Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

Banking Sector Liberalisation in Uganda
Process, Results and Policy Options

Research report

Editors: Madhyam & SOMO

December 2010

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By:
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Editors:
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December 2010

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Colophon

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Layout design: Annelies Vlasblom
ISBN: 978-90-71284-76-2

Financed by:
This publication has been produced with the financial assistance of the Dutch Ministry of Foreign Affairs. The contents of this publication are the sole responsibility of SOMO and the authors, and can under no circumstances be regarded as reflecting the position of the Dutch Ministry of Foreign Affairs.

Published by:
SOMO
Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

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Contents

Acronyms

ATMs	Automatic Teller Machines
BOU	Bank of Uganda
CAMELS	Capital, Assets, Management, Earnings, Liquidity and Sensitivity analysis
CAR	Capital Adequacy Requirements
CIC	Currency in Circulation
CK	Core Capital
CMFL	Commercial Microfinance Ltd
CSO	Civil Society Organisation
DANIDA	Danish International Development Agency
DFCU	Development Finance Company of Uganda
EAC	East African Community
EADB	East African Development Bank
FIA	Financial Institutions Act
FS	Financial Services
GDP	Gross Domestic Product
GoU	Government of Uganda
GTZ	German Technical Cooperation
IMF	International Monetary Fund (IMF)
M2	Broad money supply
MCR	Minimum Capital Requirement
MDI	Microfinance Deposit-taking Institutions
MGDP	Monetary Gross Domestic Product
MOFPED	Ministry of Finance, Planning and Economic Development
NBFI	Non-Bank Financial Institutions
NGO	Non-governmental Organisation
NPART	Non-Performing Assets Recovery Trust
PFPs	Policy Framework Papers
SAP	Structural Adjustment Programmes
SIDA	Swedish International Cooperation for Development Agency
TB	Treasury bills
TRWA	Total risk-weighted assets.
UBOS	Uganda Bureau of Statistics
UCB	Uganda Commercial Bank
UDB	Uganda Development Bank
UGX	Uganda shillings
UMK	Uganda Microfinance Limited
US	United States

Note from the editors

Dear Readers,

It is a well-recognized fact that banking sector is very important for higher economic growth, improved productivity, increased savings and better investment rates. A deep and widely accessible banking system is also crucial in improving income levels and lifting poor people out of poverty. Besides, a safe and stable banking sector can protect an economy from external and domestic shocks.

This study critically examines the major developments in the banking sector in Uganda over the past two decades. In particular, the study documents the outcomes of banking sector liberalization policies which were initiated since the early 1990s. It also deals with recent developments in the Ugandan banking sector in the aftermath of global financial crisis.

With a special focus on the entry of foreign banks, the study assesses the major impacts and consequences of market-led banking reforms on economy, development and poverty eradication. It examines the large presence of foreign banks with particular attention on access to credit to poor people, access to financial services by small and medium enterprises, and the impact on the rural and informal economy.

The findings of this study are relevant in the light of increased foreign ownership of domestic banks and financial institutions in many poor and developing countries. From a host country perspective, the study raises several policy-oriented issues related to the entry of foreign banks in the developing world. It highlights several adverse impacts of foreign bank entry which are not given due attention in policy and academic circles

We hope that this study will stimulate policy debates and discussions about the benefits and costs of market-led reforms as well as increased presence of foreign banks in the poor and developing world.

We welcome your valuable comments and inputs on this study which can be sent to: m.vander.stichele@somo.nl

Editors,

Kavaljit Singh, Madhyam (Delhi, India)

Myriam Vander Stichele, SOMO (Amsterdam, The Netherlands)

Summary

This case study about the financial sector in Uganda critically examines major developments in the banking sector over the past two decades. In particular, the study provides an overview of banking sector liberalisation policies that were initiated since the early 1990s and their outcomes. The major impacts and consequences of market-led banking reforms on the economy, development and poverty eradication are being assessed. It also deals with recent developments in the Ugandan banking sector in the aftermath of global financial crisis.

The study has a special focus on the entry of foreign banks. From a host country perspective, it provides new insights into the role of external actors such as foreign banks, including their involvement in the pushing of financial deregulation and liberalisation policies in Uganda.
The study examined the large presence of foreign banks with particular attention on access to credit to poor people, small and medium enterprises, rural and informal economy, as well as whether the entry of foreign banks leads to increased financial stability, technological upgrading, higher investments and better access to credit.

Some of the key findings of the study are following:

- Foreign banks dominate the domestic banking system in Uganda. As much as 87 percent of existing banks in the country are foreign–owned. Of late, there is growing trend towards mergers and acquisitions in the banking sector.

- The banking sector reforms have not led to reduction in the gap between formal and informal sectors of finance.

- The foreign banks are predominantly located in Kampala (capital city) and urban areas.

- The majority of rural population is under-banked. The rural households are largely dependent on informal sources of finance to meet their consumption and investment needs. The microfinance institutions serving the rural population charge very high interest rates and other transaction costs.

- To some extent, local banks have performed better than foreign banks in terms of providing financial services to small and medium-sized enterprises and low-income rural households.

- The loan portfolio of banks has not witnessed sufficient diversification over the years.

- Since 2006, there is a considerable decline in lending to the agricultural sector.

- Interest rate spreads have remained very high, despite the implementation of the financial liberalisation policies.

- Foreign banks have a tendency to “cherry pick” the most lucrative bank transactions. They provide bank services to a niche market consisting of big corporations and high income households located in urban areas.

- The foreign banks have hardly passed on management skills and knowledge to the local banking system.

- The large presence of foreign banks has serious implications on the conduct of monetary policy and exchange rates.

- The government should play a major role in providing access to banking services in the under-banked rural areas through tax and other policy measures.

From a host country perspective, the study raises several policy-oriented issues related to the entry of foreign banks in the light of increased foreign ownership of domestic banks and financial institutions in many poor and developing countries.

The full version is also available for download at:
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1. Introduction

Uganda's banking sector has evolved over time from a period of "financial repression" during the 1970s and 1980s to a period of liberalization that started in the late 1980s. The reforms were initiated with a view to addressing major misalignments in the financial sector that were believed to impede economic growth through inefficient performance of the banking sector. Major concerns included inefficient allocation of credit and limited access to financial services by the larger population. While cognizant of these important concerns in the banking sector was critical, equally important was the need, on the part of the central bank, to ensure soundness of banks to guarantee security of depositors' money, among other things. Accordingly, the financial sector reforms Uganda implemented were aimed at achieving efficiency in financial intermediation on the one hand and strengthening the banking sector through efficient and effective supervision by the central bank study on the other.

This study traces the development of the banking sector in Uganda and attempts to assess the extent to which the twin objectives of efficiency and soundness in the banking sector have been achieved. It starts by reviewing the historical and institutional context of the banking sector liberalization in section 2 followed by a review of the current status of financial sector reforms in section 3. The regulatory and supervisory framework for the banking sector is reviewed and assessed in section 4. The section puts the discussion on liberalization of the banking sector into proper context.

In sections 5 and 6, the study assesses both the quantitative and qualitative aspects of the banking services respectively. The discussions in these sections analyze the impacts of financial sector reforms, highlighting the increased dominance of foreign owned banks in the country and the implications on the broader objectives of deepening and broadening the financial sector and the soundness of banking institutions. Through implementation of the International Monetary Fund (IMF) and the World Bank driven financial sector reforms, Uganda's banking institutions are currently soundly run. However, competition in the financial sector that should drive the cost of investment down remains an illusion, poor access to commercial bank financial services especially in rural areas continues to be a challenge and private sector credit remains skewed in favour of trade.

In section 7 the study looks at emerging risks and vulnerabilities in the Uganda banking sector associated with the increasing dominance of foreign owned commercial banks arising, partly, from implementation of the financial sector reforms. This is complemented by a critical review of the impact of the global financial crisis on Uganda's banking sector and the economy as a whole in section 8. Section 9 is devoted to a discussion of peoples' response to financial issues, providing an input into the conclusions and policy recommendations presented and discussed in section 10.

2. The historical and institutional context of banking sector liberalization in Uganda

Uganda's banking sector has evolved from the first commercial bank established in 1906 - the National Bank of India which later became the Grindlays Bank and is now the Stanbic Bank - to the current 22 commercial banks, six credit institutions and three Microfinance Deposit-taking Institutions (MDIs). These are in addition to the rapidly growing semi-formal and informal financial sector in the country. The sector has also undergone several policy, legal and regulatory reforms with various degrees of results.

The evolution of the banking sector has been characterized by bank closures, mergers and acquisitions. Before the country's independence in 1962, the banking sector was dominated mainly by foreign owned commercial banks (Beck and Hesse, 2006). In addition to the National Bank of India, Standard Bank was opened in 1912 and the Bank of the Netherlands was opened in 1954 and later merged with Grindlays Bank.

Uganda Credit and Savings Bank which became Uganda Commercial Bank (UCB) in 1969 was established in 1965 by an Act of Parliament. This was the first local commercial bank established in the country. Bank of Baroda was established, first in 1953, but regularized as a commercial bank in 1969 with the enactment of the Banking Act of 1969. This was the first legal framework for regulation of the banking sector following the country's independence. The Bank of Uganda – country's central bank – which was established in 1966 under the Bank of Uganda Act (1966), was followed by the establishment of the Uganda Development Bank under the Uganda Development Bank (UDB) Decree (1972).

With the establishment of UCB and UDB, the government-owned banks dominated the banking industry. UDB received all foreign loans and channelled them to the local companies for development; UCB, with the biggest number of branches (about 67 in number), handled the majority of the customers while the East African Development Bank (established in 1967) handled the East African Community (EAC) business.
By 1970, Uganda had more than 290 commercial bank branches but this number reduced to 84 in the period between 1970 and 1980's following political instability and economic decline during the same period. Of the 84 commercial bank branches in the country, the UCB owned a total of 50.[1] Table 1 gives a summary of the evolution of the banking sector in Uganda. As shown in the Table, over 40 commercial banks have been established since 1906, the majority of which were established after independence, but more specifically following Structural Adjustment Programmes (SAPs) adopted in the second half of the 1980s and heavily supported by the IMF and the World Bank.

Through attachment of advisors from the World Bank and IMF headquarters in Washington D.C, these international financial institutions had a big bearing on Uganda's financial sector reforms. Furthermore, the IMF and World Bank trained staff of the Bank of Uganda and Ministry of Finance and Economic Development, to develop capacity in these institutions to implement the financial sector reforms as dictated by the IMF and World Bank. Regular IMF and World Bank missions ended with conditionality

[1] Association of African Central Banks, November 2003 (http://www.aacb.org/rubrique916.html, accessed on 5 October 2010).

attached to attainment of specified performance targets. Effectively, the World Bank and IMF influenced Uganda's banking sector reform process mainly through the Policy Framework Papers (PFPs), which were the major instruments of economic reforms in Uganda starting from 1988 (IMF, 1999).

Through "performance benchmarks", which essentially was a list of actions the Government of Uganda was required to undertake if the country were to continue benefitting from foreign aid, the IMF ensured that Uganda remained on a very firm course of economic reforms (GOU, 2003). Examples of performance benchmarks included liberalization of the interest rate market, closure of failing banks, creation of Non-Performing Assets and Recovery Trust (NPART), liberalization of the foreign exchange market, development of new legal and regulatory framework for the banking sector, assigning the privatization of UDB to the Privatization Unit and engaging a privatization advisor to handle the privatization, and implementation of internationally accepted standards in banking – particularly the Basel standards.

Bilateral donors such as the German Technical Cooperation (GTZ), Swedish International Cooperation for Development Agency (SIDA) and the Danish International Development Agency (DANIDA) influenced the reform process through provision of technical support in the form of providing technical advisors, training of local staff and provision of aid in form of grants and loans.

While several banks have been established in Uganda, equally a significant number has been closed, merged or acquired. Before 1962, four commercial banks were established and were characterized by mergers. Between 1962 and 1988 prior to initiating financial sector reforms, nine banks were established or restructured. These included foreign banks such as the Arab Libyan Bank for Foreign Trade and Development which was renamed Tropical Africa Bank Uganda Ltd in 2006 and Diamond Trust Bank which was revived in 1997. Local private banks such as Centenary Rural Development Trust and Sembule Bank Ltd were established, but the banking sector was dominated by UCB – the Government-owned commercial bank.

With privatization and divestiture of Government from provision of banking services the dominance of state-owned banks in the 1960s, the 1970s and most of the 1980s, decreased as several private owned banks were opened in the 1990s – the central bank licensed over 10 private banks between 1988 and 1999 to operate in the country. A significant number of these banks were private local banks. They included the Nile Bank Ltd, the Greenland Bank Ltd, the Cooperative Bank Ltd, the Gold Trust Bank Ltd, the Teefee Bank Ltd and the TransAfrica Bank Ltd. Between 2000 and 2009, 10 banks were licensed with 70 percent licensed in 2008 and 2009 due to on and off moratorium imposed on bank licensing for an extended period of time from 1996 to 2007. There were also non-bank financial institutions established during this period including the International Credit Bank Ltd and a number of other credit institutions and microfinance deposit taking institutions.

As indicated in Table 1, many of these banks and non-bank financial institutions have closed through merger, acquisition or outright closure. Other banks such as the Kigezi Bank of Commerce were restructured and renamed. All the banks that closed or were acquired were locally owned. However, foreign owned banks have acquired some of the banks that closed or acquired some of their branches. The implications of the bank closure or restructuring, in the short run, have been a reduction in branch network and limited access to financial services. Important development associated with bank closure and restructuring has been a stronger and sound financial system that has resulted in improved confidence in the system. Further discussions on the banking sector reforms and their implications on banking sector soundness and financial access are presented in the subsequent sections of this study.

The banking sector evolved partly as a result of reforms implemented in the financial sector. From independence in 1962 up until 1969 Uganda pursued a mixed economy policy, whereby the public sector worked with the private sector. For example, while exporters were required to surrender their foreign exchange earnings to commercial banks at the prevailing official exchange rates, the banks held foreign exchange earnings and re-allocated them to importers. The exchange rate was fixed, but the trade policy was relatively liberal. Interest rates were administered, and loans granted to selected sectors, including small farmers, usually in kind through the co-operative movement, practices which were a common feature of the pre-1987 reforms instituted by the National Resistance Movement Government.

In 1987 the Government launched a Comprehensive Economic Recovery Programme (ERP) to bring down and stabilize the inflation rate and reduce imbalances in the economy (World Bank, 1990, 1993; Kibirango and Kasekende, 1992; Bategeka, 1999). While stabilization policies were designed to restrict the demand within the overall resource envelope to restore internal financial equilibrium, SAPs were designed to increase efficiency, stimulate the economy and encourage economic growth.

Table 1: Evolution of Uganda's commercial banking sector from 1906 to 2009

Year	Name of Bank established	No. of Banks
1906	National Bank of India which later became Grindlays Bank Ltd and now Stanbic Bank Uganda Limited	1
1912	Standard Chartered Bank Ltd acquired some branches of Cooperative Bank Ltd when the latter collapsed in 1999	1
1927	Barclays Bank Ltd which acquired Nile Bank Ltd in 2007	1
1954	Bank of Netherlands became part of Stanbic Bank Ltd	1
1965	Uganda Credit and Savings Bank Ltd established under Uganda Commercial Bank Act, 1965. Was replaced by Uganda Commercial Bank in 1969.	1
1965	Bank of Baroda Ltd first established in 1953	1
1969	Uganda Commercial Bank (UCB) Ltd which was acquired by Stanbic Bank Uganda Ltd in 2002	1
1972	Diamond Trust Bank Ltd revived in 1997 and Uganda Development Bank Ltd	2
1973	Arab Libyan Bank for Foreign Trade and Development renamed Tropical Africa Bank Uganda Ltd in 2006	1
1983	Centenary Rural Development Trust was first established in 1983 became Centenary Rural Development Bank Ltd in 1993 and started providing financial services in 1985. Today it is called Centenary Bank Ltd	1
1984	Sembule Bank Ltd became Allied Bank Ltd and later Bank of Africa Ltd	1
1988	Nile Bank Ltd acquired by Barclays Bank Uganda Ltd	1
1991	Kigezi Bank of Commerce Ltd renamed National Bank of Commerce Ltd	1
1992	Greenland Bank Ltd – closed in 1999	1
1993	Stanbic Bank Uganda Ltd Orient Bank Uganda Ltd Centenary Rural Development Bank Ltd	3
1995	Crane Bank Ltd Cairo International Bank Ltd Gold Trust Bank Ltd acquired by DFCU Limited in 2005	3
1996	Allied Bank Ltd became Bank of Africa Ltd in 2006	1
1997	Diamond Trust Bank Ltd	1

1999	Citibank Uganda Ltd	1
2002	Stanbic Bank Ltd acquired UCBL	1
2005	DFCU Bank Ltd merged with DFCU Ltd	1
2006	Bank of Africa Ltd Tropical Africa Bank Ltd	1
2007	Kenya Commercial Bank Ltd	1
2008	Housing Finance Bank was Housing Finance Company of Uganda Ltd Fina Bank Ltd Equity Bank Ltd acquired Uganda Microfinance Limited (UML) United Bank of Africa Ltd Global Trust Bank acquired Commercial Microfinance Ltd (CMFL)	5
2009	Ecobank Ltd ABC Capital Bank which acquired Capital Finance Corporation Ltd	2
	Trust Bank Kenya (closed in 1999), Teefee Bank (closed in 1993), Cooperative Bank Ltd (closed in 1999) and TransAfrica Bank Ltd (closed in 2000), Ugadev Bank (closed in 1993)[2], Uganda Microfinance Ltd acquired in 2008, Capital Finance Cooperation acquired by ABC Capital Bank Ltd in 2009	

Source: Author's Compilation, 2010

As the wider economy was being reformed, the process of financial liberalization rather belatedly followed, starting in 1988. New laws pertaining to financial sector were enacted and the monetary policy formulation and implementation shifted from an administered to a market-based approach, where open market operations (OMO) became the major means of influencing the level of money supply in the economy. For example, the Bank of Uganda Act, 1966 was replaced by the Bank of Uganda Statute, 1993 (Government of Uganda, 1993). The Government also undertook to divest from owning any financial institution, a policy objective that was fully realized in 2002, when the last government-owned commercial bank, UCB was privatized. Broadly, the measures included divestiture of Government from providing financial services, thereby creating increased space for participation of the private sector in the provision of financial services, building bank supervision capacity in the central bank, improving the quality of commercial banks' assets by removing the non-performing loans from the balance sheets of commercial banks and putting them into a NPART, and liberalizing interest and exchange rates.

Financial benefits to Uganda arising from privatization of commercial banks are hardly documented and data in this regard hardly exists. Information obtained from interviewing an official of Bank of Uganda were that privatization of publicly owned banks was intended to bring about efficiency in the banking system and not necessarily to raise money to finance the national budget. For example, Uganda Commercial Bank was reported to have been sold at a very low price, which the buyer Stanbic Bank Uganda Ltd recovered by selling only one of the building of the bank to another buyer.

Prior to the reforms, the banking sector was bedevilled with severe challenges such as negative real saving and lending interest rates, rising non-performing loans, inefficiency in the distribution of credit, and a weak supervision of the sector by the central bank. The reforms were accordingly geared towards promoting efficiency and strengthening of the banking sector.

Abuka and Egesa (2010) have argued that regulatory reforms in the financial sector in Uganda lagged behind the liberalization policy as several reforms which included liberalization and privatization were

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[2] Information on when Trust Bank Kenya Ltd, Teefee Bank Ltd, Cooperative Bank Ltd, TransAfrica Bank Ltd and Ugadev Bank.

undertaken prior to regulatory reforms in the banking sector. As a result, a number of weak banks that later collapsed were licensed, a development that threatened the stability of the financial system. A counter argument to this is that commercial banks that collapsed during the late 1990s and early 2000s were licensed under reviewed banking sector regulations. It can thus be argued that it was weak oversight on the part of the central bank and not necessarily delayed regulatory reforms that led to bank failures.

Table 2 gives a summary of banking sector reforms. As shown in the Table, the reforms started in 1988 with a reduction in directed credit (lending by the government or central bank directly or indirectly). However, major and wide ranging reforms were carried out in the 1990s. These included revision of banking sector laws and regulations, liberalization of interest and exchange rate policy and abolition of controls in current and capital accounts. By 1997, significant policy reforms had been implemented. As the liberalization policy was being pursued, the Government, through privatization, also divested from owning and operating commercial banks.

Table 2: Banking Sector Reforms in Uganda

Reform	Content	Period
Interest rate liberalization	Interest rate regulations changed by adjusting nominal interest rates to match inflation	1989
	Treasury bill market changed from ad hoc issuance to a market based auction system through which interest rates were determined	1992
	Interest rates were fully liberalized and the Central Bank switched to a new interest rate management regime that used monetary policy instruments with treasury bill interest rate as an anchor	July 1994
	Treasury bonds were introduced as monetary policy instrument	2004
Reduction in directed credit (lending by the government or central bank directly or indirectly)	Coffee financing was withdrawn from commercial banks	1988
	Direct financing of coffee procurement by the Bank of Uganda (BOU) was reversed	1991
	Rural farmers scheme continued	1994
	Development finance operations at the BOU continued	2003
Privatization of financial institutions	Government sold its shares in 3 banks jointly owned with foreign owners	1994
	Government sold 49 % of its shares in UCB to a bank in Malaysia but reversed the sale and placed UCB under the Bank of Uganda management in 1999.	1996 and 1999
	UCB was finally sold to Stanbic Uganda Ltd.	2002
	Government also divested its shares in Bank of Baroda and DFCU Bank in 2002 and 2004 respectively	2002 2004
Legal and Regulatory reforms	Bank of Uganda Statute was enacted	1993
	Financial Institutions Statute, Microfinance Deposit-taking Institutions Act, and Financial Institutions Act and Foreign Exchange Act were enacted	1993, 2003, 2004
	Ban on licensing banks first imposed in 1996 for two years, extended in 1997 to 2000, and lifted in July 2007.	1996-2007
Capital Account Liberalization	Controls on capital account were lifted. Citizens were allowed to hold foreign currency denominated assets and operating foreign currency denominated accounts in the domestic financial system and abroad. They were allowed to bring in capital for investment and take it out without restrictions.	1997

Liberalization of exchange rate regime	Dual exchange rate regime was adopted	1996
	Foreign bureaus were legalized	1990
	Foreign exchange auction system was adopted	1990
	Restrictions on current account transactions were eliminated to conform to Article VIII Status of International Monetary Fund (IMF) Agreement	1994

Source: Author’s Compilation, 2010

3. The current status of banking sector reforms

The previous section presented the history of banking sector in Uganda and the major reforms that have been undertaken. These reforms have contributed, in a substantial way, to the current structure of the banking sector in the country discussed in this section.

Table 3: Current Status and Ownership of Commercial Banks and NBFIs in Uganda, October 2010

Banks (Tier I)	Current Status	Ownership
Bank of Uganda	Operating	Government of Uganda (100%)
Standard Chartered Bank Ltd	Operating	Foreign (subsidiary of Standard Bank Group, UK)
Bank of Baroda Ltd	Operating	Foreign (Bank of Baroda India owns 80%)
Barclays Bank Ltd	Operating	Foreign (Barclays Plc owns the majority share)
Eco Bank Ltd	Operating	Foreign (Ecobank, Togo owns majority share)
Kenya Commercial Bank(KCB) Ltd	Operating	Foreign (subsidiary of KCB Ltd, Kenya)
Fina Bank Ltd	Operating	Foreign (Fina Group, Kenya holds majority shares)
Equity Bank Ltd	Operating	Foreign (Equity Bank, Kenya owns 99% of shares)
United Bank of Africa (UBA) Ltd	Operating	Foreign (UBA Nigera own majority shares)
Housing Finance Bank Ltd/HFCU	Operating	Government of Uganda (100 %)
DFCU Bank Ltd	Operating	Foreign (Commonwealth Development Corporation owns 60%)
Global Trust Bank Ltd	Operating	Domestic
Arab Libyan Bank for Foreign Trade and Development	Operating	Foreign (The Libyan Government owns 100%)
Diamond Trust Bank Ltd	Operating	Foreign (Diamond Trust Bank Kenya owns 51%)
Orient Bank Ltd	Operating	Foreign (Bank PHB Groups own 80%)
Crane Bank Ltd	Operating	Domestic
Cairo International Bank Ltd	Operating	Foreign (National Bank of Egypt and other banks in Egypt own it)
Centenary Bank Ltd	Operating	Domestic
Citibank Uganda Limited	Operating	Foreign (Citibank Group USA owns it)
National Bank of Commerce	Operating	Domestic
ABC Bank Capital Bank Ltd	Operating	Foreign (ABC Bank Kenya owns 40%; others 60%)
Bank of Africa	Operating	Foreign (Bank of Africa Kenya holds 51.2% shares)
Global Trust Bank	Operating	Foreign (Industrial and General Insurance Company and National Insurance Corporation own 98% of shares)
Credit Institutions (Tier II):		
Mercantile Credit Bank Ltd	Operating	Domestic
Opportunity Uganda Ltd	Operating	Foreign (Opportunity Transformation Investments and Opportunity International Australia own 100%)
PostBank Uganda Ltd	Operating	Government
Stanhope Finance Ltd	Unclear status	Domestic
Imperial Credit Institution	Unclear status	Domestic
Microfinance Deposit-taking Institutions (Tier III):		

Finca Uganda Ltd	Operating	Foreign (Finca International, USA, owns majority share)
Pride Microfinance Ltd	Operating	Government of Uganda
Uganda Finance Trust Ltd	Operating	Domestic
Development Banks:		
East African Development Bank	Operating	EAC countries
Uganda Development Bank	Operating	Government of Uganda

Source: Author's Compilation, 2010

Table 3 gives the current status and ownership in the banking sector in Uganda. The sector can be categorized into the central bank, commercial banks, credit institutions, microfinance deposit-taking institutions, and development banks. Credit institutions and microfinance deposit-taking institutions are generally called non-bank financial institutions (NBFIs). Development banks are not licensed and supervised by the Bank of Uganda.

As shown in Table 3, currently there are 22 commercial banks with a total of 392 branch network in the country, about six credit institutions and three MDIs, an indication of a clear dominance of the banking sector by commercial banks. The distribution of the financial institutions across the country is presented in Table 4. About 38 percent of the commercial bank branches are located in Kampala with the distribution about even in the Central, Eastern and Western parts of the country. The Northern part of the country has about 11 percent of commercial bank branches, largely because of several years of conflict that severely affected economic activities in the region.

Using the distribution of commercial bank branches across the country as a proxy measure for bank concentration, it is clear that banks are mainly located in Kampala - the capital city of the country and the surrounding areas with branches spread rather thinly across the country. Moreover, those branches located outside Kampala are located mainly in the urban centers. Typical rural areas are still substantially underserved. While this is changing over time, it is taking place very slowly, and this is understandable given that the overall financial sector policy pursued by the Government of Uganda is demand following – financial services are provided in response to demand for them - rather than supply leading – financial services provided ahead of demand for them (Robinson, 2002).

This characteristic of banking in Uganda has continued to limit access to financial services, especially to the majority of the rural population who are perceived to have limited effective demand for financial services. In addition, most of the banks fund trade, implying that loan portfolios of these banks are not sufficiently diversified. The banks have also not entered into other businesses such as insurance, stock trading, assets management, etc as a result of legal and regulatory restrictions imposed by the existing banking laws and regulations.

With respect to ownership, about 87 percent of the existing banks are foreign owned, and their participation is mainly through direct investment in equity holdings. They are subsidiaries of their parent banks in the countries of origin, but registered in Uganda as legal entities. Recent evidence suggests that mergers and acquisitions are on the increase e.g. Equity Bank Ltd, Global Trust Bank Ltd, and Orient Bank Ltd have all been established through acquisitions.

There are also foreign banks such as Standard Chartered Bank Ltd, Stanbic Bank Uganda Ltd and Barclays Bank Ltd that have expanded their branch network through acquiring branches of other banks either after their collapse or in the process. Equity Bank Ltd acquired Uganda Microfinance Ltd, Global Trust Bank Ltd acquired Commercial Microfinance Ltd, Barclays Bank Ltd acquired Nile Bank Ltd, Stanbic Bank Ltd bought UCB and Standard Chartered Bank acquired some braches of Cooperative Bank Ltd. The banks whose branches have been taken over have been domestic or local banks. But a number of foreign banks have also entered the banking industry and expanded through direct foreign investment. Recent entrants include Ecobank Ltd, Fina Bank Ltd and KCB Ltd.

From interviews held with an official from the Bank of Uganda, the majority of the banking assets are under the control of foreign banks. Similarly, a larger proportion of saving deposits are under the control of foreign banks, but mainly during the post reform period and before completion of the privatization process as UCB and Cooperative Bank Ltd dominated the banking sector during the pre-reform period and before UCB was privatized.

The foreign banks are more capitalized and more profitable than their local counterparts, partly as a result of their superior management expertise especially in the management of risks in liberalized markets, but also due to the existing sound regulatory framework in Uganda. Non-performing loans belonging to both foreign and domestic banks have reduced tremendously as they currently (2010) stand at below 4 percent, far lower than the benchmark of 10 percent.

Development banks are few in the country. Currently, they are only two: Uganda Development Bank and East African Development Bank. The former is the financing arm of the Government of Uganda, but performing extremely poorly in spite of several attempts to revive it. The performance of the later has improved in the recent past and its products have been diversified.

Table 4: Bank distribution in the country as of October 2010

		Branches					Total
	Name of Bank	**Kampala**	**Central**	**Eastern**	**Northern**	**Western**	
1	Orient Bank Ltd	7	2	2	1	0	12
2	Standard Chartered	6	0	2	1	1	10
3	Barclays Bank Ltd	23	8	6	3	5	65
4	Bank of Baroda	4	1	3	1	1	10
5	National Bank of Commerce	2	0	0	0	1	3
6	Crane Bank Ltd	2	2	4	3	4	15
7	Stanbic Bank Ltd	11	14	13	9	18	67
8	Bank of Africa	9	1	2	1	1	14
9	United Bank of Africa	4	1	2	0	2	9
10	Global Trust Bank	4	1	2	1	0	7
11	Ecobank Ltd	6	2	0	1	0	9
12	Centenary Bank	6	10	5	5	11	37
13	Cairo International Bank	2	0	0	0	0	3
14	Housing Finance Bank	9	0	1	1	1	13
15	Diamond Trust Bank	10	0	3	2	0	15
16	Citibank Uganda Ltd	2	0	0	0	0	2
17	Fina Bank	4	0	0	0	2	6
18	DFCU Bank Ltd	12	1	2	6	3	24
19	Tropical Africa Bank	4	2	1	0	0	7
20	KCB Ltd	6	0	2	3	4	15
21	Equity Bank Ltd	13	12	8	4	10	47
22	ABC Capital Bank Ltd	2	0	0	0	0	2
1	Postbank Uganda Ltd	7(0)	7(0)	4(9)	5(0)	7(4)	30 (13)[3]

3 Branches = 30 and mobile units = 13.

2	Opportunity International	6	2	2	0	1	11
3	Credit Bank Ltd	1	0	0	0	0	1
4	Faulu Uganda Ltd	1	0	0	0	0	1
5	Stanhope Finance Ltd	1	0	0	0	0	1
6	Imperial Credit Institution	1	0	0	0	0	1
7	Finca Uganda						22
8	Pride Microfinance Ltd	9	3	6	2	9	29
9	Uganda Finance Trust	7	5	10	0	5	27

Source: Author's Compilation, 2010

4. The regulatory and supervisory framework

The legal instruments that provide for licensing of financial institutions in Uganda include the Bank of Uganda Act 2000, the Financial Institutions Act (FIA) of 2004, the Micro-Finance Deposit-taking Institutions (MDI) Act of 2003, Foreign Exchange Act, 2004, the Uganda Development Bank Decree of 1972, the NGO Statute of 1989, the Co-operatives Act of 1991, Chapter 85 of the Companies Act of 1964, and the Moneylenders Act of 1952. Prior to the enactment of the Bank of Uganda Act, 2000, there was Bank of Uganda Act, 1966 and the Bank of Uganda Statute of 1993. Similarly, prior to the enactment of the current Financial Institutions Act, 2004, there was the Banking Act, 1969 and the Financial Institutions Statute, 1993.

From the review of these laws, those governing the formal financial sector have undergone more rapid review compared to the others, signifying the rapid developments taking place in the formal financial sector in Uganda.

Commercial banks and credit institutions are licensed under the FIA, 2004 and the MDIs are licensed under the MDI Act, 2003, all of which are supervised by the BOU. Other financial institutions grouped as Tier 4 financial institutions are not licensed under these laws and are not supervised by the Bank of Uganda. In the rest of this section, the focus is on the Bank of Uganda Act 2000, the Foreign Exchange Act, 2004, the Financial Institutions Act (FIA), 2004 and the Micro-Finance Deposit-taking Institutions (MDI) Act, 2003. The latter two are operationalized by the Financial Institutions Regulations of 2005 and MDI Regulations of 2004.

According to the Bank of Uganda Act, 2000 the functions of the Bank of Uganda shall be to formulate and implement monetary policy directed to economic objectives of achieving and maintaining economic stability (Government of Uganda (GoU), 2000).

Without prejudice to generality of its functions above, the bank shall:

1. Maintain monetary stability;
2. Maintain an external assets reserve;
3. Issue currency notes and coins;
4. Be the banker to the Government;
5. Act as financial adviser to the Government and manager of public debt;
6. Advise the Government on monetary policy;
7. Where appropriate, act agent on financial matters for the Government;
8. Be banker to financial institutions;
9. Be the clearing house for cheques and other financial instruments for financial institutions;
10. Supervise, regulate, control and discipline all financial institutions and pension funds institutions; and
11. Where appropriate, participate in the economic growth and development programmes.

Bank for Uganda Act, 2000 further states: “Subject to this Act, the Bank shall have all the powers pertaining to a legal person and may do all things necessary for better carrying out its functions.” The Act provides that “The Minister may, after consultation with the governor and subject to this Act, give direction of a general nature in writing, relating to the financial and economic policy of the bank.” It further states that “The Minister may, after consultations with the board, make regulations generally for better carrying into effect the provisions of this Act." The Bank may also, in consultation with the Minister, by statutory instrument, prescribe a variety of aspects of a loan, interest rates, etc.

FIA 2004 and MDI Act, 2003 provide for the regulation, control and discipline of financial institutions by the Central Bank. They lay out and prescribe what should or should not be done in respect of (1) Licensing, (2) Shareholding in financial institutions, (3) Capital requirements, (4) Prohibitions and restrictions, (5) Accounts and financial statements, (6) Corporate governance, (7) Supervision, (8) Corrective actions, (9) Receivership, (10) Liquidation, (11) The Deposit Protection Fund, (12) Amalgamations, arrangements and affected transactions, and (xiii) Miscellaneous. The Acts give the Central Bank the mandate to license (Entry of financial institutions), supervise and discipline (Operations and Exit of financial institutions) the financial institutions licensed under them. Further, the Acts do not distinguish between foreign and domestic banks and non-bank financial institutions.

In addition to FIA, 2004 and MDI Act, 2003, there is the Foreign Exchange Act, 2004 which provides for the exchange of foreign currencies in Uganda and making of international payments transfers of foreign exchange and for other related and incidental matters. The BOU is the regulatory authority for purposes of giving effect to this Act. The BOU licenses entities that deal in foreign exchange transactions, regulates their operations and disciplines them in cases of non-compliance. The exchange rate is currently market determined and the monetary and exchange rate policies are determined through consultations between the Central Bank and the Government through the Ministry of Finance, Planning and Economic Development.

In order to operationalize the Acts above i.e. FIA, 2004, MDI Act, 2003 and the Foreign Exchange Act, 2004, respective statutory instrument supplements have been provided. They include Financial Institutions Statutory Instrument Supplement for specific activities performed under the FIA, 2004, the same for MDI Act, 2003 and for the Foreign Exchange Act, 2004. For example, for FIA 2004, there are specific Statutory Instrument Supplements for licensing, ownership and control, capital adequacy, asset quality and supervision. These specific Statutory Instrument Supplements give detailed requirements and procedures to guide the Bank of Uganda in executing its responsibilities. For regional banks, the Bank of Uganda cooperates with the home and host country supervisors in the process of licensing while the Ministry of Finance, Planning and Economic Development or any other legislative body can only express an opinion about bank licensing, but do not directly play a role in determining which bank to license and which one not to. For foreign non-regional banks, there is no cooperation between the home and host country supervisors in the process of licensing and supervision.

Commercial banks, credit institutions and MDIs as of 2010 have a minimum capital requirement (MCR) of Uganda shillings (UGX) four billion, one billion and 0.5 billion respectively (GOU, 2004, 2003)[4]. This MCR should be in the form of: a) notes and coins which are legal tender in Uganda; b) balances with the Central Bank; c) balances with banks and other financial institutions licensed to accept deposits in Uganda; d) money at call in Uganda; e) treasury bills issued by the government and maturing within three months, excluding days of grace; and f) such other assets as the Central Bank may from time to time approve. The capital requirements as well as other requirements under the banking sector laws are neutral regardless of whether the bank is foreign and domestic, but there are suggestions that the minimum capital requirements should be raised, and this could be take effect in the next few years.

[4] In 2003, the exchange rate between US$ and Uganda Shilling (Ushs) was US$1 to Ushs1,964

Once a bank or a NBFI has obtained a license, it has to adhere to certain capital adequacy requirements (CAR), the level of capital that must be available in the institution to cover unexpected risk. It is calculated in the form of ratios of core capital (CK) or total capital (TK) to total risk-weighted assets (TRWA). The Banking sector regulation is guided by Capital, Assets, Management, Earnings, Liquidity and Sensitivity analysis (CAMELS) framework, which requires banks to have a governance structure and practices in place that the central bank introduced following the bank failures witnessed in the country in the late 1990s and in 2000.

In addition, through issuance of guidelines the Bank of Uganda requires the commercial banks to operate in a prudent manner, a practice that could constitute market discipline, but there are no incentives specifically for good performance. The laws and regulations punish poor performance. The Bank of Uganda also requires commercial banks and other banking institutions to have additional policies and internal controls for prudent operations and risk management. This is in addition to ensuring that all new products put in the market by the banking sector are approved by the Bank of Uganda. Similarly, the regulatory regime does not create incentives for an efficient allocation of capital within the banking sector across different business areas and different asset classes, but emphasizes prudence in the provision of banking services.

The international capital adequacy standards outlined in the Basel Accord provide a maximum leverage ratio of core capital (CK) to TRWA for banks of 8 per cent. In Uganda there are two CARs; one derived by dividing the CK (primary capital) by total TRWA, and the other derived by dividing TK (primary plus secondary capital) by total TRWA. For an MDI the CK/TRWA is 15 per cent and TK/TRWA is 20 per cent.

With regard to the existing international capital adequacy standards - Basel II Accord which aims to encourage banks, through lower capital requirements, to improve their risk management process-, the Bank of Uganda thinks that - it is practically difficult to implement some of the provisions of the Basel II Accord in one go because of capacity weaknesses within both the central bank and commercial banks. On the one hand some commercial banks, especially the local banks, lack capacity to comply with additional requirements under the Basel II, and on the other hand, Bank of Uganda is yet to put in place a framework for compliance to Basel II. The Bank plans to implement it in a phased manner. Foreign banks, such as Stanbic Bank Uganda Limited are expected to implement Basel II if their mother banks in the home countries implement it. For example, Stanbic Bank Uganda Ltd set appropriate action plans to ensure alignment of its internal processes and systems in a build-up to the Standard Bank Group Basel II capital requirements implementation date of 1st January 2008 (Stanbic Bank Uganda Ltd, 2008). In this way, it will ease the process of implementation of the Accord. Nevertheless the Bank of Uganda will need to strengthen its supervisory capacity through capacity building to be able to implement Basle II Accord and other reforms necessary to continue improving the status and performance of the banking sector.

By the time of writing this study, the Bank of Uganda was thinking of reviewing the banking sector regulations. However, this is not because the current banking sector legislations are weak and/or outdated, but they are considered not to be comprehensive enough. The internal reporting standards and credit risk management procedures are generally considered to be strong to avoid crisis and neutral between foreign and domestic banks. This has been demonstrated during the period of global financial crisis that started in 2007 and intensified in 2008. During this period, the banking sector in Uganda showed resilience as it did not buckle under the pressure of global financial crisis (see section seven).

As at the end of 2010, the laws and regulations do not provide for Islamic banking in the country. The current level of minimum capital requirements is also considered low. However, from the Bank of Uganda's point of view, the legislations provide a strong basis for enforcement, although this will require reinforcement in view of provision for Islamic banking in the country. A draft law on money laundering is also before the Parliament of Uganda to provide a legal basis to address fraud and other forms of banking indiscipline.

5. The quantitative aspects of banking services

Sections 2, 3 and 4 present and discuss the history of banking sector in Uganda including the reforms as well as the current status. This section assesses the results of the reforms that have been carried out with focus on selected banking sector performance indicators. It should however, be noted that not all the outcomes discussed in this section are a result of financial sector reforms, but can partly be attributed to them.

Table 5 presents loans to the private sector from 2000 - 2008. The figures show a clear trend in the growth of loans to some sectors. For example, loans to trade and agricultural production show a clear growth up to 2005 and thereafter a decline while those to marketing, manufacturing and other sectors are sluggish or even declining. Loans to electricity and water, building and construction and wholesale and retail trade have been increasing. From the foregoing analysis, the results indicate that reforms in the financial sector have had mixed outcomes, but overall it has led to three outcomes: rapid increase in trade loans, restructuring of loan portfolios and overall increase in the supply of loans to the private sector. Lending for consumption in Uganda could not be established because of data limitations.

Table 5: Loans to the private sector by sectors as % of total loans, 2000-2008

Sector/Period	2000	2001	2002	2003	2004	2005	2006[5]	2007	2008
Agriculture (Production)	1.82	2.56	1.70	2.67	4.08	6.09	3.7	2.6	2.3
Agriculture (Marketing)	5.37	5.99	6.80	6.69	6.51	3.93	1.6	1.9	2.0
Mining and Quarrying	0.01	0.39	0.08	0.16	0.07	0.06	0.0	0.1	0.3
Manufacturing	33.0	34.94	24.70	23.34	20.22	20.08	9.1	10.6	9.3
Electricity and Water	5.30	5.49	6.50	6.58	5.89	5.96	4.3	5.4	8.2
Building and Construction	4.39	4.11	3.60	3.26	4.01	3.40	4.5	5.0	11.8
Wholesale and retail trade	50.18	46.51	58.30	57.29	59.23	60.49	47.5	48.82	66.1

Source: Bank of Uganda Annual Reports (various years)

Furthermore and as an outcome of the reforms, the increase in the supply of loans to the private sector has not been the result of substantial reduction in interest rates except in the early years of economic reforms. It is thus difficult to argue that increase in supply of loans is a result of a reduction on the cost of investments proxied by the level of interest rates.

Table 6 gives interest rate structure for the period 2000 to 2008. Treasury bills (TB) rates have generally showed downward trend over the years although they were unusually high in 2003. Savings rates have ranged between 2-3 percent and time deposit rates have ranged between 14 – 10 percent. With the exception of TB and deposit rates, loans and savings rates have shown limited adjustment flexibility with lending rates adjusting between 18 – 20 percent. As a result, the interest rate spreads have been very high (16 – 18 percent) in absolute terms (also see Beck and Hesse, 2006). This has been a source of concern and the hope had been that with more banks being licensed, interest rates as well as the spreads would reduce. This is yet to happen, and therefore remains a concern and a challenge to the government and monetary authorities in Kampala.

5 Ratios for 2006, 2007 and 2008 exclude loans denominated in foreign currency due lack of data.

Table 6: Interest rate structure, 2000-2008

The structure of interest rates	2000-2005[6]	2003	2004	2005	2006	2007	2008
91 days	11.41	21.44	9.64	7.61	9.34	7.31	9.30
182 days	13.77	23.28	12.79	8.56	10.34	10.28	12.91
364 days	15.82	22.33	13.82	9.94	10.92	10.34	12.52
Savings	2.41	2.49	1.76	1.77	2.02	2.7	2.19
Time deposits	11.00	13.27	13.27	13.27	7.57	10.08	11.62
Lending rates	20.03	18.34	18.34	18.34	18.6	18.2	19.00

Source: Bank of Uganda Annual Reports (various years)

Interestingly, as the supply of loans to the private sector has increased in spite of high lending rates, financial sector deepening has also progressed appreciably. Banks have introduced several new products such as Automatic Teller Machines (ATMs), Mobile Money, Interbank connections for some banks, better interest rates, larger loan amount, more appropriate loan duration and better repayment terms. The foreign banks have played a significant role in most of the innovations taking place in the banking sector given that over 80 percent are foreign owned. At the same time, foreign banks have tended to deal with high income categories of income earners, which implies that the new services are only for a very limited group of clients.

Table 7 gives selected indicators of financial sector growth. Financial savings (FS) as a proportion of broad money supply (M2) increased from 0.3 in financial year 2000/01 to 0.36 in financial year 2007/08. However, as a proportion of GDP, there has been only a marginal increase. M2/GDP also went up but currency in circulation as a proportion of M2 and GDP has not changed significantly. Based on these performance indicators, the sustainability of banking sector reforms is not clearly visible.

Table 7: Selected banking sector growth indicators, 2000/01 – 2007/08

Indicators	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
FS/M2	0.30	0.31	0.32	0.31	0.32	0.33	0.34	0.36
FS/MGDP	0.06	0.07	0.08	0.08	0.08	0.06	0.06	0.07
FS/GDP	0.04	0.05	0.06	0.06	0.06	0.06	0.06	0.07
CIC/M2	0.29	0.27	0.26	0.28	0.28	0.29	0.29	0.28
CIC/GDP	0.04	0.04	0.05	0.06	0.05	0.04	0.04	0.04
M2/MGDP	0.19	0.22	0.24	0.25	0.26	0.17	0.16	0.18
M2/GDP	0.13	0.16	0.17	0.18	0.19	0.14	0.14	0.16
Monetary GDP/GDP	0.71	0.72	0.72	0.73	0.73	0.85	0.86	0.87

Source: MOFPED; UBOS and BOU (various years)
Note of explanation:
FS: Financial Services
MGDP: Monetary Gross Domestic Product
CIC: Currency in Circulation
M2 Broad Money Supply
GDP: Gross Domestic Product

Banking sector reforms have also been responsible for several other outcomes both within the financial sector and the wider economy. As presented in section 3, the banking sector reforms have attracted new banks into the sector. From a small number of commercial banks in the 1980s, currently the sector boasts of over 20 commercial banks. In the process several banks have also gone under.

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[6] The interest rates for 2000-2005 and 2003-2005 are annual averages.

The concentration of banks in the urban centers however, means that there is still a big population not served by the formal banking system. A FinScope Uganda survey done in 2006 established that the formal banking sector serves only 18 percent of the potential clients (FinScope Uganda, 2007). Thus, banking sector reforms have hardly led to substantial reduction in the gap between the formal and informal sectors of finance. There is widespread argument that with rapid population growth in Uganda, the informal financial sector has expanded with liberalization of interest rates and increased participation in saving and credit societies and microcredit programmes.
Nevertheless, the reforms in the regulatory regime have been translated into a sound and safe financial system which has improved the management of monetary policy and the stability of the macro economy. While the wider legal systems still require substantial reforms, commercial legal system has registered significant improvement. Coupled with a much stronger oversight of the Bank of Uganda and improvement in the governance system of the banks themselves, dishonest financial behavior and/or mismanagement of financial institutions have reduced.

The foreign banks have performed relatively better than local banks as regards/related to the provision of more financial products and better financial services to clients, but have hardly imparted management skills and knowledge to the local banking industry except when staff of these banks leave to go to work in the local banks, a practice which is generally limited. Banks have also taken steps to secure their loans and with introduction of Credit Reference Bureau, the situation is expected to improve further. Of course, there are still dangers related to people taking multiple loans and provision of inadequate security due to limited land titling and poor land tenure system still in practice in the country - freehold, leasehold, mailo and customary tenure systems.
Savings volume as proxied by deposits has grown, not necessarily due to higher real interest rates offered to depositors, but rather due to some requirements imposed particularly on the working class who are compelled to use the financial system while receiving their pay.

Other indicators of the performance of the banking sector are given in Table 8. As can be seen from the Table, the financial sector has grown and become stronger. Total assets have increased from about UGX2 billion in 2000 to nearly UGX7 billion in 2008. Similarly loan portfolio has increased by more than five folds during the same period while the capital and reserves have multiplied several times. Loans to assets and loans to deposits have increased steadily while debt equity ratio has reduced from 20 in 2001 to 8.7 in 2008, implying that the banks are relying less on debt. This is a significant development in the banking sector.

Table 8: Selected indicators of commercial banking sector performance

Indicator (UGX where applicable)	Period								
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total assets (Billions)	1,802	1,913	2,596	3,030	3,396	3,676	4,002	4,820	6,706
Loans (Billions)	570.1	639.4	649.0	855.8	997.7	1,1137	1,473	1,823	2,851
Capital and Reserves (Billions)	87.3	91.2	230.1	238.5	229.9	199.6	301	447	694
Liabilities (Billions)	1,714	1,822	2,366	2,792	3,166	3,476	3,702	4,372	6,012
Total Deposits (Billions)	1,201	1,255	1,732	2,115	2.307	2,414	1,819	2,130	2,828
Loans/Assets	0.32	0.33	0.25	0.28	0.29	0.31	0.37	0.38	0.43
Loans/Deposits	0.48	0.51	0.38	0.41	0.43	0.47	0.81	0.86	1.01
Capital and Reserves/Assets	0.05	0.05	0.09	0.08	0.07	0.05	0.08	0.09	0.10
Debt/Equity ratio	19.6	20.0	10.3	11.7	13.8	14.4	12.3	9.8	8.67
Exchange rate (UShs/US$)	1,645	1,756	1,797	1,964	1,811	1,781	1,825	1,716	1,710

Source: Bank of Uganda Annual Reports (various years)

6. The qualitative aspects of banking services

Section 5 discussed the quantitative progress made in Uganda's banking sector following reforms undertaken in the financial sector. This section is restricted to a discussion of the qualitative aspects of the banking services in Uganda.

As already indicated before, foreign banks in Uganda constitute up to about 87 percent of the banking sector. With this in mind, it can be argued that the visible performance of the sector can also be significantly attributed to the foreign domination of the sector. However, the performance of the sector is also influenced by the existing policy, legal and regulatory framework in Uganda, which was important in shaping the direction of adjustments. There is qualitative evidence indicating that the entry of foreign banks has improved the quality, pricing and availability of banking services for both existing clients and to attract new ones. Through demonstration effects and the ratings by the Bank of Uganda, the local banks have been able to benefit from the good performance of foreign banks.

The entry of foreign banks through acquisitions and takeovers of the domestic banks and/or their branches has contributed towards their expansion into the country side, but the typical rural areas remain under-banked and poorer households still have limited access to financial services from formal banks. There are several programmes established by both foreign and local banks to improve access to financial services by Small and Medium Enterprises (SMEs), but this has remained modest. Indeed, foreign banks are performing worst in this direction, partly due to application of strict measures in their financial operations. Local banks such as Centenary Bank Ltd have performed a lot better than foreign banks in improving access to financial services to low income earners and SMEs. However, this practice has the effect of compromising the quality of loan portfolios and profitability. The foreign banks give priorities to foreign or high income clients considered less risky compared to local or low income clients and more so those located in rural areas. In urban areas, some of the foreign banks have focused on giving financial services, especially loans tied to salaries of the low income employees in urban areas.

Based on interviews held with an official from the Bank of Uganda, foreign banks use their financial power to cherry pick the most lucrative transactions, thus relegating domestic banks to more risky markets. For example, importers and exporters of petroleum products tend to be clients of foreign banks. Through this practice as well as application of prudent bank governance, the foreign banks are more profitable compared to local banks.

Due to the domination of the banking sector by foreign banks and their practices of cherry picking the most lucrative transactions, the major deposits are made in foreign banks. The same pattern applies to lending as well. However, the bulk of credit by foreign banks goes to trade.
Data on interest charges by banks are generally scarce. From available information, foreign banks charge lower interest rates for their services to prime clients compared to charges by local banks. However, overall, interest rates depend on the level of riskiness of the clients. Clients with lower risks are charged lower rates of interest compared with risky clients who are charged higher rate of interest, and because local banks tend to deal with high risk clients, they tend to charge higher rate of interest compared to foreign banks.

Owning to competition in the banking sector, both foreign and local banks are providing basic banking services electronically (such as internet banking and ATMs) to save costs. This however, has not restricted access to wealthy and educated clients, but even the less educated use some of these basic banking services. The major difference comes from the level of efficiency and reliability of the services provided. Services from some local banks tend to be less reliable compared to services from foreign banks. Apart from participation in the primary market of treasury bills, foreign banks hardly lend money to state-owned enterprises.

Foreign banks, just like local banks, make most of their profits from lending to the private sector. Taking one foreign-owned bank (Stanbic Bank Uganda Ltd) and one domestic bank (Centenary Bank Uganda Ltd) for which data was available, and examining their rates of return on equity, Stanbic Bank Uganda Ltd posted rates of return on equity of 43.3 percent and 48.3 percent in 2007 and 2008 respectively while Centenary Bank Uganda Ltd posted rates of return on equity of 36.4 percent and 35.4 percent in 2007 and 2008 respectively. From this performance, one can say that foreign banks make more profits than domestic banks, although it can be argued that one bank in each case is not a representative number.

7. The global financial crisis and Uganda: role of foreign banks

Following the global financial crisis, there was limited debate on how the crisis was likely to affect Uganda's banking sector and the economy. At a macro level there was a consensus that first-round effects of the global financial crisis would hardly affect Uganda's banking sector because, as outlined above, Uganda's financial sector is only weakly linked to the international financial system. Related to this there were arguments that the Uganda financial system is strong, and well managed, and is therefore resilient to adverse effects of the global financial crisis. Furthermore, first-round effects of the crisis were expected to be limited because Uganda was yet to begin engaging in financial sector innovations that were instrumental in bringing about the crisis in the United States and Europe, such as dealing in derivatives and securitized products.

However, the global financial crisis was expected to affect Uganda through what was called second round effects or the flow of financial capital into or out of the country. Inflow of foreign capital receipts from exports, remittances, foreign aid, and foreign direct investment were expected to decline. With an open capital account Uganda was expected to witness outflow of foreign capital to enable firms abroad to pay more attention to financing needs in their domestic economies to address adverse effects arising from the global financial crisis. Reversal flow of remittances was also expected to take place to address increased economic household financial demands of remitting families.

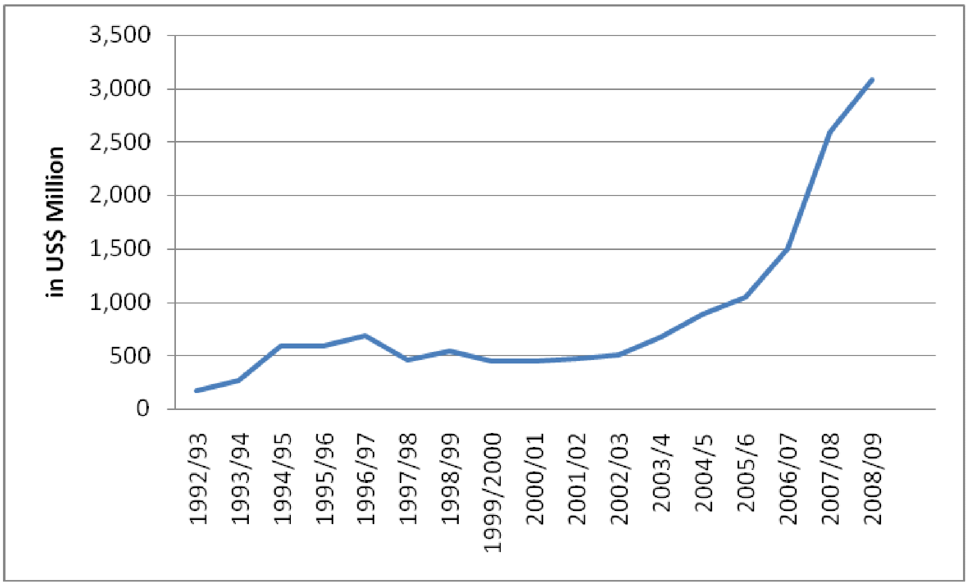
7.1 Inflow of capital during the global financial crisis

Contrary to expectations of a decrease in export inflows, Uganda witnessed significant increase in export earnings during the period of the global financial crisis from 2008 to 2010. The increase was attributed to increased exports of food and manufactured goods to neighboring countries especially to the Democratic Republic of Congo and Southern Sudan. Uganda's trade with the East African Community (EAC) countries and Common Market for Eastern and Southern Africa (COMESA) has also increased significantly. The signing of market access protocols and treaties such as Customs Union that became effective in 2005, the Common Market protocol that became effective in 2010 and the tripartite treaty between EAC, COMESA and Southern Africa Development Cooperation (SADC) partly explain the increase in intra-regional trade.

Total exports in 2008/09 increased by 8.3 per cent compared to the previous financial year to US$2,811.6 million. Export earnings from regional informal trade increased by 16 per cent from US$1,068.4 million in 2007/08 to US$1,242.1 million in 2008/09 (MoFPED). The significant increase in regional informal trade was mainly on account of high prices of both food and manufactured goods that Uganda exported to neighbouring countries during the global financial crisis.

As member of the EAC regional bloc, Uganda has also been negotiating an Economic Partnership Agreement (EPA) with European Union for a reciprocal trade arrangement where Ugandan goods except arms will be allowed to enter the EU market duty free. In turn, up to 80 percent of EU goods should also be allowed to enter Uganda's market duty free. So far two deadlines for signing the agreement have passed: one in December 2007 and the other in November 2010. The basic argument for failing to sign the agreement has been that Uganda is not yet ready to implement a number of provisions in the EPA. For instance, traders and manufacturers in Uganda fear that imports from EU will drive local firms out of production.

Figure 1: Exports of goods and services, 1992/93-2008/09



On the contrary coffee exports fell from US$394 million in 2008 to US$280 million in 2009 due to a combination of decreased export volumes and decreased price of coffee on the international market. The decrease in the price of coffee on the international market could be attributed to decreased demand that arose because of the global financial crisis.

7.2 Remittances and foreign aid inflows

Investment on the Kampala stock exchange was reported to have decreased because of decreased inflows of capital from abroad (MoFPED). Foreign aid hardly decreased mainly because donors chose to honour commitments that were made prior to the crisis. Remittances were reported to have declined during 2008 but quickly recovered the following year (BoU). Broadly, Uganda suffered very minimal effects of decreased capital inflows arising from the global financial crisis.

7.3 Outflow of capital

With a liberalized capital account expectations were that Uganda would witness significant outflow of capital as a consequence of the global financial crisis. A liberalized capital account would enable firms to freely move capital out as and when they want. However, information obtained from interviewing a Bank of Uganda official was that although Uganda witnessed some outflow of capital, the adverse effects were short-lived because of subsequent reversal flow of capital into the country. During the global financial crisis in 2008 Uganda witnessed outflow of capital of a portfolio nature but by 2009 investments on the Kampala Stock Exchange were reported to have risen to pre-global financial crisis level. Limited capital flight out of Uganda following the global financial crisis is partly attributed to the confidence that the foreign banks have in investing in Uganda and the strength of Uganda's financial sector.

8. New risks and vulnerabilities in the Ugandan banking sector

Foreign ownership of commercial banks in Uganda has increased over time, raising new risks and vulnerabilities in Uganda's banking sector. Broadly, in a liberalized banking sector where 87 percent of banks are foreign owned, their actions would be expected to heavily impact on exchange rates, interest rates, monetary policy, and access to financial services.

8.1 Monetary policy

The conduct of monetary policy in Uganda is heavily influenced by actions of foreign banks, which play the most significant part in the primary market of treasury bills that Bank of Uganda issues for monetary policy purposes. Although the primary market of Treasury Bills had by 2010 evolved to allow all commercial banks to participate in the primary market, initially in the 1990s participation in the primary market of Treasury Bills was limited to only four foreign banks. In the 1990s foreign banks had the exclusive right to buy and resell Treasury Bills issued by the Central Bank. However, the secondary market of Treasury bills remained shallow as foreign banks preferred to hold treasury bills to maturity.

However, Bank of Uganda's strong capacity to supervise and regulate activities of all commercial banks including foreign banks, has limited the excesses that foreign banks could indulge in such as leaving the country, illegal capital flight accumulated through corrupt means and engaging in risky and speculative businesses such as stock lending, derivative trading, and real estate. For example, foreign banks cannot leave the country abruptly because of strong regulations imposed by the Central Bank. Consequently, foreign banks have settled down to do business in Uganda, but left little room to local banks to make comparable or good profits.

8.2 Exchange Rates

Off-shore investment in Treasury Bills in response to high interest rates in 2003/04 was suspected to be a major cause of the appreciation of the Uganda shilling. During the Global Financial Crisis in 2008/09, outflow of capital was suspected to be a major cause of the depreciation of the Uganda shilling. Accordingly, foreign banks behaviour as regards the movement of foreign exchange has a large bearing on the determination of exchange rates in Uganda. However, movement of capital by foreign banks is not illegal because Uganda's capital account is liberalized. In line with the policy of an open capital account, foreign banks are free to repatriate all or part of their earnings. However, information on repatriation of earnings could not be established concretely.

8.3 Access to financial services

Although the number of branches of some foreign owned commercial banks such as Barclays Bank Ltd, Stanbic Bank Ltd and Equity Bank has increased enormously in recent times, the increase has occurred mainly in Kampala and/or other urban areas. Emergence of foreign banks could be associated with concentration of banking services in urban areas, which has left the rural areas heavily dependent on microfinance institutions for financial services. Microfinance institutions invariably have high operational costs, which compel them to charge high interest rates to cover their operation costs. Greater competition is squeezing profits of local banks, which are increasingly locating their business operations in areas where foreign banks have little or no presence. Indeed, the Central Bank closed several local banks during the late 1990s partly because of having been made weaker by competition from foreign banks.

Foreign banks that entered the market from 2008 are finding it difficult to attract and retain high caliber borrowers; the good ones were taken already. As such, new foreign banks are locating to Uganda for speculative or prospective purposes but not to engage in traditional financial intermediation; for example, in anticipation of future qualifying clients several foreign banks have opened branches in a small town of Hoima where oil and gas has been discovered! Such banks do not serve the financial needs of the people; there is a paradox of many banks that are not willing to lend to people on the one hand, and people that have high demand for credit on the other.

8.4 High commercial bank lending rates

In response to greater competition from foreign banks, local banks tend to provide financial services to the more risky lower segment of the market. Weaker local small banks have fled from financing formal businesses to the informal sector, which is less lucrative. Consequently, local banks are more vulnerable to risky borrowers, lower earnings, and poor management as they can hardly hire and retain good managers. The likelihood of bank failure is higher among local banks compared to foreign banks.

High commercial bank lending interest rates are partly a reflection of the unwillingness on the part of commercial banks to lend to a large category of borrowers, whom they perceive to be risky. The Government of Uganda plans to establish a Credit Reference Bureau to assist commercial banks to get information about prospective borrowers. The good intention of the move notwithstanding, the measure could reduce the credit market even further. While commercial banks are competing over borrowers, they remain risk-averse with the consequence of poor access to credit by the majority of the people, especially those in rural areas.

8.5 Risks to regulation by international and regional liberalisation agreements

Uganda has so far not signed free trade agreements that liberalise financial services. Although Uganda is part of the World Trade Organisation (WTO), it has not made commitments to liberalise financial services under the WTO's General Agreement on Trade in Services (GATS). However, during the GATS negotiations, the European Union (EU) has requested Uganda to mainly liberalise direct foreign investment (establishment) of banks that provide basic services such as acceptance of deposits, lending of all types, all payment and money transmission services, as well as direct insurance. In addition, the EU wishes that Uganda does not limit the entry of intra-corporate transferees and business visitors of European (financial) services suppliers. Making financial services liberalisation commitments under GATS would not only mean that Uganda becomes more attractive for foreign banks but also that Uganda has to limit its financial regulation to what is allowed under GATS rules. For instance, Uganda would need to treat foreign banks at least in an equal way as national banks ('national treatment') and national licensing regulations and qualification standards should be according to GATS principles such as being least trade distortive. In addition, it would be forbidden, under 'market access rules', to implement restrictive regulations such as limiting the number of service suppliers, limiting the total number of service operations or limiting the total value of transactions, unless Uganda would make exemptions to such GATS rules.[7] Control on capital movements would also be made conditional to what is allowed under GATS.

As one of the 19 members of COMESA, Uganda is part of COMESA's trade in services programme to develop a Regional Framework for Trade in Services (RFTS) that would give member states preferential access for services. In addition, this programme intends to provide technical assistance to allow member countries to carry out an assessment of how to implement GATS rules and commitments, and what their impact is.[8]

Uganda is part of the East African Community (EAC) whose Treaty (2007) does not liberalise services but includes commitments to undertake actions to develop banking and capital markets (Art. 85) and encourage cross-border trade in financial instruments (Art. 96). Some EAC members, not including Uganda, have agreed on an interim Economic Partnership Agreement (EPA) with the EU and its member states. By the end of 2010, negotiations have failed to agree on a full EPA which would include liberalisation of services and of which Uganda would be part. Given the strong interest of the EU to open up markets for European financial services, as was the case with the EPA between the EU and CARIFORUM, it is likely that any full EPA would include liberalisation of financial services by Uganda. Such an agreement would make Uganda's regulation subject to very similar limitations as under GATS, as explained above, unless Uganda would make exemptions on national treatment and market access rules.

Uganda has signed seven bilateral investment treaties (BITS)[9] which protect foreign investors, including financial services investors, such as banks and insurance companies, coming from European countries. These BITs also result in Uganda having to provide national treatment to foreign financial service investors, as well as 'fair and equitable treatment' to investors from those seven countries. Also, investors from those countries are protected against undue expropriation and even against loss of profits due to new regulations (called 'indirect expropriation'), and governments are limited in restricting capital flows from investors. In case of disputes, foreign investors can sue the state of Uganda before an international investment dispute resolution panel, often the International Centre for Settlement of Investment Disputes (ICSID) which is administered by the World Bank.

Uganda has adopted, together with the other 18 COMESA member states have, in May 2007, the Investment Agreement for the COMESA Common Investment Area (CCIA)[10] which liberalises investment among the COMESA member states. The CCIA has similar provisions as the BITS to protect foreign investors with the intention to promote foreign direct investment from investors coming from the region into other countries of the region.

The risks from potentially agreeing to, and implementing, the above mentioned international and regional trade and investment agreements, is that these agreements restrict the governments' and

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[7] For more explanation, see M. Vander Stichele, R. van Os, Business as usual?, How Free Trade Agreements Jeopardise Financial Sector Reform, SOMO paper, December 2010, downloadable at http://somo.nl/publications-en/Publication_3611

[8] V. Ancharaz, T. Kandiero and K. Mlambo, The First Africa Region Review for EAC/COMESA, African Development Bank Group Working Paper No. 109, April 2010, p. 22.

[9] UNCTAD, Country-specific lists of BITs, data base, consulted in December 2010: Uganda BITS which entered into force are with Denmark, France, Germany, Italy, The Netherlands, Switzerland, the United Kingdom.

[10] The text of the Investment Agreement for the COMESA Common Investment Area (CCIA) is downloadable at: http://programmes.comesa.int/attachments/104_Investment%20agreement%20for%20the%20CCIA%20FINAL%20_English_.pdf

parliament from Uganda, as well as regional parliamentary bodies, from introducing and implementing financial sector regulations that would be adapted to the situation of Uganda and deal with the negative impacts of foreign financial services suppliers but that would restrict and limit the operations by foreign banks. COMESA explains that "[l]iberalisation of trade in services involves the reduction of regulatory barriers to market access and discriminatory national treatment".[11] The above mentioned agreements could take away the policy space needed to implement the COMESA Financial Development and Stability Plan, the Action Plan for Harmonisation of Bank Supervision and regulation and the Assessment Framework for the Financial System Stability adopted by the Central Banks of COMESA countries (and implemented by the COMESA Monetary Institute (CMI)).[12] The EAC's Treaty commitment to harmonise the regulatory and legislative frameworks and regulatory structures (Art. 85) could be hampered by the disciplines in the trade and investment agreements covering liberalisation of financial services.

[11] COMESA, Trade in services, http://programmes.comesa.int/index.php?option=com_content&view=article&id=58&Itemid=63&lang=en

[12] COMESA, Monetary Co-operation in the COMESA Region, viewed December 2010 at http://programmes.comesa.int/index.php?option=com_content&view=article&id=35&Itemid=27&lang=en

9. Peoples’ response to financial issues and needs

The general level of debate and discussion on the banking sector reforms in Uganda is generally very low, perhaps because of limited understanding of financial sector issues and the shallowness of the financial sector. Similarly debate on and discussion about the global financial crisis was limited to a few institutions such as the central bank, MoFPED, research institutions, academic institutions, the formal business sector, and Uganda’s development partners.

Foreign banks are generally perceived by the business community and other clients to be well managed and unlikely to fail. However, there is a general concern that the foreign banks meet financial needs of a very small proportion of the population who invariably reside in urban areas. Restrictive requirements by foreign banks for opening and operating a bank account, high minimum balances on a bank account, high transaction charges, and high interest rates are some of the limiting factors that make it difficult for the majority of people to seek financial services from foreign banks. Box 1 (see below p. 37) gives an overview of the operations and activities of Stanbic Bank Uganda Ltd, one of the several foreign owned banks operating in Uganda.

Liberalization has not led to sufficient competition in the banking industry, which would see some or all of these concerns fully addressed.

The consequence of concentration of foreign banks in urban areas was the creation of a void in rural areas as regards access to financial services by rural dwellers. Microfinance institutions, which face high operating and intermediation costs came it to fill the void, and consequently charge high lending interest rates in the range of 3 to 5 per cent per month or about 60 per cent per annum. Microfinance deposit-taking financial institutions hardly offer interest on deposits. The cost of borrowing in rural areas is about three times compared to that in urban areas where lending is mainly by foreign banks, which charge their prime borrowers about 18 per cent per annum. Although the lending rates by foreign banks are lower compared to that of microfinance institutions, there is concern by the business community that lending rates of 18 per cent per annum or even slightly higher are too high to finance their business operations. One of the major adverse consequences of financial sector reforms is persistent high lending interest rates.

Civil society actors, bank employees, parliamentarians, business associations, and other banking sector stakeholders have voiced their concern about high commercial bank lending rates. Commercial bank lending interest rates in Uganda are high partly because of “crowding out effects” that arise out of Government conduct of monetary policy that prioritizes the control of inflation. Coupled with the desire to maintain a competitive exchange rate through accumulation of foreign exchange reserves, market forces in Uganda have pushed lending interest rates very high. Debate on alternative policy choices available to Uganda in this regard is limited – the IMF and the World Bank have advised Uganda to prioritize control of inflation and pursue an export-led growth strategy, a combination of policies that lead to high commercial bank lending interest rates. Capacity of CSOs and business community to engage Government and her development partners in debate on these issues is limited.

Debate on the behavior of foreign banks following the global financial crisis was also limited to only a few institutions such as MoFPED, Bank of Uganda, and a few research institutions that had good understanding of the crisis and its likely impact on the Uganda banking sector and the economy. There was little debate on how Uganda's banking sector and/or economy could get affected by the global financial crisis. Little debate on a crucial matter like this one is partly because Uganda's banking system is irrelevant to the majority of the people's financial needs. People's hope as regards access to financial services lies with the few local banks and microfinance institutions, the threats to their survival notwithstanding.

Box 1: Operations and activities of Stanbic Bank Uganda Ltd

Establishment and Ownership of the Bank

Stanbic Bank Uganda (SBU) Ltd is a subsidiary of Stanbic Africa Holding which is in turn owned by Standard Bank Group Limited. The bank was founded in Uganda as the National Bank Of India in 1906, and later became Grindlays Bank. When the Standard Bank Group bought the Grindlays' network in Africa it also, in October 1993, re-established a connection with Uganda. In 2002, the SBU Ltd acquired Uganda Commercial Bank Limited (UCBL). SBU Ltd is a public limited liability company licensed as a merchant banker, stockbroker and financial adviser by the Uganda Capital Markets Authority and listed in Uganda Securities Exchanged in 2007.

Banking Services provided

As of October 2010, SBU Ltd provides the following financial services:
(Note: Exchange Rate: 1 US$= 2300 UShs (end-December 2010))

Products	Characteristics, terms and conditions
Saving account	Initial deposit of UShs35,000 for a pure Save account
Transact Plus accounts	Debit card-based e.g. ATM; does not earn interest; has charges i.e. UShs750 per withdrawal at the ATM and a monthly maintenance charge of UShs2,000. Initial deposit of UShs15,000
Personal current account	Comes with a cheque book; free ATM card; minimum balance of UShs100,000; maintenance charge of UShs11,000 per month; have the credit card and internet banking solution but do not earn interest.
Bonus investment account	Fixed deposit account with an initial deposit of UShs500,000 and a minimum withdrawal period of one year; No charges, but earn interest ranging between 1-9%.
Contract save account	Savings are deducted from say salary for an agreed period of time to raise a pre-determined amount of money in the holder's account; No charges, minimum withdrawal period of one year and earn interest ranging between 1- 9%.
PureSave account	Is a card-based savings account for people who want to build up their savings. It allows the holder to keep their money safe while earning attractive interest and can make deposits and withdrawals at their convenience. Parents/guardians may open a PureSave account in the name of minors. PureSave is free of monthly management charges, hence keeping savings intact and growing.
Fixed Deposit account	No charges, minimum withdrawal period of one year and earn interest ranging between 1- 9%.
Salary Earners' loan	Loan amount ranges between UShs500,000 and UShs30 million sub-divided into: a) the non-guaranteed loans where the employer/company does not provide the bank with a formal guarantee to cover the individual's facility within an agreed "blanket facility"; b) guaranteed loans, where the employer enters into a formal agreement with the bank to advance its respective employees' loans under the scheme against its' surety/guarantee, within the level of the agreed "blanket facility"; Repayment is over 12, 24, 36, 48 or 60 months; Lending interest rate varies between 18 and 24%

Products	Characteristics, terms and conditions
Home loan – buying and improving a house, equity Release, completion of a house, re-finance or building loan	Financed up to 90% of the market value; Repayment period up to 20 years; Monthly repayment not exceeding 30% of net income with an exception of 35% for salary earners; lending rate currently 16% i.e. a prime of 15% +1%.
Business working capital loan	Period of between 6 and 24 months, sometimes longer. The repayment frequency can be scheduled weekly, monthly or quarterly.
Business revolving credit line	An on-going business loan where repayments are calculated over between 1 to 5 years in equal monthly installments. Once a borrower has met monthly repayments for a minimum of six months, he/she can withdraw funds up to the original limit, without monthly repayments being affected. It has a fluctuating interest rate which is linked to the bank's base.
Business term loan	For any period from 5 to 10 years and repayable aligned to your business cash flow and business cycle. Where property is being used as the offered collateral, the loan amount can be up to 70% of the property's assessed value. It has a fluctuating interest rate which is linked to the bank's base.
Vehicle and asset finance	Moveable assets that are currently identifiable, removable, insurable and which can be leased or sold in event of default.
Agricultural loan	Two agricultural loan schemes: Kilimo trust fund (AGRA) funds maize, beans, rice, soybean, sunflower, barley, sorghum; interest rate: 18-20% and 0% facility fee. Collateral: Cession of crops, debtors, risk sharing agreements and tangible security if available. Government of Uganda funds (Government ACF) - Crops, poultry, livestock, fish farming, horticulture. Interest rate is 10% p.a. on reducing balance and there is a management fee of 0.5% of the loan. Collateral: Assets financed and/or, tangible security.
Credit card	Holder buys goods and services without using cash. Cash overdraw can be instant; monthly repayments is at a minimum of 10% of the outstanding debit balance. There is a limit on amount of credit but holder gets up to 55 interest-free days.
Money transfer	Allows money transfer between bank accounts.
ATM card/Debit card	Gives the holder flexibility to do his/her banking activities without physically visiting a bank, e.g. lets the holder deposit and withdraw money whenever he/she needs to and can do their banking at anytime of the day at any AutoBank throughout Uganda; can easily and quickly check the details of their account without physically visiting a bank.
Overdraft e.g. for working capital	Linked to a current account and allows the holder to use as much as he/she needs up to their limit. It is ideal for managing a cash flow.
Joint account	An account in the names of more than one holder.
Compulsory saving account	Where savings payments are required as part of loan terms.
Investment account	Includes the pureSave account, Contract save and Bonus investment account
Internet banking	The transactplus and the personal current accounts have the internet banking solution which allows account holders to view their accounts on internet, make money transfers and also pay utility bills; they can access latest balance, statements, view account details, print, download their statements and obtain a history statement on all accounts linked to their AutoBank.
Corporate account	SBU provides commercial and investment banking services to multinationals and regional and large local corporations; they develop and customise products for their clients, to enable them finance their projects and meet their goals.

General requirements for account opening at SBU Ltd:

1. Two passport size photographs.
2. Valid identification: ID from employer/Passport/Driving permit/Voters card and two photocopies of IDs to be presented together with the original copy.
3. Local Council letter or utility Bill e.g. Electricity, Water (less than 3 months old). For Non residents: Passport and Work permit/Residence Permit.
4. Two letters of introduction from customers maintaining current or savings accounts with SBU Ltd OR Letter of introduction from employers who hold A/Cs with SBU Ltd if you are employed OR Letter of introduction from the school for students and birth certificates for secondary school students.

Status and Performance

Following acquisition of UCBL, SBU Ltd has dominated the banking sector in terms of its size and branch network (World Bank, 2009). As of February 2010, the bank had 67 branches, which is about 17.1 percent of all the commercial banking branch network in the country. The branches are located in 45 out of 110 districts. Table below indicates the regional distribution of the branches with Kampala city treated as a region.

	Kampala	Central	Eastern	Northern	Western	Total
Number of branches	12	13	11	13	18	67
Number of districts with branches	1 out of 1	9 out of 22	10 out of 31	11 out of 30	14 out of 26	45 out of 110

As of December 2008, the bank's equity was UGX164.778 billion, way above the minimum capital requirement of UGX4 billion, total assets was UGX1,596,318 million, loans and advances was UGX730,865 million (56.7 percent of deposits and 45.8 of total assets) and a deposit base of UGX1,289,674 million. For the year 2008, the bank made a profit of UGX103,945 million and the return on equity was 48.3 percent – quite high by any standard.

Note: Exchange Rate: 1 US$= 2300 UShs (end-December 2010).
Source: Author's Compilation from a meeting with SBU Ltd official.

10. Conclusions and policy recommendations

Uganda's desire to achieve the twin objectives of ensuring soundness of commercial banks and efficiency in the banking sector through liberalization of the sector led to mixed results. To achieve soundness of the banking sector, the 1969 Banking Act was replaced with the 1993 Financial Institutions Statute with strong regulatory and supervisory measures, which most local banks could not meet and hence their closure.

Because the central bank perceived liberalization of the banking sector as risky and not likely to lead to achievement of desired twin objectives of outreach and sustainability of the sector, it put a moratorium on licensing of new banks which was in effect from 1999 to 2007. When the moratorium was finally removed in 2007, the new banks that the central banks licensed thereafter were almost exclusively foreign owned. By 2010, 87 per cent of the banking sector operating in Uganda was foreign owned.

Foreign owned banks have tended to locate their businesses operations mainly in Kampala (the capital city) and in a few major urban areas, which has left rural areas under banked. While Government has taken deliberate policies that would lead to filling the void that foreign banks cannot fill by allowing four tiers in the banking industry, even the other remaining 13 per cent of banks that are locally owned prefer to locate their business operations in urban areas because they have to comply with the central bank rules and regulations, one of which is meeting high asset quality requirement. In the process foreign banks end up making relatively huge profits, which may be their hidden primary objective.

Accordingly, liberalization of the banking sector in Uganda has led to limited competition in the sector. Commercial bank lending interest rates have remained persistently high at between 18 – 20 percent mainly on account of Uganda's policy choice to control inflation and ensure a competitive exchange rate through accumulation of reserves or deliberate intervention in the market. This choice ordinarily leads to a freely market determined interest rates, which in the face of high risky borrowers (or few credible borrowers) and risk-averse behavior of the banks explain the persistence of high commercial bank lending rates in Uganda.

As such, the drive for soundness of the banking sector in Uganda has been achieved at the cost of surrendering the key tenets for which liberalization of the banking sector was fronted i.e. competition, and reduced investment costs. Access to financial services especially in rural areas remains a daunting challenge, with microfinance institutions offering financial services that not only hardly meet the needs of the rural dwellers, but also at very high cost in terms of high nominal interest rates and other transaction costs. Moreover Uganda is rated very low with regard to the cost of doing business, number 112 out of 183 countries (World Bank, 2010).

To strengthen the domestic banking system in Uganda to consolidate its safety and soundness while at the same time expanding its outreach, both the supply side issues of financial service delivery and the demand side issues will need to be addressed simultaneously.

On the supply side, banks particularly commercial banks have difficulties in dealing with clients especially those located in rural areas on whom they have limited information because the cost of obtaining information on them is high. Factors explaining low demand for effective financial services include lack of collateral, risky borrowers, and low economic activities that lead to lack of bankable projects that commercial banks could finance. Where information asymmetry exists, the banks end up dealing with clients on whom they (the banks) have limited information about their behaviours. In such a situation a recommended policy option is to improve the attractiveness of such clients to commercial banks i.e. increase the demand for financial services.

Enhancement of demand for financial services would entail implementation of a comprehensive rural development strategy that focuses on economic empowerment of people in rural areas. The role of the public sector in this regard includes building the requisite rural development economic infrastructure such as transport infrastructure (rural roads), power infrastructure (electricity) which can be used to add value to agricultural products, and telecommunications infrastructure. Other measures would focus on improving factor productivity in rural areas through heavy investment in education, health, rural water and sanitation, agricultural research, and rural technology to promote value addition. Furthermore, to address lack of collateral by rural dwellers, the public sector needs to implement land reform so that rural dwellers are able to obtain titles for their land to use in accessing credit facilities where necessary to improve their productivity. In addition, rural dwellers would need education in financial literacy for effective use of the banking institutions. Enterprises of low income people would also be provided with business development services such as providing simple recording keeping skills, project identification and appraisal skills, etc as well as market information.

However, a capitalist developmental state that has the commitment to improve the wellbeing of its people could opt for the “supply of financial services leading development” model. The model presumes the existence of strong public sector institutions where corruption or abuse of office is punishable, transparency and accountability strong, and the risk of bank failure arising from public mismanagement such as accumulation of non-performing loans zero – all of which are in very short supply in Uganda. Such a model would take into cognizance of the fact that the market mechanism only works well in areas where the private sector is likely to make profits i.e. the urban areas. Provision of financial services in rural areas would therefore have to be undertaken by the public sector mainly as a public good to help lagging areas to improve economically. With requisite effective institutions in place, it is also possible for the public sector to partner with the private sector to provide financial services in rural areas.

This therefore leads to the conclusion that poor access to financial services in rural areas is largely a reflection of poor political governance. Until poor political governance is addressed, we should expect neither state commitment to rural development (to improve the quality of the borrower and make him/her demand financial services) nor building of strong and effective institutions that would make it possible for the supply of financial leading development model to succeed.

With a strong state in place, the supply side policy options for improving access to financial services would be:

1. Give tax holidays to banks which operate far deep in rural areas. At central government level, the following tax categories apply: Income Tax, both personal and business; Value Added Tax (VAT); Customs Duty; Excise Duty; Stamp Duty; and Fees, Fines and other levies. There are also taxes at local governments level. Of the central government taxes, one that is more applicable in this recommendation is income tax on business. It is also called corporate tax or tax on profits. The current rate is 30 percent on businesses registered in Uganda and qualify to pay it. This tax can be waived off for a defined period of time as the banks attract a critical mass of clients with good track records;

2. Subsidize construction of physical banking facilities such as buildings for banks that open branches in more rural areas;
3. The Bank of Uganda should promote outreach of financial institutions through a review of the requirements for branch opening. This can be supplemented by the central bank strengthening its supervision function by recruiting and training more supervisors to provide effective supervision;
4. Promote and develop microfinance institutions which promote viable alternative pro-low income earners' banking systems (not so much relying on traditional collateral such as land titles, for instance, but on other acceptable forms of collateral) while constantly assisting and assessing their viability by independent experts; and
5. Ultimately though, a more long term solution to poor access to financial services lies outside the realm of the banking sector: building of nationhood, effective institutions, and working democracy that would make it possible for both markets and sate institutions to function well. These are in short supply in Uganda and will require addressing them.

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