by Centenary and the loan sizes. On his frequent trips to Mbale, he deposits his savings in Centenary. He has far-reaching expansion plans, expecting more and ever-bigger loans from Centenary: building other types of mills in various locations and going into coffee hulling. *Robinah Koire* has a rice farm of 1.3 ha of her own, sells soft drinks out of two refrigerators, and runs two commercial video shows.

5.2 Urban customers of the Mbale Centenary branch

Madina Naro, sole proprietor and supporter of the family: *Nadina Naro* is 50 years old, married, and has seven children. Her first investment, self-financed, was a small textile store in 1978. As this did not do well, she converted it in a cosmetics store in 1988, with three employees. From the proceeds, she acquired a farm with 20 cattle and purchased two lock-up stores. Since 1998, she has received six working capital loans from Centenary, increasing from Ush 2 million to 9.8 million, to expand her business. All these businesses are in her own name. *Suleiman*, her husband, has no income of his own and does not share in the work.

Connie Watuwa's business empire in Mbale:

I worked when I was pregnant up to my 9th month. I can work. All I need to expand is bigger loans.

Connie Watuwa is a married woman with six children, who doesn't want to tell her age. Born in a village, where she now owns a house, she found that the town is the place where business opportunities are unlimited. She is one of the few women we met who started out with her husband, opening a Wimpy's Restaurant in 1971. From the income she earned, she saved money in a bank. In 1975, she used her savings to open a hardware store, which is her biggest single investment. During the 25 years in operation, it has grown to an asset size of Ush 40 million, now trading in hardware and building materials. She got her first loan in 1986 from the now defunct Cooperative Bank and opened a lock-up store. In 1991 she got a loan from the Uganda Women's Finance Trust (UFWT) for produce trading, buying rice at Ush 400/bag and selling it after 3 months at Ush 1000/bag. She complains about the Trust's high interest rate; but it is quite clear that with a 150% gross profit margin in three months she could have paid virtually any interest rate. She received several loans from Bank of Baroda. When the Mbale branch opened in 1998, she became one of Centenary's first depositors with a current account. *Centenary is a greener pasture*, she explained, *it gives you no headaches*. During the same year, she obtained a six-month loan of Ush 2 million, followed by two other loans of Ush 4 million and Ush 10 million. As all her payments had been on time, she then graduated to an *automatic loan* of Ush 15 million at a substantially reduced interest rate. She invested the loans in a second lock-up store, a mattress store, and in an extension to the restaurant. From the proceeds she finances, among other things, her children's education: one at Makerere and another one at Nairobi University. Her business empire comprises a hardware store worth Ush 40 million, a mattress store of 15m, a restaurant of 3m, two lock-up stores of 20m, commercial plots of 20m, a ranch of 50m, 2 vehicles of 22m, plus a residential house of 35m and a house in her home village of 30m: all in all Ush 230 million (\$134,000).

5.3 NGO customers in Mbale: graduating to Centenary?

Uganda Women's Finance Trust (UWFT): a linkage partner for Centenary? UWFT, with support from IFAD, is one of several NGOs providing financial services in Mbale and the surroundings. UWFT and Centenary start approximately within the same range of small loans, but differ widely in the upper range. Entrepreneurial growth among UWFT customers is held back by UWFT's limited financial capacity; while Centenary's capacity, for all practical purposes, is virtually unlimited. In addition, NGOs finance start-ups, while Centenary does not. NGO loan terms tend to be standardized or restricted by a *regression toward the mean* of groups of customers, while Centenary is far more flexible in its individualized loan terms. All this raises the question of *linkage banking*: linking UWFT (and other NGO/MFIs) to Centenary by opening fast-growing UWFT customers the opportunity to graduate to Centenary with its commercial banking opportunities. First steps towards graduation were taken in 1998, but have not been followed through. Pursuing this option systematically would require an agreement between the head offices of the two institutions, backed up perhaps by a linkage banking agreement between Centenary and the microfinance community.

Start-up finance from UWFT: *Asina Sijja* is 25, married, and has 3 children between the ages of 5 and 10. She sells second-hand baby clothes. She started her business in November 2000 with a total investment of Ush 920,000. Ush 120,000 she had saved with UWFT; the remaining Ush 800,000 she received as an individual loan, which she repaid in six monthly installments. In May 2000, she received a second loan of Ush 800,000, again for six months, which she is now (August 2001) paying back in monthly installments. Her total assets are now Ush 1 million. During the 9 month period, the net worth of her business has grown from Ush 120,000 to Ush 600,000: small in absolute value but spectacular in percentage terms. Without the loan from UWFT, *Asina Sijja* could not have started out at her own.

Betty Muliro's Beauty saloon, cosmetics store and secretarial services: *Betty Muliro*, 42 years old, married, has six children between the ages of 11 and 18. From 1981 to 1997, she worked as a secretary for a cooperative union in Mbale. When she was retrenched in 1997, she received Ush 1 million as compensation from the union and Ush 540,000 in accumulated payments from the National Insurance Corporation and invested Ush 1.2 million in a cosmetics store and beauty saloon – entirely self-financed. In 1998 and 1999, she received two small loans through a women's group from UWFT, one of Ush 250,000 and one of Ush 500,000, each for four months with bi-weekly installments. In 2000, she received an individual loan of Ush 1 million for 6 months with monthly installments; and in June 2001 a loan of Ush 2 million for 9 months. She finds the size of her loans adequate, which she used for working capital and the purchase of a computer. *Betty Muliro* has diversified her business operations within her store. Besides operating a saloon and cosmetics store, she sells soft drinks and fabric and provides secretarial services at Ush 1000/page from her own computer. During the three years since 1998, the value of her business has grown from Ush 1.2 million to Ush 3 million, an increase of 150%.

5.4 Customers of Centenary in the Kampala area

The village woman who built a microbusiness empire in the city - self-financed start-up, profit- and credit-financed expansion: *Grace Mangeni*, 45 years old, is a client of Centenary in Ntinda, a periurban area of Kampala. She comes from a farming family in Busia District in the eastern part of Uganda. She has been married since 1977 and has six children between 10 and 22 years of age who all go to school. Her husband is a civil servant.

At the age of 13, her parents sent her to Kampala where she lived with an uncle, went to high school for four years, and subsequently attended a secretarial college. For nine years she worked as a secretary in the Public Service, saving as much as she could. In 1979, she was one of the first customers to open a savings account (*no. 173*) with Centenary. In 1986, while in the public service, she opened a small general merchandise shop. She financed it with the savings at Centenary, about Shs. 350,000, and a loan of Shs1 million. The start-up was entirely self-financed, there was no other source of funding. She repaid the loan, which at that time carried an interest rate of 40%, within six months. Since then she has taken about eight loans. In 1992 she left the public service because she found business more profitable. In 1996, she moved to a bigger shop, *St. Theresa's Supermarket*, at Shs 400,000 rent a month, where she is now, with two employees. Only once was she late with a payment, because of a death in the family in 1997, when she had to stay away from her business for two months.

She currently has a loan of Shs 7 million at 22% interest p.a. for one year, with monthly installments. Half of it she invested in her business, buying merchandise. The other half she put into a building of her own where she will open her own shop, probably in January 2002. She built her first house in 1994-97 with loans from Centenary and from the profits of her business. She rents out five shops in that building, which is a commercial building. The value of her business is around 15m. Her monthly profit from the store is Shs1.5 million; her rental income is Shs 0.5 million.

Since 1999, she also has a poultry farm with 500 chicken, managed by an employee. The investment was Shs 2.5 million, financed through part of a loan of Shs 7 million from Centenary. The monthly income from the poultry farm is Shs 300,000.

Her first loans were securitized by her husband's land title. As both buildings belong to her and are titled in her own name, she now uses them as collateral, plus movable business and household property, such as refrigerators.

What are the benefits of her longstanding relationship with Centenary? Setting up and expanding her shop, putting up two own buildings, a chicken farm, and a savings account with Shs 1 million, plus income and employment for several. Economically, she is independent; her husband has his own income, she does not know how much. For a woman of her background from a rural area, what she built is a microbusiness empire, financed through accumulated savings, profits and loans.

The village woman who made Ush 200 million in seven years, with unlimited further opportunities in manufacturing: Jane Draville Assimwe was born in 1960 in a farming family in Bushenyi District, western Uganda. She is now married and has four children between eight and 16 years of age. After high school, she went to a business college in Kampala, paid for by her father. Her first job a sales executive for her uncle in his textile store; she then worked in the Ministry of Education as a sales officer for chemicals. In 1994, she retired from the civil service because the pay was too low. With the severance pay of Shs 3 million plus one million of savings from her current account at Centenary, she established *JEC Science Equipment, Chemicals & Laboratory Supplies* in a backyard in central Kampala in 1995, providing supplies to schools for their chemistry and physics classes – much of it on credit. In addition to herself, the store employs three people. The start-up was completely self-financed, without any loan.

Jane had opened her first current account in 1986 with UCB which she kept for the transfer of her salary as long as she worked at the Ministry. She eventually discontinued her banking relationship with UCB, because she was unable to get the loans she wanted. She now has two deposit accounts with Centenary, a personal current account since 1987 and a company current account since 1997. She has no savings passbook. She started borrowing from Centenary in 1996, a total of seven loans by mid-2001, all for working capital: the first two loans for six months each, Shs 2.5 million and Shs 5.0 million; the following loans all for one year each: Shs 7.5 million, Shs 10 million, Shs 15 million, Shs 20 million, and currently Shs 25 million. The current loan is repayable in three installments; all other loans were paid back in monthly installments. On loan security she said:

“They take everything: a land title, household items, guarantors. In case you default, they take everything.”

The monthly turnover varies from Shs 5-20 million. Within a seven-year time span, 1994-2001, the total value of her business grew from the initial investment of Shs 4 million to Shs 200 million in 2001: a phenomenal growth, which enabled her to pay any interest rate on her loans. To diversify her business operations, she opened a retail shop for general merchandise in 1999. She financed the Shs 2 million investment with the sale of her car.

Centenary is a good bank, Jane says. But despite a banking relationship which has been highly profitable for the customer as for the bank, she finds the terms and volume of available loans inadequate. The maximum loan period is one year; and the Bank does not finance start-up businesses, except when repayments are made from the income of an existing business. With a loan of Ush 150,000, she would start a manufacturing enterprise for chemicals. She herself has the necessary business experience. For the technical part, she would hire technical staff. Knowing that her collateral is not sufficient, she has not yet discussed her business plan with the bank.

With access to bigger loans, she could also produce all kinds of school supplies, for instance wooden rulers and retort stands, which are all imported at high costs. There are 4,000 schools in the country, the market is virtually unlimited, she says.

A booming family enterprise in plastics manufacturing: Peter Kayongo and Farida Kayongo are business partners. They have six children, aged 4-18 years. Peter received his technical training certificate in 1980, then learned shoemaking from his father, who is a shoemaker. In 1985, he started his own leather shoemaking business with an initial investment of Shs 250,000, which he received from his father as gift. For the next eight years, the business kept growing from its profits without any other source of finance. In 1993, he went to UK for one year, leaving his business with his wife. During that year his main job was in a hotel. Through his part-time work in a plastics factory, he got to know the process of plastics manufacturing and became acquainted with the machinery. When he returned in 1994 with savings of 5,000 pounds, he hired a technician, bought parts in Kampala and Nairobi, and had the machines built by informal sector craftsmen for plastics manufacturing. In Kibuye, the outskirts of Kamala, he and his wife established a plastic soles manufacturing workshop, *Peter Kayongo & Co*, and gradually diversified production. He now has 12 workers working in shifts, producing plastic shoes and heels, tricycle tires, pallets, and other plastic articles. The raw material are recycled and ground-down plastic soles, which are provided by informal sector suppliers. Farida, Peter's wife, works on the finishing of the products. During the one-year absence of her husband in England, she ran the family business.

Peter Kayongo has been banking with several banks, but switched to Centenary in 1997 because of the prospect of loans. Within four months after having opened a current account, he applied for a loan of Ush ten million and got his first loan of Ush one million. With his own money and the loan, he ordered a first set of moulds from Manchester at a cost of Shs 8 million. Since then, he has received approximately eight loans, increasing in size up to the present level of Ush 6 million, which he repays in 12 monthly installments. He has never been late on a single payment.

The value of the business in 2001 is Ush 45 million; monthly sales are Ush 5-8 million; monthly profits are Ush 3 million. In addition, the Kayongos have built three houses with a total value of Shs 25 million, financed from the profits of the manufacturing business. The monthly rental income is Ush 300,000. In 16 years, Peter and Farida Kayongo's assets have grown from a parental grant of Shs 250,000 to a total investment of Ush 70 million.

The present investment needs are Ush 15 million to buy more moulds from England, moulds being his main capital-intensive investment. Beyond that, the Kayongos want to relocate from the present backyard location and built a factory at an investment of Ush 100 million. This could only be financed through a big loan; but the problem is: *You don't get what you ask for*. The Kayongos have their houses as collateral, but no title – a common problem in Kampala. The houses are build on land owned by the Kabaka, the traditional king of the Baganda, and the Catholic Church. They have applied for the registration of a lease, which would allow them to offer the houses as collateral; but this is a long process. Their overall assessment of Centenary: *The service is good, but the size of loans is inadequate* – as is their collateral.

Fotos P1/ 16-28; P2/1-5: Peter Kayongo & Co, a family enterprise manufacturing plastic items from recycled shoe soles. Farida Kayongo works on product finishing and ran the family business during a one-year absence of her husband.

6. Conclusions and recommendations

6.1 Successful commercialization and reform of a rural financial institution

The results of the reform of Centenary have been impressive. They are proof that rural and agricultural bank reform is feasible in Africa. This is of particular relevance to the member institutions of AFRACA as well as NENARACA; IFAD has supported their services to member institutions and MFIs, including agricultural development bank reform in the case of NENARACA.

With an equity capital of \$6.84 million and total assets of \$49.85 million (*Dec. 2001*, up 35% over *Dec. 2000*), Centenary Rural Development Bank:

- mobilizes its own resources (\$ 39.9 million, up 34%) from 280,000 depositors (up 18%) , some 115,000 of them women;
- lends to 22,000 small borrowers (up 29%), some 7,000 to 8,000 of them women, at practically unlimited loan sizes (\$ 14 million loans outstanding, up 31%);
- has its loans repaid by both its male and female borrowers at a portfolio-at-risk rate of 2.1%;
- pilot-lends to 3,000 male and female smallholders (14.4% of the portfolio) at below-average arrears;
- earns returns of 4% on average assets and 28% on average equity during 2001;
- and, since 1999, finances its expansion from its profits.

6.2 Challenges and opportunities

In reaction to the banking crisis of 1998 and continually TB rates up to 31% during the following two years, Centenary's single most important **weakness** has been a low propensity to lend. The expansion of its borrower outreach has lagged behind its saver outreach: far beyond a healthy ratio of 1:6 to 1:8.

Major **constraints** to a rapid increase in outreach are a lack of capacity to train large numbers of new staff, inadequate premises, and limited management capacity.

Given its highly successful financial technology and the virtually unlimited size of the rural market, untapped in many areas, **expansion of outreach to rural areas** remains the Bank's biggest task. This is of particular importance to low-income people, among them **microentrepreneurs, smallholders, women and the enterprising poor**. They require banking services – including deposits, credit and money transfer – near their place of residence and operation, lest their costs of transaction exceed their value. Convenient deposit services for small savings, which are currently not available at village level, are of utmost importance; they are the self-help basis of self-reliance and self-financed business growth – particularly among the poor.

In this vein, major **challenges and opportunities** include the following (*no ranking implied*):

(1) **Bringing the bank to the people:**

- ❖ Expanding its services into remoter rural areas through a network of sub-branches and linkage banking, thereby bringing the bank to the people and diminishing customer transaction costs
- ❖ Improving its branch services by expanding its staff and premises
- ❖ Expanding its small saver outreach through deposit services at sub-branches and door-step collection services
- ❖ Expanding its small borrower outreach substantially through sub-branches and by balancing staff incentives for disbursement and arrears prevention

- (2) **Bringing the bank closer to women:** Including sex of customer in the bank's MIS
 - ❖ Providing information differentiated by sex of customer to branches
 - ❖ Monitoring discrepancies in outreach to women and men between branches
 - ❖ Developing differential marketing strategies and products for women, men and youth as seen fit
- (3) **Bringing the bank to intermediaries:**
 - ❖ Expanding its wholesale lending to NGOs, MFIs and associations of farmers and microentrepreneurs
 - ❖ Deepening financing services to clients of NGOs and self-help organizations, who are ready to graduate to larger individual loans, deposits and money transfer
- (4) **Deepening financial services and impact:**
 - ❖ Improving financial services at lower bank transaction costs through tied savings-cum-credit products and cross-selling of different financial products
 - ❖ Strengthening the entrepreneurial and self-financing capacities of its customers through cooperating agencies with business development services
- (5) **Strengthening the delivery capacity of the bank:**
 - ❖ Expanding staff and staff training facilities
 - ❖ Expanding and modernizing bank premises
 - ❖ Expanding management capacity
- (6) **Disseminating the lessons of rural and agricultural bank reform:**
 - ❖ Spreading the reform message to rural and agricultural banks in the region through an institutionalized exposure training program
- (7) **Harnessing donor support:**
 - ❖ Working out strategies of expansion and financial deepening jointly with donors
 - ❖ Coordinating donor inputs through a lead donor agency with local presence
 - ❖ Encouraging co-financing by financial and technical assistance agencies
 - ❖ Revising the business plan as a living document in cooperation with major donors.

6.3 Recommended donor interventions

Donors may intervene in the support of the expansion of financial services by Centenary deeper into rural areas at the following levels:

- (1) development of strategies of expansion including new products at national level
- (2) capital adequacy bridging
- (3) cooperation with NGOs and MFIs (*linkage banking*) at national and local level
- (4) expansion into underbanked areas with a potential for sustainable banking
- (5) management and staff training
- (6) national and regional exposure programs for agricultural banks and rural MFIs
- (7) coordination of donor interventions and co-financing with leading TA agencies.

Donor cooperation will be of crucial relevance, to be coordinated by lead technical assistance agencies with local presence. DFID and GTZ are potential partners to IFAD. DFID is a major donor of technical assistance to Centenary. GTZ provides technical assistance to Bank of Uganda (BoU) in financial systems development as well as regional training capacity building; and to AFRACA's regional linkage banking program.