UGANDAN MICROFINANCE AT CROSSROADS: THE QUEST FOR CORPORATE GOVERNANCE

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1. INTRODUCTION

After two decades of inactivity, governments in Africa have demonstrated new commitment to reforms and a correspondingly enhanced potential for national development. These reforms have targeted governance, decentralization, democratization, and economic liberalization, contributing to the emergence of a competitive private sector.²

In almost all of the 53 African countries, the private sector is dominated by Small and Medium-Sized Enterprises (SMEs). SMEs have been heavily dependent on microcredit, often not made available by the commercial banks that have dominated the economies since independence. In Uganda, the need for credit and other financial services to sustain the SMEs has led to a proliferation of Microfinance Institutions (MFIs). The late 1990s and 2000s have registered an unprecedented amount of growth for the Ugandan Microfinance Industry. There are over 900 MFIs in Uganda mainly operating in the urban and semi-urban areas³. These institutions have affected the population both in a positive and negative way: they have provided ready financial services for all, but they have also cheated the unsuspecting public by taking deposits and paying the executives excessive amounts and/or closing off businesses without paying the depositors.

The MFIs are organisations that provide savings and/or credit facilities to micro and small-scale business people. MFIs provide financial services to people who have experienced difficulties obtaining these services from the most formal financial institutions because of the nature of their businesses, savings levels, and credit needs. Moreover, they lack the appropriate collaterals required by big financial institutions. In 2007, MFIs in Uganda included two banks, several companies limited by shares and a large number of NGOs, companies limited by guarantee,

cooperatives and credit unions. At present, most banks have an MFI arm, which results in an additional reason for the MFIs to straighten up their operations in order to keep afloat in the field. In this search for survival, corporate governance has become an option for MFIs. Corporate governance refers to the way that corporate power is exercised by an organisation in the management of its portfolio of assets and resources, with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its mission.

Corporate governance translates into a balance between economic and social goals, and between individual and collective aims, while encouraging efficient use of resources and higher levels of accountability. This paper is intended to document the initiatives undertaken in Uganda to foster corporate governance over the microfinance industry: capacity building programs, partnerships with development partners, and associations with corporate-governance focused institutions. The paper is divided into three parts. It begins with a section that investigates the need and emergence of corporate governance in Uganda. Secondly, it discusses the code and practices of corporate governance in Ugandan MFIs. Finally, it speculates on possible future challenges and recommends a series of strategies for generating and reinforcing a corporate governance culture in Uganda’s MFIs.

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2. THE NEED AND EMERGENCE OF CORPORATE GOVERNANCE IN UGANDA

Financial systems as a whole continue to evolve and find new ways to meet demands for financial services in emerging markets. The innovative and rapid development of many localized efforts to provide financial services to the poor outside of formal channels has generally anticipated government action through new policies and regulations.\(^5\)

MFIs have therefore devised innovative strategies to keep afloat in the competitive realm of retail lending and deposit-taking operations. The liability structure highlights the primary sources of funding for MFIs: equity, donor funds, concessional and commercial borrowings, members’ savings, wholesale deposits from institutional investors and retail savings from the public. MFIs differ from each other mainly because of their liabilities, rather than their asset types.

It is this liability structure that has forced Ugandan MFIs to pay attention to corporate governance. Donor funds have been declining, contributed equity capital is marginal, there are few wholesale lenders, and deposits from the public are becoming elusive because of some financial scandals in which MFIs took people’s deposits and then went out of business. MFIs have thus been trying to appear good and responsible organisations, highlighting their relevance for the public they committed to serve.

The need for corporate governance cannot be over emphasized in the case of Uganda, like in other African countries. In fact, the drive toward corporate governance has been fuelled by a number of factors. First, there was a wide recognition that corporate governance would contribute to economic success and long-term sustainability. Second, it was recognized that good corporate governance links with and enhances corporate social responsibility, improving company

reputations, which in turn can attract local and foreign investors. Third, corporate governance was also seen as a deterrent to corruption and unethical business practices that scarred Africa’s business image many times in the past. Finally, the market discipline and transparency that can result from corporate governance further drove the quest for good governance in Africa.⁶

A 2002 report produced by the Institute of Directors of South Africa⁷ offered an additional motivation for an inclusive approach, emphasizing the need for a corporate governance model in line with local values and traditions. In this regard, explicit mention is made of the value system that Africans across the continent embrace; the African value system is sometimes referred to as Ubuntu, a concept that translates into a commitment to coexistence, consensus, and consultation.

In conclusion, it would be false to claim that corporate governance is alien to Ugandan society or Africa in general. Indeed, for most African countries, a variety of factors and motivations are consistently pushing for the adoption of an inclusive approach.

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3. CORPORATE GOVERNANCE IN UGANDAN MICROFINANCE INSTITUTIONS

There is a range of reform initiatives being taken in the field of corporate governance in Uganda that bears the potential of positively affecting corporate governance standards in general, with a direct influence on business ethics.

The Association of Microfinance Institutions of Uganda (AMFIU), an umbrella organisation that groups MFIs and service providers, launched an anticorruption initiative calling upon member institutions to exercise integrity, honesty, diligence and due care in carrying out their duties and responsibilities. A series of guidelines are now included in a Code of Conduct, developed and approved by the Association’s members in 2000. This Code guides the operations of all AMFIU members. Over the years, the AMFIU has lobbied for best-practice microfinance operations in Uganda and has constantly carried out visits to aspiring applicants, assessing whether they met the eligibility criteria or not. Indeed, the greatest contribution of AMFIU to the growth of corporate governance in Uganda can be found in its eligibility criteria. In fact, MFIs which are currently not regulated by the Central Bank strive to become members of AMFIU, thus obtaining some credibility and acceptance in the MF community. Some of the key eligibility requirements that best reinforce corporate governance include the following:

- Members must have a valid certificate of incorporation/registration;
- Members must have a clear institutional set-up, both transparent and democratic;
- Members must conduct business with the highest degree of professionalism;
- Members must be in good working relations with local authorities, target communities, other actors in the microfinance industry and other development partners;

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• Members must be willing to be independently audited;
• Members must put their clients /communities at the centre of operations, i.e. clients must have a right to be heard;
• Members must not be involved in any dubious activities that could disgrace the microfinance industry;
• Finally, the owners/managers of aspiring institutions must be persons of high integrity, with a clean criminal record.

Development partners including the German Technical Cooperation (GTZ), the Netherlands Development Organisation (SNV), the Department for International Development (DFID), and the United States Agency for International Development (USAID), have jointly or independently launched various advocacy campaigns within the Ugandan population, all aimed to discourage people from giving presents or tipping MFIs employees for any service they are required or supposed to render. The outcome of these initiatives is a greater awareness of the need for adherence to strong ethical standards, both in the private and public sector.

As for the deposit-taking institutions, Section 4 of the 2003 Microfinance Deposit-taking Institutions (MDIs) Act stipulates a number of provisions aimed at ensuring good corporate governance. Currently there are four MDIs in Uganda: FINCA Uganda Limited, Pride Microfinance Limited, Uganda Microfinance Limited (recently bought by Equity Bank), and Uganda Finance Trust.10 Other MFIs that are good candidates for an MDI transformation include, among others, Brac, Pearl Microfinance, and UGAFODE. Faulu Uganda Ltd, which has been in the field since 1999, recently acquired a license to operate as a credit institution (non-bank financial institution under Tier 2). The Central Bank supervises MDIs and ensures that there is good corporate governance in these institutions. Moreover, the 2004 Financial Institutions Act also advocates for corporate governance and has contributed to streamlining the operations of the regulated financial institutions that have recently started to work in microfinance. However, it must be noted that other MFIs, not yet regulated by the Central Bank, are also integrating good corporate governance.

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governance within their operations, with the final aim of consolidating and strengthening their market position.

As for the education sector, a concerted effort has been made by universities and other institutions to introduce programs on corporate governance, and some of these programs have distinct business ethics components. Moreover, a postgraduate diploma in microfinance was developed and launched in 2004, through a tripartite agreement between AMFIU, Swiss Contact East Africa (a development partner), and Makerere University Business School. MFIs are a major employer for several graduate business students; in addition, various MFIs have organized tailor-made training programmes for their own staff, aimed at raising business ethics and other corporate governance values within their organisation.

Leading finance institutions such as the International Finance Corporation, FINCA International, and Opportunity International have provided wholesale loans and working capital to several MFIs (Uganda Microfinance Limited, FINCA Uganda Limited, Ugafode Limited), using socially responsible and environmentally friendly business practices as a precondition for granting funding, thus helping to generate and strengthen corporate governance. They have also organised trainings and workshops for MFI managers, enhancing their management skills and building a solid corporate governance awareness.

The advent of the New Partnership for Africa’s Development (NEPAD) has also been helping to enhance corporate governance in general and business ethics in particular as an integral part of development. The Institute of Corporate Governance of Uganda (ICGU) was appointed Lead Partner Institute (LPI) in Uganda by the New Partnership for Africa’s Development (NEPAD) for the Corporate Governance Pillar, under the Africa Peer Review Mechanism (APRM). In this role, ICGU developed a country assessment questionnaire on corporate governance and submitted it to the National African Peer Review Commission (NPA). ICGU also assisted with the final harmonization of the reviews that contributed to the Uganda

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12 The ICGU is a company limited by guarantee that was formed to build the capacity of companies to implement corporate governance principles and promote good practices.
Country Assessment Report. Additionally, many chief executives and directors of Ugandan MFIs have participated in training programmes organised by the ICGU. With the support of the Center for International Private Enterprise (CIPE), the ICGU managed a project to train directors and senior managers of public and private enterprises in corporate governance practices. Participating directors received technical assistance in integrating corporate governance standards into their own enterprises. Similarly, the International Law Institute - African Centre for Legal Excellence (ILI-ACLE) has also been organizing related programmes in corporate governance. Finally, the Institute of Chartered Secretaries and Administrators (ICSA Uganda) has also organised continuous professional development (CPD) courses in conjunction with the Uganda Law Society, promoting business ethics and corporate governance more generally.

In summary, it can be expected that all these initiatives will further develop corporate governance, and business ethics will become one of the most prominent elements of it. Indeed, some MFIs such as FINCA and Faulu Uganda are already engaged in several CSR (corporate social responsibility) activities.

4. CONCLUSION

Corporate governance is becoming one of the safest ways to restore public confidence in MFIs. There is no question that corporate governance has a big role in solving the microfinance crisis.

The 2003 MDI Act provides a wonderful opportunity for promoting Corporate Governance in Uganda. The requirements therein for MFIs concerning ownership (ownership structures of private capital), management, financial disclosure, and capital adequacy, help foster prudent management. However, the good laws such as the MDI and FIA are not applicable to the MFIs that are not regulated. This disparity creates a tension between complying with the regulations and the associated costs, because the regulated MFIs do compete with the unregulated MFIs for the same clientele. Moreover, some provisions of the MDI act are so stringent that they deter many competitive MFIs from becoming regulated entities. In fact, the Central Bank should relax some of the MDI requirements, especially the capital requirement, in order to enable as many MFIs as possible to be regulated.

The risk with corporate governance practices such as corporate social responsibility is that they are sometimes seen as cosmetic and time wasting activities. Moreover, the Ugandan national code of corporate governance recommends that the board of directors should ensure that a code of ethics is developed and endorsed. However, experience has shown that boards are not always willing to design and/or adhere to a rigorous code of ethics. As a result, it appears clear that the code should be designed and monitored by an external and independent institution.

The ICGU is not well known, and its activities are limited due to limited funds and poor publication. Most of the corporate governance organisations mentioned in this article have good programmes, but the latter are not adequately publicised as to catch the attention of many MFIs. Additionally, the AMFIU is confronting the challenge of maintaining high standards for the member companies, although it lacks the funding necessary to ensure effective supervision. Finally, the
Government is a strong supporter of microfinance activities because of their role in reducing and eradicating poverty: this is the main reason why government is hesitant to interfere in microfinance operations, and it has often intervened too late and too little.

In conclusion, it is important to stress that without corporate governance, MFIs stand to lose funding from investors, donors, and public trusts, with the possible worst case scenario of business closure. Companies must adhere to the laws and business ethics in order to build and restore public confidence.