



**IFAD**  
**INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT**  
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**REPORT AND RECOMMENDATION OF THE PRESIDENT**

TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE

**REPUBLIC OF UGANDA**

FOR THE

**RURAL FINANCIAL SERVICES PROGRAMME**





## TABLE OF CONTENTS

<b>CURRENCY EQUIVALENTS</b>	<b>iii</b>
<b>WEIGHTS AND MEASURES</b>	<b>iii</b>
<b>ABBREVIATIONS AND ACRONYMS</b>	<b>iii</b>
<b>MAP: UGANDA, SHOWING PREVALENCE OF MICROFINANCE INSTITUTIONS</b>	<b>iv</b>
<b>LOAN SUMMARY</b>	<b>v</b>
<b>PROGRAMME BRIEF</b>	<b>vi</b>
<b>PART I - THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY</b>	<b>1</b>
A. The Economy and Financial Sector	1
B. Lessons Learned from Previous IFAD Experience	3
C. Country Poverty Situation and Eradication Strategy	4
D. Donor Support for Microfinance Development	5
E. Programme Rationale and Strategy	6
<b>PART II - THE PROGRAMME</b>	<b>6</b>
A. Programme Area and Target Group	6
B. Objectives	7
C. Components	7
D. Costs and Financing	9
E. Procurement, Disbursement, Accounts and Audit	12
F. Organization and Management	12
G. Benefits and Justification	13
H. Risks and Responsiveness	13
I. Environmental Impact and Mitigation	14
J. Innovative Features and Linkage to IFAD Corporate Strategy	14
<b>PART III - LEGAL INSTRUMENTS AND AUTHORITY</b>	<b>14</b>
<b>PART IV - RECOMMENDATION</b>	<b>14</b>
<b>ANNEX</b>	
<b>SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES     INCLUDED IN THE NEGOTIATED LOAN AGREEMENT</b>	<b>15</b>



**APPENDIXES**

<b>I.</b>	<b>COUNTRY DATA</b>	<b>1</b>
<b>II.</b>	<b>PREVIOUS IFAD FINANCING TO UGANDA</b>	<b>2</b>
<b>III.</b>	<b>LOGICAL FRAMEWORK</b>	<b>3</b>
<b>IV.</b>	<b>ORGANIZATIONAL ARRANGEMENT</b>	<b>7</b>
<b>V.</b>	<b>FLOW OF FUNDS ARRANGEMENT</b>	<b>8</b>
<b>VI.</b>	<b>FINANCIAL, ECONOMIC AND BENEFICIARY ANALYSES</b>	<b>9</b>
<b>VII.</b>	<b>ELIGIBILITY CRITERIA FOR SOURCING PROGRAMME FUNDS, PERFORMANCE INDICATORS AND FINANCING/IMPLEMENTING ARRANGEMENT</b>	<b>13</b>



## CURRENCY EQUIVALENTS

Currency unit	=	Ugandan shilling (UGX)
USD 1.00	=	(UGX) 1 770 (March 2002)
(UGX) 1.00	=	USD 0.00056

## WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m <sup>2</sup> )	=	10.76 square feet (ft <sup>2</sup> )
1 acre (ac)	=	0.405 ha
1 hectare (ha)	=	2.47 acres

## ABBREVIATIONS AND ACRONYMS

AMFIU	Association of Microfinance Institutions in Uganda
BOU	Bank of Uganda
COSOP	Country Strategic Opportunities Paper
DFD	Development Finance Department (of BOU)
EU	European Union
GTZ	German Agency for Technical Cooperation
HIPC	Heavily Indebted Poor Country
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
MFI	Microfinance Institution
MFPED	Ministry of Finance, Planning and Economic Development
NAADS	National Agricultural Advisory Services Programme
NGO	Non-Governmental Organization
PAU	Programme Administration Unit
PMA	Plan for Modernization of Agriculture
RFSP	Rural Financial Services Programme
SACCO	Savings and Credit Cooperative
UCAP	Uganda Microfinance Capacity-Building
UCSCU	Uganda Cooperative Savings and Credit Union

## GOVERNMENT OF THE REPUBLIC OF UGANDA

### Fiscal Year

1 July - 30 June

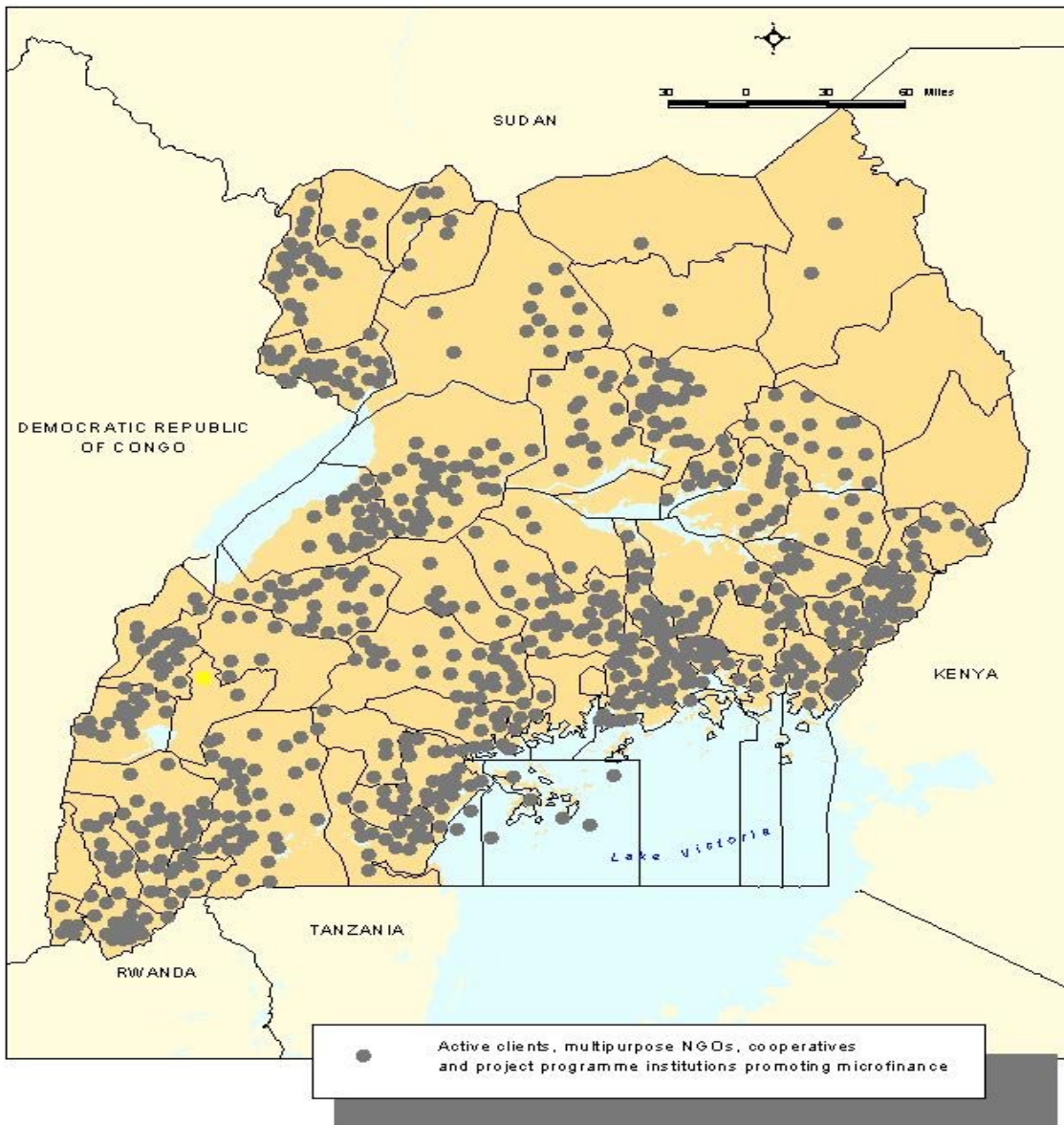


**MAP: UGANDA, SHOWING PREVALENCE OF MICROFINANCE INSTITUTIONS**



**REPUBLIC OF UGANDA**

*Prevalence of Microfinance Institutions  
(as at June 2001)*



Source: IFAD

*The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.*



**REPUBLIC OF UGANDA**  
**RURAL FINANCIAL SERVICES PROGRAMME**  
**LOAN SUMMARY**

<b>INITIATING INSTITUTION:</b>	IFAD
<b>BORROWER:</b>	Republic of Uganda
<b>EXECUTING AGENCY:</b>	Ministry of Finance, Planning and Economic Development (MFPED)
<b>TOTAL PROGRAMME COST:</b>	USD 24.51 million
<b>AMOUNT OF IFAD LOAN:</b>	SDR 13.90 million (equivalent to approximately USD 18.43 million)
<b>TERMS OF IFAD LOAN:</b>	40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum
<b>COFINANCIERS:</b>	None
<b>CONTRIBUTION OF THE BORROWER:</b>	Government: USD 1.10 million Microfinance institutions: USD 4.63 million Beneficiaries: USD 352 827
<b>APPRAISING INSTITUTION:</b>	IFAD
<b>COOPERATING INSTITUTION:</b>	International Development Association (IDA)



## PROGRAMME BRIEF

**Who are the beneficiaries?** Because the programme is essentially aimed at institutional development, direct beneficiaries will include active microfinance institutions (MFIs), MFI apex organizations, MFI capacity-building and related training institutions, as well as commercial banks and other providers of rural financial services. Beneficiaries will comprise any type of rural finance agency that meets stipulated eligibility criteria and serves the rural poor, including especially rural women. Specific to the component on the promotion of a rural business culture, direct beneficiaries will include the poorest sections of the rural population – active men and women largely illiterate and involved in subsistence farming.

**Why are they poor?** Microfinance is relatively underdeveloped in Uganda; thus there are areas of ‘gaps’ that limit the industry in playing the critical role expected of the subsector in catalysing household income increases, improving food security and alleviating poverty. Among the key gaps to be addressed under the programme are: inadequate number and capacity of training organizations; limited types of financial products; weak apex organization; and the difficulty of bringing men and women subsistence farmers/microentrepreneurs into the mainstream economy because of low literacy; lack of trust, understanding and a common language; and lack of a business culture. The country is severely underbanked, with only about 10% of the rural population and 5% of the rural poor having access to financial services in terms of savings and credit.

**What will the programme do for them?** Taking into consideration ongoing and planned activities in the microfinance industry in Uganda and available resources, the programme will support and complement the effort of the Government and the donor community to create an extensive, strong rural finance system. The goal is to offer rural poor populations the opportunity for higher, more stable income, thus alleviating poverty. The programme will fill gaps existing in the country’s microfinance subsector, facilitate expansion of sustainable financial services and extend services to areas that have been poorly served. Activities will be implemented over seven years in four components: (a) expanding the outreach and services of the rural finance system (involving the promotion of product innovations and rural area penetration); (b) building the capacity of rural MFIs and clients (by strengthening of the training and business-development service market, MFI capacity-building and promotion of a rural business culture); (c) strengthening and upgrading the rural finance system (through support to key microfinance apex/umbrella institutions and MFI upgrading); and (d) supporting programme administration, monitoring and evaluation. With respect to the promotion of a rural business culture, the programme will support smallholders and entrepreneurs in moving from subsistence farming/enterprises to the level of operating within the market economy.

**How will the beneficiaries participate in the programme?** Because of the demand-driven approach to be used in implementing programme activities, under the promotion of a rural business culture beneficiary smallholders and rural residents will formulate their detailed plans and activities. Under the other sub-components, MFIs will develop their own proposals as a basis for their applications to source programme funds, satisfying the stipulated criteria and conditions. A publicity campaign will ensure that potential MFIs, communities and other beneficiaries are aware of the opportunities offered by the programme, as well as the ways in which they can participate.





**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD  
TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE  
REPUBLIC OF UGANDA  
FOR THE  
RURAL FINANCIAL SERVICES PROGRAMME**

I submit the following Report and Recommendation on a proposed loan to the Republic of Uganda for SDR 13.90 million (equivalent to approximately USD 18.43 million) on highly concessional terms to help finance the Rural Financial Services Programme. The loan will have a term of 40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum. It will be administered by the International Development Association (IDA) as IFAD's cooperating institution.

**PART I - THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY**

**A. The Economy and Financial Sector**

**Introduction**

1. Uganda is a landlocked country with a surface area of 241 000 km<sup>2</sup>, 15% of which is covered by freshwater lakes and rivers (Map and Appendix I). Located on the Equator at an altitude of 1 000-2 000 metres, the country enjoys generally favourable soil and climatic conditions for agriculture. By current estimates the population is approximately 22 million, with an expected annual growth rate of 3.1% for the period 1998-2015. About 85% of the population lives in rural areas and is young, with 47% of the total population below 15 years of age. The Government of Uganda regards the development of smallholder agriculture and the rural sector as crucial to achieving rapid economic growth and eradicating poverty in the country.

2. In the Plan for Modernization of Agriculture (PMA) approved in September 2000, the Government acknowledged the critical importance of rural finance and the microfinance industry in increasing the incomes of farms and other rural enterprises while also guaranteeing food security. In developing the PMA, the Government identified 13 key thematic areas in which efforts to reduce poverty and improve food security need to concentrate. These include: private-sector participation in development initiatives; institutional reform and support; agricultural research and technology development; dissemination of technology and advisory services; agro-processing and marketing; and rural financial services. As clearly demonstrated in the PMA and various planning and policy documents<sup>1</sup>, and in recognition of the critical role of rural finance and the microfinance industry, the Government is committed to supporting and promoting the growth of a robust rural finance system throughout the country, in collaboration with the financing and development community. Through the Rural Financial Services Programme (RFSP), IFAD will augment the ongoing development efforts in Uganda's microfinance industry.

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<sup>1</sup> Documents reflecting the Government's policy/strategy for the microfinance industry include: Plan for Modernization of Agriculture, Poverty Eradication Action Plan, Financial Institutions Statute, Microfinance Deposit-Taking Institutions Bill, Medium-Term Competitiveness Strategy for the Private Sector, Expanding the Outreach of Sustainable Microfinance in Uganda and Uganda Microfinance Capacity-Building Framework.



## Macroeconomic Framework

3. Over the past 15 years, the Government has made policy choices creating an environment conducive to the sustainable development of the country. Starting with the Economic Recovery Programme in 1987, it has successfully undertaken governance, trade and structural reforms. These have included decentralization and democratization of the country's political, financial, planning, governance and administrative framework, and have involved: substantial devolution of responsibilities from central to local government levels; rationalization and restructuring of the civil service; liberalization of input and output markets in terms of decontrolling prices; lifting of restrictions on foreign exchange; streamlining of investment and tax incentives and better enforcement of tax collection; promotion of private-sector participation in the development process; divestiture of public enterprises; and containment of public spending through budget discipline and a strict medium-term cash budget regime.

4. The performance of the economy has been impressive as a result of these policy reforms. However, the Government still faces major challenges on the economic front: very low domestic savings rates, varying annually from 2.0 to 4.0% of the gross domestic product (GDP); very low human development indicators on literacy, education and health; an inequitable distribution of the benefits of economic growth and poverty reduction between rural and urban areas; a major security concern in some of the border districts; and declining world market prices for the country's major export, coffee.

## Country Strategic Framework for Rural Finance

5. **Sectoral context.** The rural financial sector is largely underdeveloped, fragmented and not adequately integrated into the formal financial sector. Uganda is one of the most severely underbanked countries in Africa, with most of the currency circulating outside the banking system, thus limiting the rate of investment and employment creation, particularly in rural areas. Consequently, the Government's thinking in this sector centres on developing a policy/strategy that will enable Uganda to: (a) facilitate the emergence of a commercially viable, transparent and diversified finance system in rural areas and link this system increasingly with the formal financial sector; (b) focus on defining the Government's catalytic role in the creation of an enabling environment for the development and expansion of sustainable rural financial institutions; (c) enhance cooperation and synergy among financing/donor agencies and associated development partners; and (d) strengthen a national forum in which representatives of microfinance institutions (MFIs), the Government, non-governmental organizations (NGOs) and other stakeholders meet regularly to address issues related to the development and promotion of rural financial services.

6. **Lessons from past initiatives.** A compelling reason for an entirely new approach to making financial services available to rural smallholders is the failure of and dissatisfaction with past attempts, in particular approaches initiated and implemented directly by the Government. In each of the four decades 1960-2000, there were major attempts to reach Uganda's rural poor with credit lines, but these had no sustainable impact: the Savings and Credit Bank Scheme (the forerunner of the Uganda Commercial Bank, later relocated in the now defunct Cooperative Bank Limited); the Cooperative Credit Scheme; the Group Farm Scheme; the Rural Farmers Scheme; *Entandikwa*<sup>2</sup>; and the Youth Entrepreneur Scheme. These rural finance schemes emerged in a relatively ad hoc manner, with multiple external agencies utilizing diverse methodologies and sponsoring a broad spectrum of microfinance activities. In addition, the schemes were often politically motivated, had a large grant element, were not linked to savings mobilization and broadly lacked linkages with the wider network

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<sup>2</sup> *Entandikwa* was a kick-start fund set up by the Government in 1996 to provide direct government loans to economically active poor men and women within the electoral area of each member of Parliament. In September 2001, the Uganda Microfinance Forum presented a plan to President Museveni to discontinue the scheme, and a Cabinet decision was being awaited at the time of RFSP appraisal in March 2002.



of the financial sector. Consequently, the Government has recently reviewed its rural credit policy and adopted a strategy that directs the public sector to divest from direct delivery of credit. The role of the public sector will henceforth focus on creating and maintaining an enabling environment in which MFIs can operate freely and optimally.

### **Status of Microfinance Development**

7. Uganda's *financial sector* comprises the central bank (Bank of Uganda, BOU), 17 commercial banks, six credit institutions, the Postbank, two development banks, the National Social Security Fund, the Uganda Securities Exchange, about 76 licensed foreign exchange bureaux, as well as a fairly diversified microfinance industry. Commercial banks and formal credit institutions focus primarily on urban operations.

8. BOU classifies the institutions that undertake microfinance into four tiers: Tier-1 banks; Tier-2 credit institutions; Tier-3 deposit-taking MFIs, which are allowed to take deposits subject to stipulated capitalization and other requirements; and Tier-4 semi-formal MFIs of two types: (a) credit-only institutions that are not allowed to take deposits; and (b) small member- and community-based organizations/groups mobilizing member subscriptions. According to the current proposal, Tier-4 institutions will not be regulated by the new microfinance bill, nor supervised by BOU.

9. For practical and presentational purposes, the *microfinance subsector* is commonly divided into four main categories: (a) entities that hold a commercial banking license and are included in the formal financial sector; (b) about 90 larger, specialized and relatively well-established MFIs consisting mostly of local and international NGOs; (c) about 700-1 000 smaller, multisector NGO-created or member-based organizations at the community level; and (d) three apex/umbrella institutions: one for the microfinance subsector in general (Association of Microfinance Institutions in Uganda, AMFIU), one for credit unions (Uganda Cooperative Savings and Credit Union, UCSCU), and one for savings and credit cooperatives or SACCOs (Uganda Cooperative Alliance).

10. The Government has been instrumental in establishing the *Uganda Microfinance Forum* and its PMA/Microfinance Forum Subcommittee on Rural Financial Services as an effective institutional framework for promoting private-sector and donor efforts in strengthening the microfinance subsector. The forum has recently produced two far-sighted plans that provide an excellent basis for the development of the country's microfinance industry: Expanding the Outreach of Sustainable Microfinance in Uganda and the Uganda Microfinance Capacity-Building (UCAP) framework.

11. *Gender focus.* The microfinance industry represents an example of a trend in the position of women in Ugandan society. Most major MFIs in rural Uganda have either a specific gender focus or a large percentage of women clients. This development is not only related to the attention given to women by promoters of rural microfinance, but also to the fact that women have proved to be worthy customers (especially in terms of short-term loans for quick-turnover enterprises), as well as potential talent for the organization of rural groups. As a direct result of MFI activities in rural areas, an increasing number of women are assuming managerial and staff positions in financial services institutions.

### **B. Lessons Learned from Previous IFAD Experience**

12. The IFAD Country Strategic Opportunities Paper (COSOP) for Uganda (1998) set out a framework for continuing collaboration with the Government, governed by four strategic thrusts: (a) the promotion of strong civil-society organizations and community-based development in order to integrate rural and smallholder producers into the national economy and enable them to operate increasingly as partners of the organized private sector; (b) improved smallholder agricultural production and entry into the cash economy in order to raise family incomes and enable smallholders



to exploit new opportunities for agricultural exports and import substitution; (c) increased capitalization at farm and household levels through availability of and access to rural financial services, especially to generate new income for the adoption of improved agricultural technologies and production techniques; and (d) targeted public-sector support to strengthen and deepen the decentralization, planning, coordination and implementation of development programmes.

13. Of the 12 IFAD investment interventions since 1982, eight were designed to include rural finance activities: provision of credit through revolving funds, mobilization of savings, strengthening of beneficiary organizations, and MFI training and other capacity-building interventions. Several valuable lessons have been learned, especially regarding the limitation of delivery mechanisms and access to credit by smallholders. Commercial banks have proved to be slow, lacklustre intermediaries for lines of credit to smallholder farmers. In contrast, non-bank microfinance intermediaries have been relatively more successful in getting funds down to the intended communities and in obtaining generally satisfactory recovery rates. However, administrative costs for delivery institutions, which are often new, have invariably been high.

### **C. Country Poverty Situation and Eradication Strategy**

14. Poverty is pervasive throughout Uganda, even though the country is one of the few in sub-Saharan Africa in which poverty has declined in terms of income, with the population below the poverty line decreasing from 56% in 1992 to 35% in 2000. The annual per capita income is USD 310, but income inequality appears to be increasing, as demonstrated by a rise in the Gini coefficient<sup>3</sup> from 0.33 in 1993 to 0.39 in 1998. This observation is supported by a 1999 participatory poverty assessment by the United Nations Development Programme (UNDP) that suggests that the benefits of the country's impressive economic performance have not been widely shared to improve living standards for all<sup>4</sup>.

15. Principal factors associated with people afflicted by poverty include their location, gender and livelihood, as well as the seasonality of agricultural production. While 48% of the rural population lives below the poverty line, the figure for urban areas is only 16%. There are also substantial regional differences. Similarly, the rate of decline of poverty in terms of income since 1992 has been much higher in urban (43%) than in rural areas (18%). The threat of HIV/AIDS remains paramount throughout the country. Although the adult prevalence rate has dropped remarkably, from 30% in 1986 to 8.4% in 2002, the epidemic still results – in addition to the loss of life – in loss of time and resources by many families caring for the sick and children orphaned by the disease. Although there is no clear segregation of available data, more women than men appear to be in poverty. The literacy level of women is presently estimated at 51%, compared to 77% for men. Although women constitute 47% of the labour force and are responsible for 80% of food production, they are more vulnerable to poverty because they have limited economic opportunities.

16. The Poverty-Eradication Action Plan (PEAP) is the Government's strategic framework for poverty reduction in Uganda. The four pillars of the PEAP include: rapid economic growth and structural transformation; good governance and security; increased ability of the poor to raise their incomes; and enhanced quality of life. The Poverty Action Fund (PAF) was established with savings from the debt relief to Heavily Indebted Poor Countries (HIPC) granted by various financing

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<sup>3</sup> The Gini coefficient expresses income equality in society by measuring the extent to which actual incomes fall short of a totally egalitarian income distribution. In practice, coefficients vary from 0.20 for societies with a relatively even income distribution to 0.45 for highly unequal societies.

<sup>4</sup> The poor define 'poverty' to include, beyond income, "a feeling of powerlessness to influence the things around". A recent workshop in Uganda has suggested that the measurement of poverty levels needs to include such indicators as food deficiency, limited land available for families, poor access to services (including health care), social and physical isolation, and insecurity.

agencies, including IFAD<sup>5</sup>. Interested donor countries make contributions to the fund for poverty eradication interventions, and PAF in turn channels funds directly to poverty-reducing services such as basic education, water supply and health. The Ministry of Finance, Planning and Economic Development (MFPED) has developed principles for the coordination of contributions by financing/donor agencies. The poverty-eradication strategy emerging from the PEAP and PAF directs that the following actions be taken to improve the country's poverty situation: (a) empowering the poor by increasing their access to productive assets, making financial services and information more broadly available; (b) providing improved physical and social infrastructure; (c) promoting good governance and making government institutions work better for the rural poor; (d) promoting widely shared growth; and (e) facilitating stakeholder participation in planning and implementation.

#### **D. Donor Support for Microfinance Development**

17. During the last decade, several multilateral and bilateral agencies have provided assistance to Uganda's MFIs and the apex/umbrella organizations serving them. Table 1 summarizes the involvement of the different agencies in intervention areas whose 'gaps' RFSP is intended to fill. In addition, the World Bank has provided valuable support to policy dialogue on rural finance.

**Table 1: Involvement of Local/External Agencies in Intervention Areas for RFSP Support**

<b>Intervention Area</b>	<b>Local</b>	<b>External</b>
Rural area penetration	DFD/BOU; MFPED Microfinance Forum (Plan for expanding outreach)	DANIDA; EU; USAID; The Netherlands Government; GTZ; AfDB
Strengthening the training market and MFI capacity-building	Microfinance Competence Centre/ Uganda Institute of Bankers; RMSP; BOU	EU; DFID; DANIDA; GTZ; USAID; The Netherlands Government; AfDB; World Bank
Promotion of product innovations	Several MFIs (supported by FINCA)	MicroSave-Africa; DFID; GTZ; EU; DANIDA; Austrian Government
MFI upgrading scheme	BOU (Supervision Department)	DANIDA; NORAD; EU; Tridos Bank; Stromme Foundation (Norway)
Support to apex structures	Microfinance Forum (UCAP framework) MFPED; BOU	EU; USAID; DFID; GTZ; DANIDA; Austrian Government; CIDA; SIDA
Promotion of a rural business culture	PMA; NAADS; USSIA; UNFA	None

**Note:**

AfDB	= African Development Bank	NAADS	= National Agricultural Advisory Services Programme
CIDA	= Canadian International Development Agency	NORAD	= Norwegian Development Agency
DANIDA	= Danish International Development Assistance	RMSP	= Rural Microfinance Support Project
DFD	= Development Finance Department (of BOU)	SIDA	= Swedish International Development Agency
DFID	= Department for International Development (United Kingdom)	UNFA	= Uganda National Farmers Association
EU	= European Union	USAID	= United States Agency for International Development
FINCA	= Foundation for International and Community Assistance	USSIA	= Uganda Small Scale Industries Association
GTZ	= German Agency for Technical Cooperation		

<sup>5</sup> IFAD's debt relief to Uganda under the Debt Initiative for HIPCs totals SDR 12 773 851 in net present value on amounts outstanding on loans approved as of 30 June 1999.



## **E. Programme Rationale and Strategy**

18. The Government has been able to engage several multilateral and bilateral agencies and development programmes to support promotion of MFIs and the development of policies conducive to their growth. Uganda should soon have modern legislation<sup>6</sup> to cover a substantial portion of MFIs. The Microfinance Forum, established as an oversight body, has developed a plan to expand the outreach of MFIs and initiate extensive capacity-building. Just as important, the number of MFIs has increased rapidly over the past six to seven years. Despite the impressive performance, however, much needs to be done to extend financial services to the majority of the rural population. Only about 10% of rural residents have access to financial services. Among areas of activity gaps are an inadequate number and capacity of training organizations, limited types of financial products, and the provision of few and inadequate services by apex/umbrella organizations.

19. RFSP will support and complement efforts to develop the microfinance industry by: (a) making a relatively long-term commitment – providing substantial funds to augment existing initiatives just as the appropriate policy and institutional arrangements are falling into place; (b) facilitating a vigorous drive for MFI activities in rural areas; and (c) providing IFAD's accumulated, global experience and know-how in rural and agricultural development. The programme design is consistent with IFAD's COSOP for Uganda, the *Strategic Framework for IFAD 2002-2006*, the Regional Strategy Paper for Eastern and Southern Africa, and the Policy on Rural Finance. It will be implemented within the framework of the policies and guidelines established for the microfinance industry, notably the Expanding the Outreach of Sustainable Microfinance in Uganda and the UCAP framework.

20. The RFSP design also recognizes the risks to smallholder families and the rural economy at large associated with a high prevalence rate of HIV/AIDS. On the part of HIV/AIDS-affected clients, the risks include potential default on loan repayment, interruption of savings and borrowing, and early withdrawal of savings. The risks faced by MFIs operating in high-HIV-prevalence areas include increased costs due to provisions for loan losses and benefits to their staff. A three-pronged response will address such risks in the context of the appropriate programme sub-components through: (a) training and capacity-building to make MFIs more knowledgeable about HIV/AIDS and its impact on clients and, hence, the MFIs themselves, as well as about emerging best practices for mitigation in the microfinance industry; (b) development and testing of new loan products, establishment of better performance-monitoring systems, and partnerships with more specialized agencies for HIV/AIDS mitigation; and (c) creation of awareness among clients about HIV/AIDS prevention and facilitation of access to organizations that provide services for mitigation of the effects.

## **PART II - THE PROGRAMME**

### **A. Programme Area and Target Group**

21. RFSP aims essentially at institution-building and is national in scope. The programme has no line of credit for on-lending to rural residents and no sub-component or activity that will directly affect individuals – except as relates to the promotion of a rural business culture. The programme addresses the needs of economically active poor men and women throughout rural areas, who are the main target group of Tier-4 MFIs in every region and district of Uganda. Programme activities will mostly target MFIs, MFI apex/umbrella organizations, MFI capacity-building and related training agencies, and commercial banks and other providers of rural financial services. Beneficiaries will comprise any type of rural finance agency that meets the stipulated eligibility criteria and serves the rural poor. However, since programme activities will ultimately benefit the clients of the microfinance

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<sup>6</sup> The Financial Institutions Statute and Microfinance Deposit-Taking Institutions Bill, under review by the Cabinet and Parliament at the time of RFSP appraisal in March 2002.



industry, there is also a need to target the rural poor particularly. Specific to the sub-component on the promotion of a rural business culture, direct beneficiaries will include the poorest sections of the rural population, active men and women that are largely illiterate and involved in subsistence agriculture.

## B. Objectives

22. The programme aims to create a healthy and extensive rural finance system that will offer rural populations the opportunity for higher and more stable income, thus alleviating poverty. More specifically, the programme will: (a) fill existing gaps in the support currently available to the microfinance subsector in order to enhance the quality of rural financial services and render them viable, with a high portfolio quality; (b) facilitate expansion of sustainable financial services to reach substantially more of the country's rural population; (c) extend financial services to areas that have been poorly served; and (d) help potential clients of rural MFIs become increasingly business-oriented. The programme objectives and performance targets are detailed in the Logical Framework (Appendix III).

## C. Components

23. The programme will be implemented over a seven-year period in four main components, with closely linked sub-components/activities.

### Expanding the Outreach and Services of the Rural Finance System

24. This component is intended to expand the outreach of financial services to rural areas for the ultimate benefit of poor men and women. It will support the development and pilot-testing of services and financial products particularly appropriate to low-income clients living in rural environments, as well as penetration into rural areas to increase the presence of MFIs and financial services.

25. **Promotion of product innovations.** Although MFIs have access to two externally-based funds that support relatively large-scale pilot activities, support targeted specifically at rural and agricultural innovations in the microfinance subsector remains largely inadequate. RFSP will facilitate the establishment of and contribute to a Rural Innovative Services Fund<sup>7</sup> that will operate on a matching grant basis. The programme will finance studies, development and testing of financial products, as well as their delivery/promotion mechanisms. It will enable financial institutions to develop, pilot-test and promote products that are innovative, rurally oriented, sustainable and responsive to the demands of rural populations. Products addressing agricultural financing and HIV/AIDS-related needs and mitigation will receive particular attention.

26. **Rural area penetration.** The programme will establish a Rural Area Penetration Fund to provide matching grants to motivate and accelerate the establishment of new microfinance outlets in rural areas, as well as to start rural finance operations in bank branches. Programme resources will be used to establish community-based MFIs; set up new rural MFI branches; rehabilitate promising, older rural finance establishments that have declined in the recent economic turmoil; establish small rural sub-branches of formal financial institutions; and support the introduction of agricultural finance schemes into operational branches of formal banks.

### Building the Capacity of Rural MFIs and Clients

27. The capacity-building component will provide a framework and financial support to vastly expand operational capacity among MFIs; develop and strengthen a network of operationally and

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<sup>7</sup> In principle, all 'funds' under RFSP will be established anew and managed separately, except where a similar arrangement already exists and is operating satisfactorily – in which case the RFSP fund will be contributed to the existing fund, provided its terms and conditions are acceptable to the Government and to IFAD.



financially independent providers of rural finance training, business development services and local advisors; and develop a more knowledgeable clientele for MFIs.

28. **Strengthening the training market.** Providers of training for Uganda's fast-growing microfinance subsector are in short supply, and only a few of the available training providers in the market are oriented towards meeting the specific needs of rural financial institutions and clientele. Thus RFSP will provide matching grants under a Training Market Fund established for the benefit of selected local training service providers in order to develop training products appropriate to smaller, rural microfinance operators. This fund will partially cover development costs of approved training courses/packages, and related costs of training-of-trainers. To encourage the move towards a more market-based approach in the provision of training and business development services, the amount of the matching grant will decrease each time a firm reapplies for product development support. The UCAP framework for managing matching grants<sup>8</sup> will be the preferred arrangement through which the RFSP Training Market Fund also will be managed.

29. **MFI capacity-building.** A majority of MFIs are not in a position to procure capacity-building services at market rates. This is particularly the case with the smaller, rurally-based MFIs that generally have fewer financial resources for capacity-building activities than the more established, urban-based institutions. Consequently, an MFI Capacity-Building Fund will be established from which matching grants will be provided to support the capacity-building activities of MFIs with a rural orientation. This fund will partially cover costs of training courses in appropriate microfinance-related disciplines; local technical assistance and consulting services; exchange and exposure visits; manual and software development; and basic equipment linked to capacity improvement. Workshops will be financed, involving representatives of the microfinance industry and service providers, as well as an independent assessment of the fund performance and its impact. Specific to training, the proposals could cover a single training event, or a comprehensive set of capacity-building interventions covering a maximum period of 12 months. The preferred implementation arrangement will be through the UCAP framework.

30. **Promotion of a rural business culture.** A Business Culture Fund will be established to give rural business-culture service providers access to resources, mostly on a grant basis, to implement activities that will enhance business orientation among rural populations. Activities will include: training in functional literacy and numeracy, community mobilization, and technical and business skills; sensitization to the importance of savings and instruction in the formation of savings groups; orientation and review workshops for service providers, orientation and training of financial extension workers<sup>9</sup>; preparation and broadcast of radio programmes (especially on HIV/AIDS and other health-related awareness and prevention/mitigation topics); and organization of farmer exchange visits.

## **Strengthening and Upgrading the Rural Finance System**

31. This component is designed to develop systems and institutional structures that strengthen the microfinance industry and raise well-performing MFIs to higher tiers, capable of providing more and improved services. This will be achieved by improving the ability of the MFI apex/umbrella organizations to promote the establishment of new units, developing systems for measuring performance and avoiding losses, and strengthening the capital base of larger MFIs aspiring to become deposit-taking institutions.

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<sup>8</sup> The UCAP framework includes a proposal for the establishment of a multidonor 'fund', the Matching Capacity-Building Grant Facility, to provide matching grants to local service providers for institutional/beneficiary capacity-building and training and the development of training products directed at Uganda's MFIs.

<sup>9</sup> Recruited and financed under the Microfinance Forum outreach plan and NAADS.





32. **Support to apex structures.** The programme will support AMFIU, UCSCU and the Uganda Cooperative Alliance to enable them to provide more and improved services to their MFI members, as well as to promote healthy expansion of the MFI industry. As the Government does not plan to supervise Tier-4 institutions, the MFI industry needs to be assisted in developing systems of internal regulation for its members, as well as in setting standards for their performance monitoring. Technical assistance and financial support will also be provided to strengthen the monitoring, information and publicity services in these organizations. They will be supported in developing and offering income-generating services. To help monitor performance of Tier-4 institutions, the sub-component will partially finance the development of an audit and inspection service for cooperatives and MFIs, and assist in the establishment of one or two cooperative/MFI audit companies and the provision of training to private-sector audit firms. In addition, the programme will finance the training of MFI staff and trustees in internal auditing and facilitate operation of a forthcoming MFI performance-monitoring system (whose development is being assisted by EU-SUFFICE (Support for Feasible Financial Institutions and Capacity-Building) and GTZ). In the specific case of AMFIU, the programme will provide partial support to its core staff from Programme Year (PY) 3 onwards (following the expiration of ongoing Netherlands support). AMFIU's coordination functions and the expansion of its publicity efforts will also be supported.

33. **MFI upgrading scheme.** Many MFIs aspire to regulated status, which allows the intermediation of savings. In order to qualify, they need to mobilize incremental capital (in order to meet the stipulated paid-up capital requirements) and to improve their management systems, physical structures and activities. In addition, some financial institutions maintain that the injection of external equity is necessary if the 'culture' of their boards is to be reoriented to a mix of sound commercial enterprise and social/development interests. Consequently, the programme will make grants of up to 20% of the total paid-up share capital to meet the costs of upgrading an MFI from Tier-4 to Tier-3, or Tier-3 to Tier-2. The matching grants will be made either directly to eligible MFIs or indirectly (in the case of MFIs that require new shareholders to hold equity and/or that wish to gradually commercialize their board orientation) to entities representing the interests of MFI clients, for investment in the eligible MFIs.

### **Programme Administration, Monitoring and Evaluation**

34. A small, lean but effective Programme Administration Unit (PAU) will be based in MFPED to handle programme funds, monitor sub-component activities and evaluate programme impact – while allowing existing agencies involved in MFI promotion to implement programme sub-components/activities. The programme will finance all incremental PAU costs, except those for office space and staff assigned to the unit by the Government. It will finance training, workshops, transport, equipment and operating expenses. PAU will create awareness, among MFIs, apex organizations and potential rural clients, of the facilities and opportunities available under the programme. Provision has been made for an internationally recruited programme facilitator for a 12-month period to help with the timely organization and start-up of activities. Funds have also been included for the conduct of a baseline study, a mid-term review and impact evaluations.

### **D. Costs and Financing**

35. Total programme costs, including price and physical contingencies, are estimated at USD 24.51 million. About 13% of this amount (USD 3.1 million) represents foreign exchange costs. The total baseline cost is USD 22.3 million, while price and physical contingencies account for USD 2.2 million (10% of baseline cost) (Table 2). Duties and taxes make up 4.1% (USD 1.0 million) of total programme costs. The programme will be financed by IFAD (USD 18.43 million), the Government (USD 1.10 million), MFIs (USD 4.63 million) and beneficiaries (USD 352 827) (Table 3).

**Table 2: Programme Cost Summary by Components <sup>a</sup>**  
**(USD)**

<b>Components/Sub-Components</b>	<b>Local</b>	<b>Foreign</b>	<b>Total</b>	<b>% Foreign Exchange</b>	<b>% Base Costs</b>
<b>A.</b> Expanding the outreach and services of the rural finance System					
-Promotion of product innovations	1 772 668	58 732	1 831 400	3	8
-Rural area penetration	4 417 000	23 000	4 440 000	1	20
<b>Subtotal</b>	<b>6 189 668</b>	<b>81 732</b>	<b>6 271 400</b>	<b>1</b>	<b>28</b>
<b>B.</b> Building the capacity of rural MFIs and clients					
-Strengthening the training market	494 375	1 500	495 875	-	2
-MFI capacity-building	4 882 000	29 000	4 911 000	1	22
-Promotion of a rural business culture	2 120 438	1 910 438	4 030 875	47	18
<b>Subtotal</b>	<b>7 496 813</b>	<b>1 940 938</b>	<b>9 437 750</b>	<b>21</b>	<b>42</b>
<b>C.</b> Strengthening and upgrading the rural finance system					
-Support to apex structures	2 271 500	267 000	2 538 500	11	11
-MFI upgrading scheme	2 570 124	67 276	2 637 400	3	12
<b>Subtotal</b>	<b>4 841 624</b>	<b>334 276</b>	<b>5 175 900</b>	<b>6</b>	<b>23</b>
<b>D.</b> Programme administration, monitoring and evaluation	<b>1 030 781</b>	<b>356 012</b>	<b>1 386 793</b>	<b>26</b>	<b>6</b>
<b>Total base cost</b>	<b>19 558 885</b>	<b>2 712 958</b>	<b>22 271 843</b>	<b>12</b>	<b>100</b>
Physical contingencies	124 783	130 848	255 631	51	1
Price contingencies	1 736 066	244 593	1 980 659	12	9
<b>Total programme costs</b>	<b>21 419 734</b>	<b>3 088 398</b>	<b>24 508 133</b>	<b>13</b>	<b>110</b>

<sup>a</sup> Discrepancies in totals are due to rounding.

**Table 3: Financing Plan <sup>a</sup>**  
**(USD)**

Components/Sub-Components	Government		IFAD		Microfinance Institutions		Beneficiaries		Total		For. Exch	Local (Excl. Taxes)	Duties and Taxes
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%			
<b>A.</b> Expanding the outreach and services of the rural finance system													
Promotion of product innovations	18 943	1.0	1 790 687	90.0	179 863	9.0	-	-	1 989 493	8.1	66 802	1 903 748	18 943
Rural area penetration	8 925	0.2	3 029 949	61.7	1 869 874	38.1	-	-	4 908 748	20.0	26 251	4 873 572	8 925
<b>Subtotal</b>	<b>27 868</b>	<b>0.4</b>	<b>4 820 636</b>	<b>69.9</b>	<b>2 049 736</b>	<b>29.7</b>	<b>-</b>	<b>-</b>	<b>6 898 240</b>	<b>28.1</b>	<b>93 053</b>	<b>6 777 319</b>	<b>27 868</b>
<b>B.</b> Building the capacity of rural MFIs and clients													
Strengthening the training market	556	0.1	410 746	76.8	123 274	23.1	-	-	534 577	2.2	1 635	532 386	556
MFI capacity-building	11 262	0.2	4 069 295	76.0	1 276 970	23.8	-	-	5 357 527	21.9	33 122	5 313 143	11 262
Promotion of a rural business culture	742 215	16.2	3 500 182	76.2	-	-	352 827	7.7	4 595 224	18.7	2 182 985	1 670 024	742 215
<b>Subtotal</b>	<b>754 033</b>	<b>7.2</b>	<b>7 980 224</b>	<b>76.1</b>	<b>1 400 244</b>	<b>13.4</b>	<b>352 827</b>	<b>3.4</b>	<b>10 487 328</b>	<b>42.8</b>	<b>2 217 743</b>	<b>7 515 552</b>	<b>754 033</b>
<b>C.</b> Strengthening and upgrading the rural finance system													
Support to apex structures	63 472	2.3	2 168 888	78.3	537 807	19.4	-	-	2 770 166	11.3	295 885	2 410 809	63 472
MFI upgrading scheme	19 890	0.7	2 159 030	76.6	638 579	22.7	-	-	2 817 499	11.5	76 404	2 721 204	19 890
<b>Subtotal</b>	<b>83 362</b>	<b>1.5</b>	<b>4 327 917</b>	<b>77.5</b>	<b>1 176 386</b>	<b>21.1</b>	<b>-</b>	<b>-</b>	<b>5 587 665</b>	<b>22.8</b>	<b>372 290</b>	<b>5 132 014</b>	<b>83 362</b>
<b>D.</b> Programme administration, monitoring and evaluation	234 924	15.3	1 299 976	84.7	-	-	-	-	1 534 900	6.3	405 313	994 559	135 027
<b>Total disbursement</b>	<b>1 100 187</b>	<b>4.5</b>	<b>18 428 752</b>	<b>75.2</b>	<b>4 626 367</b>	<b>18.9</b>	<b>352 827</b>	<b>1.4</b>	<b>24 508 133</b>	<b>100.0</b>	<b>3 088 398</b>	<b>20 419 445</b>	<b>1 000 290</b>

<sup>a</sup> Discrepancies in totals are due to rounding.





### **E. Procurement, Disbursement, Accounts and Audit**

36. The procurement of goods and services will be in accordance with government procedures to the extent that they are compatible with the current procurement guidelines of IFAD. Hiring of consultants will be in accordance with the Government's procedures, to the extent that they are consistent with the procedures of and approved by the cooperating institution. International competitive bidding will be used for the supply of goods and services estimated to cost USD 100 000 or more; local competitive bidding for supplies and services from USD 20 000 to USD 100 000; and local shopping from USD 500 to USD 20 000. Training and technical assistance will be hired through limited competitive bidding using a shortlisting procedure.

37. Withdrawals from the loan account for contract expenditures for: (a) goods, civil works and services, including contracts of a value of less than USD 50 000 or equivalent; and (b) local training and incremental operating costs will be made against certified statements of expenditure. A special account denominated in USD and a programme account in Ugandan shillings (UGX) will be established at a commercial bank and operated by PAU. The USD account will be opened with an initial deposit of USD 1.0 million. Commercial banks will also be used to maintain accounts for those sub-components managed by selected agencies outside PAU. Such accounts will be replenished quarterly on the basis of annual workplans and budgets.

### **F. Organization and Management**

38. RFSP will be implemented within the framework of the Government's outreach plan and will be an integral part of the effort of the donor community and MFI industry in the development the microfinance subsector. Thus the appropriate advisory body for the programme is the Microfinance Forum (Appendix IV). The PMA/Microfinance Forum Subcommittee on Rural Financial Services will provide technical oversight; it will serve as the Steering Committee<sup>10</sup> for the programme, be responsible for approving annual work plans and budgets, review semi-annual reports and suggest ways to implement and improve programme operations. PAU will be located in MFPED under the supervision of its Private Sector Development/Micro and Small Enterprise Policy Unit (MSEPU). In addition to generally facilitating the implementation of activities, PAU will handle financial matters relating to the programme (accounting, audit, procurement and disbursement); monitoring and evaluation; contracts with agencies implementing sub-component activities and supervision of their implementation; and activities not contracted out to other agencies. The majority of the sub-components will be implemented through a demand-driven approach by selected agencies with proven performance capabilities. Support under the programme will normally involve cost-sharing (varying from 10 to 75%). Under this mechanism, beneficiary MFIs will be required to meet a set of stipulated criteria and conditions in order to access programme funds (Appendix VI).

39. Successful monitoring of programme activities will require participation by all implementation agencies, with PAU exercising overall responsibility. PAU will: (a) contract out a baseline study to establish reference household samples to be monitored during the course of implementation; (b) monitor implementation of activities to identify constraints and propose solutions; (c) measure progress and impact at institutional and group/individual levels; and (d) facilitate impact evaluation at the field level under contracts. Annual workshops to discuss monitoring and evaluation results will be held for representatives of the agencies that manage the sub-components, members of the programme's Steering Committee and MFI client groups. At mid-term, the Government and IFAD will carry out a comprehensive review of the programme with all stakeholders, to be completed by the end of PY 4. At that point, the Government will draft a completion progress report as the basis for a programme completion mission.

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<sup>10</sup> While the membership of the Microfinance Forum is not defined and remains open to all microfinance stakeholders in the country with the MFPED as chair, the PMA/Microfinance Forum Subcommittee on Rural Financial Services presently consists of one representative each from the Microfinance Service Centre Limited (chairman); MFPED; Ministry of Gender, Labour and Social Development; Ministry of Agriculture, Animal Industry and Fisheries; PMA; NAADS; and DFD/BOU; six members representing financing/donor agencies and donor-funded projects/programmes; and four representatives of MFIs, cooperatives and other private-sector stakeholders.



40. **Programme start-up.** Key activities to be undertaken in preparation for timely programme start-up will include: (a) the establishment of PAU, starting with recruitment of the programme facilitator; (b) establishment of an accounting system and preparation of a financial operations manual; (c) preparation of work plans and budgets for PY 1; (d) initiation of the procurement process and preparation of tender documents for technical assistance; and (e) recruitment of a local contractor to conduct the baseline study and design a monitoring/management information system.

### **G. Benefits and Justification**

41. The targeted MFIs, MFI apex organizations, capacity-building agencies and other providers of rural financial services are expected to gain from expanded and more efficient operations; greater outreach; increased numbers of skilled personnel; improved performance monitoring and statistics; new savings, credit and other financial products; and a stronger capital base. Rural farmers and other clients of the participating MFIs will benefit from vastly increased access to financial services to help improve their farm productivity and incomes. The promotion of a rural business culture will directly benefit the poorest segments through functional literacy activities and training in technical and business skills that will help them move from a subsistence culture to a market orientation. The rural population will also benefit from district radio programmes on HIV/AIDS awareness and mitigation measures.

42. More specifically, the successful implementation of programme sub-components will benefit approximately 200 MFIs, whose staff will be directly targeted for training, skill improvement and other capacity-building exercises. An estimated 80 MFIs will expand their outreach services either by intensifying their activities within a given area, or expanding their networks to underbanked areas. In addition, at least eight MFIs will be upgraded to become deposit-taking institutions, while several private or semi-private training institutions/firms will have their associated trainers certified and their skills upgraded. More than 500 staff members of MFIs will be trained, and an estimated 300 000 clients will indirectly benefit from the improved services. The expansion of the MFI network will increase the number of new clients benefiting from MFI financial services by an estimated 100 000. In addition, at least 230 000 persons, many of them women, will receive direct training in technical and business skills and some 11 000 will acquire functional reading and basic numeracy skills. Based on earlier patterns of IFAD-assisted projects in Uganda and special targeting, as well as pro-poor conditions for the use of RFSP funds, at least one half of the ultimate beneficiaries in all sub-components will be women.

43. An analysis of selected, typical crop and non-farm investments that Ugandan farmers might make with borrowed funds indicates that such investments would be profitable and thus support the objectives of the programme. In economic terms, programme costs would be fully covered if the annual agricultural GDP were to increase by 0.09% during a 10-year benefit period. An 18.5% economic rate of return (ERR) for programme investments would result if the agricultural GDP were to increase by 0.11% annually during the same benefit period. In order to generate an ERR of 12.0%, it would suffice for the programme to reach about 26 000 microfinance clients as depicted in the enterprise and farm models (Appendix VII).

### **H. Risks and Responsiveness**

44. Because MFIs are expanding rapidly and have already gained wide acceptance in Uganda, most risks for the success of RFSP are moderate to negligible. The main concern exceeding these levels is the present lack of oversight of the large group of Tier-4 MFIs. Failure of a few of these could potentially damage the reputation of the whole MFI industry. In addition, the HIV/AIDS epidemic could severely affect the manpower situation in agriculture and the capacity of rural borrowers to repay their loans. The design of the programme has incorporated measures to mitigate these various risks.



## **I. Environmental Impact and Mitigation**

45. Agricultural production in the smallholder subsector in Uganda is almost exclusively manual. The majority of the smallholder population has little knowledge regarding purchased, seasonal inputs, and only a small minority use them. The agrochemicals applied by cotton producers are in the World Health Organization's Class II (i.e. seemingly less hazardous than those in Class Ia). Although the quantity of chemical inputs used is generally small, NAADS currently provides training for farmers and agro-input dealers on the correct use of agro-chemicals, thus mitigating any potentially harmful effects. The nature of the proposed investment, components and expected limited, indirect impact on the environment and the country's natural resources are such that the programme is classified as Category C, requiring no formal environmental impact assessment.

## **J. Innovative Features and Linkage to IFAD Corporate Strategy**

46. Three special features in the design render the programme different from most other rural finance interventions: (a) because numerous other development/financing agencies already support specific MFIs, individual groups and smallholders, RFSP does not aim to do so directly (except in the case of promotion of a rural business culture); rather, the programme focuses on institution-building to create a healthy and extensive rural finance system. To ensure that programme beneficiaries mostly include rural populations, and particularly women, appropriate pro-poor eligibility criteria will be used as the basis for disbursement of programme funds; (b) the design is consistent with the emerging enabling institutional and legal environment in Uganda and IFAD's country strategy; and (c) management and implementation of nearly all sub-components will be contracted out to agencies and organizations active in the microfinance field, through a demand-driven mechanism for matching grants. Furthermore, the programme reflects IFAD's corporate strategy in collaborating and working with other stakeholders.

## **PART III - LEGAL INSTRUMENTS AND AUTHORITY**

47. A loan agreement between the Republic of Uganda and IFAD constitutes the legal instrument for extending the proposed loan to the borrower. A summary of the important supplementary assurances included in the negotiated loan agreement is attached as an annex.

48. The Republic of Uganda is empowered under its laws to borrow from IFAD.

49. I am satisfied that the proposed loan will comply with the Agreement Establishing IFAD.

## **PART IV - RECOMMENDATION**

50. I recommend that the Executive Board approve the proposed loan in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Republic of Uganda in various currencies in an amount equivalent to thirteen million nine hundred thousand Special Drawing Rights (SDR 13 900 000) to mature on and prior to 1 September 2042 and to bear a service charge of three fourths of one per cent (0.75%) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

Lennart Båge  
President

## **SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES INCLUDED IN THE NEGOTIATED LOAN AGREEMENT**

(Negotiations concluded on 26 July 2002)

1. MFPED will open and maintain an account denominated in UGX in a commercial bank agreed by the Republic of Uganda (“the Government”) and IFAD, or another bank as may be proposed by the Government and accepted by IFAD, for programme expenditures incurred by PAU. The Government will designate an officer of MFPED and the programme administrator as ordinary authorized signatories for the programme account, and the financial controller of PAU as alternative authorized signatory. Two authorized signatories will be required to make any withdrawal from the programme account, at least one of which will be either an officer designated by MFPED or the programme administrator.
2. The Government will make loan proceeds available to MFPED to implement the programme in accordance with the annual workplans and budgets (AWP/Bs) and its customary national procedures for development assistance.
3. The Government will make counterpart funds available to MFPED from its own resources, in an aggregate amount of USD 1.10 million equivalent during the programme implementation period, in accordance with its customary national procedures for development assistance. The Government will deposit an initial amount equivalent to USD 35 000 from its own resources in the programme account. Thereafter, it will make budgetary allocations for each fiscal year equal to the counterpart funds called for in the AWP/B for the relevant programme year, and will make the allocations available to MFPED by depositing such amounts at least monthly in the programme account in advance.
4. IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the loan account if the programme implementation manual, or any provision thereof, has been waived, suspended, terminated, amended or modified without the prior consent of IFAD.
5. The programme will be implemented partly through the Government and PAU and partly through contracted implementing agencies. Implementation arrangements, eligibility criteria for programme funding and performance indicators for each sub-component will be described in detail in the programme implementation manual and set forth, where relevant, in the contract with each respective implementing agency.
6. The Government will ensure that agencies contracted by the programme to implement and manage programme sub-components will give adequate priority to rural areas and especially to poor men and women in order to ensure that at least 50% of the clients of MFIs or branches established under the programme are from the poorer rural areas of Uganda.
7. The Government will make annual budgetary provision for taxes as part of its counterpart fund contribution to the programme. This value will be credited against the obligation of the Government to provide counterpart funds.
8. Conditions for disbursements:
  - (a) No disbursements will be made from the loan until:
    - (i) at least two management contracts have been concluded between MFPED and selected implementing agencies acceptable to IFAD, and their detailed work plans have been prepared, acceptable to MFPED and IFAD;
    - (ii) PAU has prepared and submitted a consolidated AWP/B for programme year one (PY1) to IFAD which has approved it;



- (iii) the Government has deposited the initial amount of the counterpart contribution required for PY1.
- (b) No disbursements will be made from the loan for expenditures under any individual sub-component until:
  - (i) the agency implementing the sub-component has been selected and a management contract has been concluded between the implementing agency and MFPED;
  - (ii) the staff of the implementing agency have received training by PAU regarding the sub-component;
  - (iii) the implementing agency has established an accounting system satisfactory to MFPED.
- (c) No disbursements will be made from the loan for expenditures under the support to apex structures sub-component until the apex organizations being supported have prepared a business plan for PY1, acceptable to MFPED and IFAD.

9. The following are additional conditions precedent to the effectiveness of the programme loan agreement:

- (a) PAU has been established in offices provided by the Government, and the programme administrator and contracts/funds officer of PAU have been appointed by MFPED with prior approval by IFAD;
- (b) the posts of financial controller and monitoring and evaluation officer of PAU have been advertised for competitive recruitment by MFPED;
- (c) the programme implementation manual has been approved by IFAD in draft;
- (d) the Government has opened the special account;
- (e) MFPED has opened the programme account;
- (f) the programme loan agreement has been signed, and the signature and performance thereof by the Government have been authorized and ratified by all necessary administrative and governmental action;
- (g) a favourable legal opinion, issued by the Attorney-General of the Government or other legal counsel approved by IFAD, has been delivered by the Government to IFAD.



**APPENDIX I**

**COUNTRY DATA**

**UGANDA**

<b>Land area (km<sup>2</sup> thousand) 2000 1/</b>	200	<b>GNI per capita (USD) 2000 1/</b>	310
<b>Total population (million) 2000 1/</b>	22.1	<b>GNP per capita growth (annual %) 2000 1/</b>	1.8
<b>Population density (people per km<sup>2</sup>) 2000 1/</b>	111	<b>Inflation, consumer prices (annual %) 2000 1/</b>	2.8
<b>Local currency</b>	Uganda Shilling (UGX)	<b>Exchange rate: USD 1 =</b>	UGX 1 770
<b>Social Indicators</b>		<b>Economic Indicators</b>	
Population (average annual population growth rate) 1980-99 2/	2.7	GDP (USD million) 2000 1/	6 248
Crude birth rate (per thousand people) 2000 1/	46 a/	Average annual rate of growth of GDP 2/ 1980-90	2.9
Crude death rate (per thousand people) 2000 1/	19 a/	1990-99	7.2
Infant mortality rate (per thousand live births) 2000 1/	83	Sectoral distribution of GDP 2000 1/	
Life expectancy at birth (years) 2000 1/	42 a/	% agriculture	44 a/
Number of rural poor (million) (approximate) 1/	1.9	% industry	18 a/
Poor as % of total rural population 2/	10	% manufacturing	9 a/
Total labour force (million) 2000 1/	10.8	% services	38 a/
Female labour force as % of total 2000 1/	48	Consumption 2000 1/	
<b>Education</b>		General government final consumption expenditure (as % of GDP)	10 a/
School enrolment, primary (% gross) 2000 1/	n.a.	Household final consumption expenditure, etc. (as % of GDP)	85 a/
Adult illiteracy rate (% age 15 and above) 2000 1/	33	Gross domestic savings (as % of GDP)	5 a/
<b>Nutrition</b>		<b>Balance of Payments (USD million)</b>	
Daily calorie supply per capita, 1997 3/	2 085	Merchandise exports 2000 1/	380
Malnutrition prevalence, height for age (% of children under 5) 2000 1/	n.a.	Merchandise imports 2000 1/	1 650
Malnutrition prevalence, weight for age (% of children under 5) 2000 1/	n.a.	Balance of merchandise trade	-1 270
<b>Health</b>		Current account balances (USD million)	
Health expenditure, total (as % of GDP) 2000 1/	5.9	before official transfers 1999 1/	-1 121
Physicians (per thousand people) 1999 1/	n.a.	after official transfers 1999 1/	-746
Population without access to safe water (%) 1990-98 3/	54	Foreign direct investment, net 1999 1/	230
Population without access to health services (%) 1981-93 3/	29	<b>Government Finance</b>	
Population without access to sanitation (%) 1990-98 3/	43	Overall budget deficit (including grants) (as % of GDP) 1999 1/	n.a.
<b>Agriculture and Food</b>		Total expenditure (% of GDP) 1999 1/	n.a.
Food imports (% of merchandise imports) 1999 1/	14	Total external debt (USD million) 1999 1/	4 077
Fertilizer consumption (hundreds of grams per ha of arable land) 1998 1/	4	Present value of debt (as % of GNI) 1999 1/	27
Food production index (1989-91=100) 2000 1/	120.0	Total debt service (% of exports of goods and services) 1999 1/	23.7
Cereal yield (kg per ha) 2000 1/	1 364	Lending interest rate (%) 2000 1/	22.9
<b>Land Use</b>		Deposit interest rate (%) 2000 1/	9.8
Arable land as % of land area 1998 1/	25.3		
Forest area (km <sup>2</sup> thousand) 2000 2/	42		
Forest area as % of total land area 2000 2/	21.0		
Irrigated land as % of cropland 1998 1/	0.1		

a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Indicators* database

2/ World Bank, *World Development Indicators*, 2001

3/ UNDP, *Human Development Report*, 2000

## PREVIOUS IFAD FINANCING TO UGANDA

Project/Programme	Lending Terms	IFAD Approved Financing  (USD '000)	Board Approval	Loan Signing	Loan Effectiveness	Project Comple. Date	Closing Date	Cooperating Institutions	Project Status
<b>A. Investment projects</b>									
080 Agricultural Reconstruction Programme in Northern and Eastern Uganda	HC	20 033	17-Dec-81	26-Mar-82	18-Apr-82	31-Mar-86	30-Jun-86	IDA	Closed
159 Agricultural Development Project	HC	14 500	12-Dec-84	26-Feb-85	14-May-86	31-Dec-92	30-Sep-93	IDA	Closed
S10 Southwest Region Agric. Rehab. Project	HC	12 000	03-Dec-87	23-Feb-88	17-Aug-88	30-Aug-95	28-Feb-96	IDA	Closed
316 Smallholders Cotton Rehab. Project	HC	10 035	02-Dec-92	22-Jan-93	28-Apr-93	31-Dec-96	31-Jan-98	IDA	Closed
360 Cotton Subsector Development Project	HC	12 500	20-Apr-94	26-Jul-94	18-Nov-94	30-Jun-01	31-Dec-01	IDA	Closed
442 Vegetable Oil Development Project	HC	19 900	29-Apr-97	26-May-98	10-Jul-98	31-Dec-05	30-Jun-06	IDA	Ongoing
482 District Development Support Programme	HC	12 588	10-Sep-98	11-Feb-00	24-May-00	31-Dec-04	30-Jun-05	IFAD	Ongoing
516 Area-Based Agric. Modernization Programme	HC	13 220	08-Dec-99	15-Feb-02	20-May-02	30-Jun-08	31-Dec-08	UNOPS	Ongoing
549 National Agric. Advisory Services Programme	HC	17 500	07-Dec-00	17-Aug-01	27-Nov-01	31-Dec-08	30-Jun-09	IDA	Ongoing
<b>Total investment projects</b>	<b>9 projects</b>	<b>132 276</b>							
<b>BEF million</b>									
<b>B. Grant projects</b> (in collaboration with the Government of Belgium)									
BG05 Hoima-Kibaale Integr. Community Dev.	Grant	330	20-Sep-90	20-Sep-90	11-Oct-91	30-Jun-98	31-Dec-98	UNOPS	Closed
BG09 UWESO Development Project	Grant	50	17-Jun-94	17-Jun-94	06-Feb-95	31-Dec-98	30-Jun-99	UNOPS	Closed
BG15 Masindi District Integr. Community Dev.	Grant	150	19-Oct-95	19-Oct-95	28-Mar-96	31-Dec-99	30-Jun-00	UNOPS	Closed
BG32 UWESO Development Programme	Grant	123	06-Jun-00	03-Jul-00	31-Aug-00	30-Sep-04	31-Mar-05	UNOPS	Ongoing
BG30 District Development Support	Grant	239	10-Sep-98	11-Feb-00	24-May-00	31-Dec-04	30-Jun-05	UNOPS	Ongoing
<b>Total grant projects</b>	<b>5 projects</b>	<b>892</b>							

HC = Highly Concessional terms  
 UNOPS = United Nations Office for Project Services  
 BEF = Belgian Francs

## LOGICAL FRAMEWORK

Narrative Summary	Objectively Verifiable Indicators	Means of Verification	Critical Assumptions and Risks
<b>Overall Development Objective</b>			
Reduction of rural poverty through sustained increase of on-farm and off-farm income-generating activities resulting from increased access to financial services.	<p><b>Income Indicators</b></p> <ul style="list-style-type: none"> <li>Reduction in the number of rural people considered poor within their communities</li> <li>Reduction in the percentage of rural women considered poor</li> </ul> <p><b>Social Capital and Participation Indicators</b></p> <ul style="list-style-type: none"> <li>Increased numbers of rural households organized into self-help, self-reliant and sustainable grass-roots organizations using financial services and grass-roots training for mutual benefit and support</li> </ul>	<ul style="list-style-type: none"> <li>Participatory wealth ranking</li> <li>Assessments</li> <li>RFSP impact assessments and evaluation studies</li> <li>RFSP monitoring reports</li> </ul>	<ul style="list-style-type: none"> <li>Civil and economic stability and cessation of hostilities in districts with civil disturbances.</li> <li>Continued liberalization of financial and non-financial markets and institutions</li> </ul>
<b>Programme Purposes</b>			
Contribute towards the development of a sustainable and responsive rural microfinance industry through: (a) strengthening the institutional capacity and rural accessibility of MFIs; and (b) enhancing the rural population's capacity to access financial services for income generation.	<p><b>Institutional Capacity Indicators</b></p> <ul style="list-style-type: none"> <li>Increase in number of profitable MFIs</li> </ul> <p><b>MFI Accessibility Indicators</b></p> <ul style="list-style-type: none"> <li>Increase in number of rural branches/sub-branches of bank and non-bank MFIs, including savings and credit associations and credit unions</li> <li>Increased number of rural clients accessing new financial products and institutions</li> </ul> <p><b>Rural Poor's Capacity Indicators</b></p> <ul style="list-style-type: none"> <li>Improvement in rate of literacy in target communities</li> <li>Increase in rural enterprises' and farmers' investments in productive activities</li> </ul>	<p>MFI statistics published by AMFIU If not yet available:</p> <ul style="list-style-type: none"> <li>Annual financial statements of participating MFIs and banks</li> <li>MFI statistics published by AMFIU</li> <li>Baseline survey and later statistics by the RISE Fund management agency</li> <li>Surveys on functional literacy and numeracy</li> <li>Surveys on rural economic patterns</li> </ul>	Government adheres to financial-sector policies conducive to growth of sustainable microfinance institutions.
<b>Programme Outputs</b>			
			(Outputs to Objective)
<b>Promotion of Product Innovations:</b> The introduction of innovative financial products that enhance the benefit from rural financial services.	<ul style="list-style-type: none"> <li>Number of product innovations pilot-tested</li> <li>Number of product innovations taken up in regular MFI programmes</li> </ul>	<ul style="list-style-type: none"> <li>Semi-annual reports by participating MFIs to the RISE Fund management agency</li> </ul>	
<b>Rural Area Penetration:</b> Increased supply of microfinance services in rural areas through the expansion of viable service networks into underbanked areas.	<ul style="list-style-type: none"> <li>Number of microfinance outlets established</li> <li>Number of formal bank agricultural banking scheme established</li> <li>Number of rural clients reached by new outlets or schemes</li> </ul>	<ul style="list-style-type: none"> <li>Semi-annual reports by participating MFIs to the Rural Area Penetration Fund management unit</li> </ul>	
<b>Strengthening of Training Market:</b> Improved access to appropriate capacity-building services by microfinance providers with rural orientations	<ul style="list-style-type: none"> <li>Number of MFIs that have benefited from RFSP capacity-building grants</li> <li>Number of MFI staff and trustees trained through matching grants</li> <li>Number of MFIs that have benefited from capacity-related equipment packages</li> <li>Increased number of MFIs adhering to microfinance best practices</li> <li>Improvements in MFI efficiency and sustainability as a result of matching grants, measured by such standard indicators as clients/field officer, drop-out rates, loan recovery rates, operational sustainability, etc.</li> </ul>	<ul style="list-style-type: none"> <li>Semi-annual reports by the management unit</li> <li>Semi-annual reports by benefiting microfinance institutions to the management unit of the capacity-building matching grants facility, summarized by the management unit</li> </ul>	<ul style="list-style-type: none"> <li>Microfinance Forum and the MFI subsector remain committed to the UCAP framework and market-based approach</li> </ul>





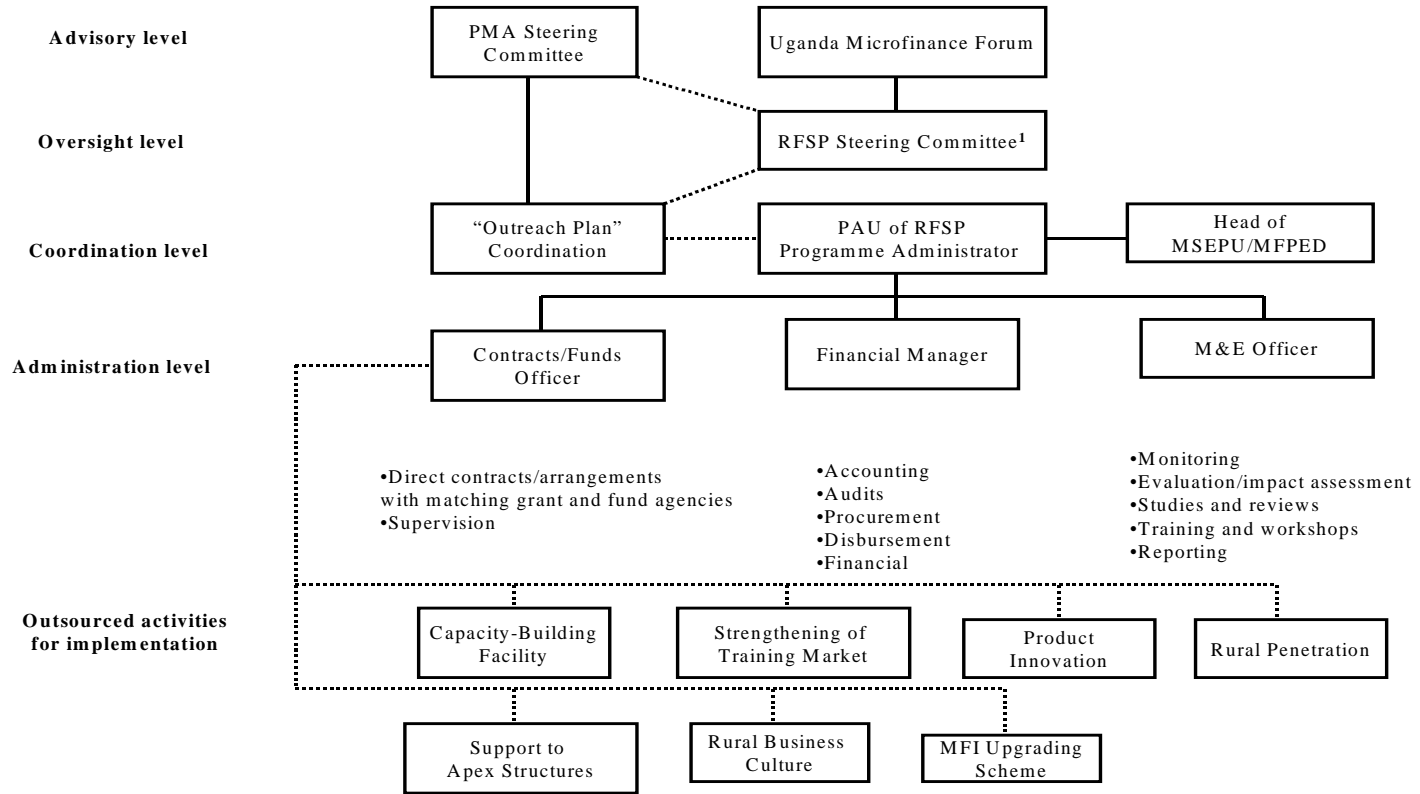
<p><b>MFI Capacity-Building:</b> Improved capacity of the microfinance training service providers to satisfy the demand by microfinance institutions.</p>	<ul style="list-style-type: none"> <li>• Number of training courses developed with RFSP support</li> <li>• Number of local trainers and consultants trained in each course developed</li> <li>• Number of training courses run for rural-oriented MFIs by the supported service providers</li> </ul>	<ul style="list-style-type: none"> <li>• Semi-annual reports by benefiting service providers to the management unit of the matching grants facility</li> </ul>	
<p><b>Promotion of a Business Culture:</b> Improved knowledge and skills of rural clients to increase production for market and to use financial services effectively.</p>	<ul style="list-style-type: none"> <li>• Number of farmers and rural poor trained or sensitized on technical and business culture</li> <li>• Number of farmers and rural poor trained in functional literacy and numeracy</li> <li>• Number of radio programmes prepared and broadcast with RFSP support</li> <li>• Improvements in marketable surplus and incomes of farmers and rural poor</li> </ul>	<ul style="list-style-type: none"> <li>• Semi-annual reports by Fund management agency on training provided by service suppliers</li> <li>• Semi-annual reports by Fund management agency on literacy training provided</li> <li>• Semi-annual reports by Fund management agency and field verification by supervision missions</li> <li>• Supervision reports and impact assessment at mid-term review and programme completion compared with baseline</li> </ul>	
<p><b>Support to Apex Structures:</b></p> <ul style="list-style-type: none"> <li>• Apex structures (AMFIU, Uganda Cooperative Alliance and UCSCU) are strengthened to perform the role of network coordinators and promote MFI expansion and self-regulation</li> <li>• Commercial activities developed to increase apex institutions' sustainability</li> <li>• Regular audits of MFIs by apexes</li> <li>• MFI performance monitoring and setting performance standards</li> </ul>	<ul style="list-style-type: none"> <li>• Percentage of apex operating expenditure financed from commercially generated funds</li> <li>• Number of MFIs and savings and credit cooperatives audited annually</li> <li>• Number of MFIs providing regular performance information</li> </ul>	<p>AMFIU, Uganda Cooperative Alliance and UCSCU reports on:</p> <ul style="list-style-type: none"> <li>• Their own activities and finances</li> <li>• Performance of their member MFIs and SACCOs</li> </ul>	
<p><b>MFI Upgrading Scheme:</b> A growing number of qualified MFIs upgraded into microfinance deposit-taking institutions.</p>	<ul style="list-style-type: none"> <li>• Number of upgrading agreements signed</li> <li>• Number of participating MFIs attaining desired tier</li> <li>• Number of clients served in activities supported by upgrading effort</li> </ul>	<ul style="list-style-type: none"> <li>• Semi-annual reports by benefiting MFIs to the sub-component management agency</li> </ul>	<ul style="list-style-type: none"> <li>• Donors subscribing and adhering to common rules</li> </ul>
<p><b>Programme Administration, Monitoring and Evaluation:</b> RFSP is implemented efficiently and relevant data is generated regularly by the management information system.</p>	<ul style="list-style-type: none"> <li>• Implementation contracts signed as scheduled</li> <li>• All key indicators reported on from the MIS as of PY2</li> <li>• Mid-term evaluation carried out during PY-4</li> </ul>	<ul style="list-style-type: none"> <li>• Semi-annual reports by PAU</li> </ul>	<ul style="list-style-type: none"> <li>• Timely availability and completeness of quarterly reports by agencies managing the sub-components</li> </ul>

<b>Programme Activities</b>	<b>Inputs:</b> as specified in programme cost tables. Cost summaries are given hereunder for respective sub-components		
<b>Promotion of Products Innovation:</b> <ul style="list-style-type: none"> <li>Matching grants to study and/or pilot test innovative rural financial products, particularly those with an agricultural or HIV/AIDS dimension</li> </ul>	USD 2.0 million	<ul style="list-style-type: none"> <li>PAU progress reports</li> <li>Supervision mission reports</li> <li>Requests for funds replenishments</li> </ul>	<ul style="list-style-type: none"> <li>Timely selection of the managing agency</li> <li>Satisfactory performance by the managing agency</li> <li>Timely processing of disbursement applications</li> </ul>
<b>Rural Area Penetration:</b> <ul style="list-style-type: none"> <li>Matching grants to establish new community-based MFIs</li> <li>Matching grants to set up new branches for existing MFIs</li> <li>Matching grants to start rural sub-branches of formal banks</li> <li>Matching grants to start up new agricultural schemes in existing formal bank branches</li> </ul>	USD 4.9 million	- do -	- do -
<b>Strengthening of Training Market:</b> <ul style="list-style-type: none"> <li>Matching grants to develop appropriate training courses for rural MFIs by service providers</li> <li>Matching grants to train local trainers in course concepts developed</li> </ul>	USD 0.6 million	- do -	- do -
<b>MFI Capacity-Building:</b> <ul style="list-style-type: none"> <li>Matching grants for MFI to procure capacity-building services from local training market</li> <li>Matching grants to MFIs to procure basic equipment linked to capacity improvements</li> </ul>	USD 5.4 million	- do -	- do -
<b>Promotion of a Rural Business Culture:</b> <ul style="list-style-type: none"> <li>Technical and business skills training</li> <li>Functional literacy training</li> <li>Radio programmes on business culture, HIV/AIDS, etc.</li> <li>Exchange of experience by farmers, service providers</li> </ul>	USD 4.6 million	- do -	- do -
<b>Support to Apex Structures:</b> <ul style="list-style-type: none"> <li>Training and provision of equipment</li> <li>Financing of information programmes</li> <li>Partial financing of AMFIU's operating costs after PY-3</li> </ul>	USD 2.6 million	- do -	<ul style="list-style-type: none"> <li>As above, and</li> <li>Timely contracting of consultants for audit and income-generating activities</li> </ul>



<b>MFI Upgrading Scheme:</b> <ul style="list-style-type: none"> <li>Grants and advisory services to MFIs to support their transition to microfinance deposit-taking institutions</li> </ul>	USD 2.9 million	- do -	New Financial Institutions Statute, 2001, and Microfinance Deposit-Taking Institutions Bill are passed before or during the first year of RFSP implementation.
<b>Programme Administration and Monitoring:</b> <ul style="list-style-type: none"> <li>Establish PAU and MIS</li> <li>Contract implementing agencies</li> <li>Carry out mid-term evaluation</li> </ul>	USD 2.1 million	Disbursement reports Supervision reports	
<b>Total programme costs: USD 25.0</b>			

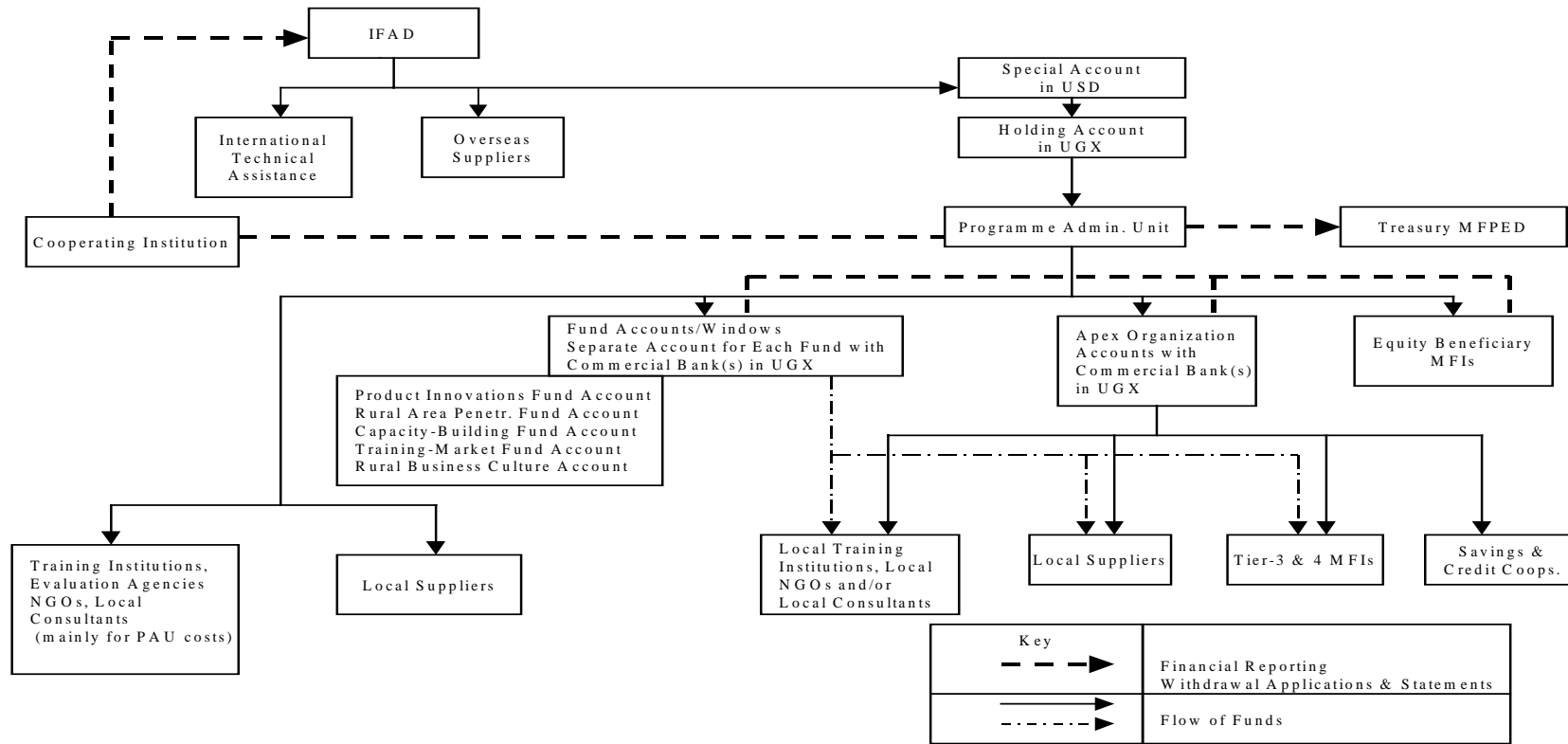
# ORGANIZATIONAL ARRANGEMENT



<sup>1/</sup> PMA/MF Subcommittee on Rural Financial Services mandated by the Government to serve as the Steering Committee of RFSP.



# FLOW OF FUNDS ARRANGEMENT





## FINANCIAL, ECONOMIC AND BENEFICIARY ANALYSES

### A. Financial Analysis

1. The activities financed by the MFIs are expected to be economically and financially viable. Given that the target group of RFSP mainly comprises MFIs providing services to rural communities, it is expected that there will be considerable demand for both rural microenterprise and agricultural financing. Over 95% of the clients currently accessing financial services in rural areas indicate that mixed-cropping agriculture is their main income-generating activity, even if they seek financing for other activities such as rural trade or agro-industries. Most clients borrow for these other activities to provide 'quick cash' as credit is currently mostly provided on a short-term basis with the lending patterns not conducive to agricultural seasons, which require longer repayment periods. The proceeds of these side-activities are usually subsequently invested in agriculture.
2. Thus, the financial analysis is based on a two-pronged approach, using both enterprise models, prepared for a few representative rural activities, and agricultural models at both the crop and farm levels. All models are based on real prices and therefore do not take inflation into account.
3. The **enterprise models** are characteristic for rural small-scale businesses countrywide, which tend to be found mostly in smaller towns and settlements. A typical women's enterprise is the production of *waragi*, which is distilled from different raw materials (usually sugarcane molasses or plantain) in different parts of the country. This model can be seen as representative of small-scale agro-processing enterprises in general, which are usually operated by women. The rural shop enterprise model is rather gender neutral, while the *boda-boda* enterprise (a bicycle taxi business) is mostly run by young men. However, the *boda-boda* enterprise model may be regarded as representative of most of the rural small-scale service enterprises that require little investment, such as tailoring and informal retailing, which are oftentimes dominated by female operators. Overall, it may be summarized that the enterprise models characterize the economic and gender realities of microenterprises in the country.
4. For the purpose of loan modelling, an average nominal interest rate of 34.5% has been deflated by an expected average inflation of 10% to apply a real interest rate of 24.5%. A shadow price of unskilled labour of UGX 1 500 per person-day has been used.
5. The **crop models**, which have been prepared on a 1 ha basis, comprise indicative food and cash crops, as well as livestock models. The programme assumes that farmers will utilize their financing, or proceeds from other financed activity, to increase production through improved farming methods and/or the purchase of improved inputs in terms of seed/seedlings, agrochemicals and fertilizers. It should be noted that the crop budgets are based on average costs for the whole of Uganda, as the crop prices vary considerably within the country, depending on the region/district.
6. Three **farm models** have been prepared that are roughly representative of the smallholder agricultural activities in the country. They have been derived from the crop budgets by assembling several crops from the indicative mixed-cropping farm models based on a total farm area of 2.5 ha each, of which around 1.5 ha is cropped. The models demonstrate the ability of households to meet debt-service obligations and generate a financial surplus, as shown in Table 1 below.
7. The cotton farm model, representative for northern and eastern Uganda, depicts a farm growing cotton, cassava, maize, beans, groundnuts and sorghum. The distilling banana farm model (western Uganda) comprises a crop and livestock mix of distilling bananas, beans, groundnuts, maize, eating

bananas, sweet potato, high-yielding cassava, some coffee and dairy goats. The coffee farm model (also western Uganda) comprises rehabilitated coffee, beans, groundnuts, maize, sorghum, finger millet, eating banana, sweet potato and low-yielding cassava. In all models, it is assumed that the labour not available in a typical family is hired and that agricultural financing is made available. The models indicate that the families could increase their incomes by around 40-70% with the provision of credit.

**Table 1: Summary of Income Change in Enterprise and Farm Budgets**

Model	Annual Income (UGX)		% Change
	Without Programme	With Programme	
<b>Enterprise Models</b>			
1. Rural retail shop	4 320 000	5 335 000	24
2. <i>Waragi</i> production	419 400	2 174 400	418
3. Bicycle <i>boda-boda</i> operator	360 000	902 800	151
<b>Farm Models</b>			
1. Cotton farm	301 900	430 300	45
2. Distilling banana farm	419 800	648 700	56
3. Coffee farm	511 600	858 500	68

## B. Economic Analysis

8. The programme is essentially an investment in institution-building. Therefore, its benefits are difficult to quantify and value, as needs to be done in classical economical analysis. The direct benefits will be reflected in the incremental number of MFIs providing more efficient and client-responsive rural financial services. Some of these benefits to the rural financial services system (and hence to the rural client) will be evident in the increased outreach to underbanked areas through: more MFI service points in rural areas; increased efficiencies of MFI operations; provision of more appropriate and demand-responsive financial products to clients; and an MFI system that has mechanisms for self-assessment.

9. In economic terms, the cost of the programme will be low relative to the overall size of the microfinance and agricultural sectors. The programme costs will be covered fully if the annual agricultural GDP increases by 0.09% during a ten-year period. Also, an 18.5% economic rate of return (ERR) for the programme investments will result if the agricultural GDP increases by 0.11% annually during a ten-year benefit period.

10. A more classical approach to the economic analysis shows that it will suffice for the programme to reach about 26 000 microfinance clients in the manner depicted in the enterprise and farm models to generate an ERR of 12.0% (if this increase in income were fully attributed to RFSP interventions). This was calculated by phasing the benefits of the access to microfinance services over the programme period, distributed across the activities as shown in Table 3. The model is based on the participating microenterprises and farming households sustaining benefits from the programme for three and five years, respectively. To reflect the free-market situation presently found in Uganda, financial prices have been used as economic prices. All programme costs have been used, including those financed by MFIs and beneficiaries as well as the costs of the activities continuing after PY 7 under the support to apex structures sub-component.



11. The results of the economic analysis justify the programme's investments in promoting enhanced and sustainable rural financial services, as well as investments in the ability of the rural population to utilize these services. The analysis shows that the programme has the capacity to generate an economic rate of return (ERR) of 12.0% over a 20-year period.

**Table 2: Estimated Economic Rates of Return**

<b>ERR (%)</b>	<b>Scenario</b>
<b>12.0</b>	<b>Overall Programme</b>
9.4	If benefits are 10% lower than estimated
9.7	If costs increase by 10%
9.4	If benefits lag by one year
6.6	If benefits lag by two years
8.4	If benefits are 20% p.a. lower than estimated after PY-10

12. **Sensitivity analysis.** A number of scenarios were tested to establish the economic viability of the programme in the event of adverse factors. The results are presented in Table 2. The ERR is remarkably stable indicating the robust nature of the programme. A 10% increase in costs, a 10% decrease in benefits or a delay in the benefit stream by one year will reduce the rate of return by less than three percentage points. Even significant delays in the realization of programme benefits of two years or more, or an annual 20% decrease of benefits after PY-10, will reduce the ERR by less than six percentage points.



Table 3: Estimate of Beneficiaries, Benefits and ERR

<b>Incremental Beneficiaries (number of households at beginning of participation)</b>											
	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10-20	Total
<b>Enterprise Models</b>											
1: Rural retail shop	50	75	250	500	500	375	250	-	-	-	2 000
2: <i>Waragi</i> production	100	150	500	1 000	1 000	750	500	-	-	-	4 000
3: Bicycle <i>boda-boda</i> operator	200	300	1 000	2 000	2 000	1 500	1 000	-	-	-	8 000
<b>Farm Models</b>											
1: Cotton (northern and eastern Uganda)	100	150	500	1 000	1 000	750	500	-	-	-	4 000
2: Distilling banana (western Uganda)	100	150	500	1 000	1 000	750	500	-	-	-	4 000
3: Coffee (western Uganda)	100	150	500	1 000	1 000	750	500	-	-	-	4 000
Total	650	975	3 250	6 500	6 500	4 875	3 250	-	-	-	26 000
<b>Incremental Economic Benefits (USD)</b>											
	PY1	PY2	PY3	PY4	PY5	PY6	PY7	PY8	PY9	Y10-20	
<b>Enterprise Models</b>											
1: Rural retail shop	-	29 237	73 093	219 280	482 415	730 932	804 025	657 839	365 466	146 186	
2: <i>Waragi</i> production	-	99 153	247 881	743 644	1 636 017	2 478 814	2 726 695	2 230 932	1 239 407	495 763	
3: Bicycle <i>boda-boda</i> operator	-	61 333	153 333	460 000	1 012 000	1 533 333	1 686 667	1 380 000	766 667	306 667	
<b>Farm Models</b>											
1: Cotton (northern and eastern Uganda)	-	1 928	9 261	26 510	69 807	140 773	205 313	250 074	243 778	173 396	
2: Distilling banana (western Uganda)	-	-	6 457	17 599	56 282	152 760	270 823	371 735	399 808	300 699	
3: Coffee (western Uganda)	-	279	10 457	31 070	96 012	246 688	425 820	566 593	589 092	440 915	
Total	-	191 930	500 484	1 498 102	3 352 534	5 283 300	6 119 343	5 457 173	3 604 217	1 863 626	
<b>Incremental Economic Costs (USD)</b>											
	PY1	PY2	PY3	PY4	PY5	PY6	PY7	PY8	PY9	Y10-20	
Investment costs	2 624 891	3 213 018	4 247 638	4 292 090	3 695 264	2 916 682	2 576 074	-	-	-	
Recurrent costs	122 766	128 326	131 534	134 822	138 193	141 647	145 189	112 300	112 300	112 300	
Total economic costs	2 747 657	3 341 343	4 379 171	4 426 912	3 833 457	3 058 330	2 721 263	112 300	112 300	112 300	
<b>Economic Results</b>											
	PY1	PY2	PY3	PY4	PY5	PY6	PY7	PY8	PY9	Y10-20	
Incremental net benefits (USD)	-2 747 657	-3 149 414	-3 878 687	-2 928 810	- 480 923	2 224 970	3 398 080	5 344 873	3 491 917	1 751 326	
<b>Economic Rate of Return (ERR)</b>											
<b>Economic Rate of Return (ERR)</b>	<b>ERR Sensitivity Analysis</b>										
	Benefits - 10%	Costs + 10%		Benefits lagged by 1 year	Benefits lagged by 2 years		Benefits decrease 20% p.a. after PY10				
<b>12.0%</b>	9.4%	9.7%		9.4%	6.6%		8.4%				

## ELIGIBILITY CRITERIA FOR SOURCING PROGRAMME FUNDS, PERFORMANCE INDICATORS AND FINANCING/IMPLEMENTING ARRANGEMENT

Eligibility Criteria	Suggested Performance Indicators	Implementing Arrangement
<p>Eligible MFIs will:</p> <ul style="list-style-type: none"> <li>• be registered in Uganda and have a minimum of two years of operational experience;</li> <li>• have a complete, accurate and updated accounting system and produce from it financial accounts and management information data on a regular basis;</li> <li>• have achieved a rate of operational self-sufficiency of at least 50% and be able to demonstrate, by means of a realistic business plan and implementation evidence, their determination to achieve full operational sustainability; and</li> <li>• have an unqualified audit report for at least the previous financial year.</li> </ul> <p>In addition, the applicant MFI will further be required to demonstrate that:</p> <ul style="list-style-type: none"> <li>• the product has a rural relevance (at least for possible future application);</li> <li>• the product is innovative in its conception and/or geographic/social application;</li> <li>• the product has the potential to respond to the demand of a large number of MFI clients;</li> <li>• the delivery of the product has the potential to be profitable in the foreseeable future;</li> <li>• the applicant MFI has the intention and capacity to integrate a successfully tested product into its regular operations; and</li> <li>• appropriate performance indicators are suggested.</li> </ul> <p>Special positive consideration, which may lead to a waiver of one or several of the above requirements, will be given to products with a strong link to smallholder agriculture and/or that respond to the particular needs of HIV/AIDS affected households/communities.</p>	<p style="text-align: center;"><b>Product Innovations</b></p> <p>Among possible key monitoring indicators are:</p> <ul style="list-style-type: none"> <li>• number of grant requests received;</li> <li>• number of grant requests approved;</li> <li>• total grant amount approved;</li> <li>• grant amount approved with an HIV/AIDS focus;</li> <li>• grant amount approved with an agricultural focus;</li> <li>• total grant amount disbursed;</li> <li>• (estimated) number of rural clients who have improved access to microfinance services as a result of the activities; and</li> <li>• the number of pilots that have been adopted in the MFI's regular activities.</li> </ul>	<p>An independent agency will be contracted to implement/manage the Rural Innovative Services Fund. Activities will be financed up to 90% by the programme and at least 10% by the applicant MFI. The Fund contribution for each activity/product will range from USD 10 000-100 000, except for agriculture-related activities, which will be eligible for a matching grant of up to USD 200 000 (on the basis of the usually longer gestation periods of such ventures). Disbursements will be based on funding agreements for approved activities.</p>
<ul style="list-style-type: none"> <li>• submission of a comprehensive business plan for the proposed expansion, including the expected outreach and services to be offered and a detailed budget and cash-flow projections for the proposed investment;</li> <li>• realistic calculations showing that operational sustainability can be reached within 1-2 years in the new area of operations;</li> <li>• evidence of the rural dimension of the expansion (area coverage, estimated clientele profile, etc.);</li> </ul>	<p style="text-align: center;"><b>Rural Area Penetration</b></p> <p>For the performance of the Rural Area Penetration Fund:</p> <ul style="list-style-type: none"> <li>• number of grant requests received;</li> <li>• number of grant requests approved/rejected;</li> <li>• number of matching grant agreements signed; and</li> <li>• total grant amount of the signed matching grant agreements</li> </ul>	<p>The preferred arrangement for the management of the RFSP Rural Area Penetration Fund will be through a separate window of the UCAP framework Matching Capacity-Building Grant facility. In the event that use of the proposed UCAP framework facility does not materialize in a form providing for an appropriate management framework for the rural area</p>

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<ul style="list-style-type: none"> <li>detailed reports on the investing institution's operational and financial status (does not apply to new community-based institutions), using standard accounting, financial and performance indicators of the microfinance industry; and</li> <li>information on potential commitments of additional financial and technical support to the expansion plan from other donor organizations.</li> </ul> <p>To avoid encouraging non-consolidated MFIs venturing into unwarranted expansion, beneficiary MFIs will be required to have reached at least 75% operational self-sufficiency in their current areas of operation before qualifying for the Rural Area Penetration Fund support.</p>	<p>For each benefiting MFI:</p> <ul style="list-style-type: none"> <li>number of microfinance outlets established;</li> <li>number of formal bank agricultural banking schemes established;</li> <li>outreach indicators for each established outlet/scheme (total clientele, portfolio, savings, segregated by gender); and</li> <li>standard MFI efficiency and sustainability indicators for each established outlet, such as clients per field officer; drop-out rates, loan recovery rates, portfolio-at-risk; prudential ratios and operational and financial sustainability to assess performance progress as a result of matching grants.</li> </ul>	<p>penetration sub-component, its management will be awarded by PAU to a competent local private-sector agency on the basis of competitive bidding.</p>
<p>Under the UCAP framework, planning is ongoing to register and certify existing local training service providers and define the need for training product development in the various areas of microfinance operations. When this exercise is completed, the definitions of currently required training courses and the developed certification criteria will provide initial direction for the processing of RFSP matching grant applications from local service providers. In reviewing proposals for RFSP funding, the following issues will be given particular attention:</p> <ul style="list-style-type: none"> <li>expected benefits and detailed description of the new product to be developed, including detailed development costs;</li> <li>company history and profile, including CVs of the course developers;</li> <li>company experience in rural microfinance training;</li> <li>potential certification by AFCAP or UCAP; and</li> <li>a marketing plan (or evidence of demand or a market survey) for the new products, especially their rural dimension.</li> </ul> <p>To encourage the move towards a more market-based approach in training service provision, the matching grant amount under RFSP will decrease first from 75 to 50% and then to 25% each time a firm reapplies for product development support</p>	<p style="text-align: center;"><b>Strengthening of MFI Training Market</b></p> <ul style="list-style-type: none"> <li>number of training courses developed with RFSP support;</li> <li>number of local trainers and consultants trained in each course developed; and</li> <li>number of supported training courses run for rural-oriented MFIs by service providers.</li> </ul>	<p>The matching grant window for training service providers will be operated under the UCAP umbrella. In the event that use of the UCAP framework for the implementation of RFSP is not feasible, PAU will award management of the training market strengthening sub-component to a competent local private-sector firm or agency on the basis of competitive bidding. The contracted firm will be required to demonstrate good technical skills and experience in funds management, as well as a strong understanding of the microfinance sector. Even when using a private fund manager, the preference will be that both MFI capacity-building grants and service provider grants of RFSP will be managed under one and the same institutional arrangement.</p>
<p>Matching grants from the Capacity-Building Fund will be provided primarily to MFIs that show a commitment to develop their rural microfinance operations on a sustainable basis, but which are not yet able to acquire the needed capacity-building services at market rates.</p>	<p style="text-align: center;"><b>MFI Capacity-Building</b></p> <p>For the performance of the capacity-building matching grant facility:</p> <ul style="list-style-type: none"> <li>number of grant requests received;</li> <li>number of grant requests approved/rejected;</li> <li>number of matching grant agreements signed;</li> <li>total grant amount of the signed matching grant agreements; and</li> </ul>	<p>Under the UCAP framework, draft eligibility criteria for individual MFIs to benefit from matching capacity-building grants have been developed and provide a basis for RFSP capacity-building matching grant operations.</p>



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<p>The applicants must be able to demonstrate how the supported investment in a particular capacity-building area will improve their overall operational and financial performance. To be considered for matching grant support, applicants will be required to provide such documents as:</p> <ul style="list-style-type: none"> <li>a training/business development plan indicating how the grant will strengthen the institution, using objectively verifiable targets and six-month performance indicators for the grant period;</li> <li>description of the proposed source and scope of the capacity-building service, if identified;</li> <li>audited accounts (if applicable), balance sheet and profit-and-loss statements from the previous 1-2 years of operation; and</li> <li>MFIs' projected cash flow for the duration of the grant.</li> </ul>	<ul style="list-style-type: none"> <li>total grant amount disbursed.</li> </ul> <p>For each benefiting MFI:</p> <ul style="list-style-type: none"> <li>number of MFI staff and functionaries trained through matching grants;</li> <li>outreach indicators (total clientele, portfolio, savings, segregated by gender); and</li> <li>standard MFI efficiency and sustainability indicators such as clients per field officer; drop-out rates, loan-recovery rates, portfolio-at-risk; operational and financial, as well as sustainability to assess performance progress as a result of matching grants.</li> </ul>	<p>However, under RFSP funding, an <i>additional</i> requirement will be that as a sign of commitment to rural operations, at least 50% of the clients of each supported institution must be from outside urban centres.</p> <p>To cater for differences in the resource base among MFIs, different subsidy levels have been proposed under the UCAP framework for institutions of differing levels of maturity. This will allow for higher support levels for small, community-based institutions, as compared to the more established MFIs. Similarly, it is proposed that the subsidy level will decrease as an MFI reapplies for further capacity-building grants. The proposed UCAP subsidy levels will be used to direct RFSP capacity-building support to smaller rural operators.</p>
<ul style="list-style-type: none"> <li>submission of a well-articulated and costed proposal for providing capacity-building service to rural clients, including a justification of the incremental benefit expected from such service based on a needs assessment. Each proposal should cover a reasonable number of clients and can include several activities;</li> <li>demonstration of capacity and/or track record for providing the required services; and</li> <li>identification of the personnel to carry out the proposed task (including curricula vitae that demonstrate individual competence to carry out the assignments under the proposal).</li> </ul> <p>In the case that demand for funds exceeds their annual availability, preference will be given to areas where the rural area penetration sub-component and the Government's Outreach Plan are providing support.</p>	<p style="text-align: center;"><b>Promotion of a Rural Business Culture</b></p> <p>For development impact:</p> <ul style="list-style-type: none"> <li>progressive increases in production for the market; and</li> <li>sustained increase in household income and assets (arising from more efficient and expanded production due to increased knowledge and skills and access to financial services).</li> </ul> <p>Progress indicators:</p> <ul style="list-style-type: none"> <li>number of farmers and rural poor trained or sensitized in technical and business skills;</li> <li>number of farmers and rural poor that have received functional literacy and numeracy training;</li> <li>number of radio programmes prepared and broadcast with RFSP support; and</li> <li>increase in marketable surplus and incomes of farmers and the rural poor.</li> </ul> <p>Financial indicators</p> <ul style="list-style-type: none"> <li>percentage actual disbursement of sub-component activity funds on annual basis.</li> </ul>	<p>The agency contracted to manage the Rural Business Culture Fund will solicit proposals from interested service suppliers, including public-sector agencies (subcounty /district community development department, functional literacy agency, environmental agency) private-sector agencies (consultancy firms, larger MFIs expanding to new areas, radio stations), NGOs and community-based organizations.</p>
<p>To qualify for assistance in any given year, apex organizations will need to attach to their applications:</p> <ul style="list-style-type: none"> <li>a business plan and budget for the coming year, including adequate plans for implementing the activities for which RFSP funds are intended;</li> <li>audited accounts for the year preceding the application and the trial balance for the latest quarter (as proof of the account being up to date); and</li> </ul>	<p style="text-align: center;"><b>Support to Apex/Umbrella Structures</b></p> <p>For development impact:</p> <ul style="list-style-type: none"> <li>apex structures (AMFIU, Uganda Cooperative Alliance and UCSCU) are strengthened to perform the role of network coordinators and promote MFI expansion and self-regulation;</li> <li>commercial activities developed to increase apex institutions' sustainability; and</li> </ul>	<p>PAU will release the approved funds for each apex organization in semi-annual allocations.</p>



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<ul style="list-style-type: none"> <li>records or account substantiating that RFSP funds for the previous year were used for the intended purposes.</li> </ul>	<ul style="list-style-type: none"> <li>MFI performance monitoring and setting performance standards</li> </ul> <p>Progress monitoring:</p> <ul style="list-style-type: none"> <li>percentage of apex operating expenditure financed from commercially generated funds;</li> <li>number of SACCOs/village banks with RFSP funds by Uganda Cooperative Alliance and UCSCU (promotion started; first year completed; consolidation level reached, that is, two years completed or assistance withdrawn due to reaching a profitable level);</li> <li>number of MFIs and savings and credit cooperatives audited annually; and</li> <li>number of MFIs providing regular performance information.</li> </ul> <p>Financial monitoring:</p> <ul style="list-style-type: none"> <li>financial outcome of income-generating activities;</li> <li>financial outcome in SACCOs/village banks promoted;</li> <li>average costs of SACCOs/village banks promoted by Uganda Cooperative Alliance and UCSCU; and</li> <li>average cost of MFI performance-monitoring activities (per MFI/SACCO; per member).</li> </ul>	
<p>To become eligible for support under the upgrading scheme sub-component, an MFI will need to:</p> <ul style="list-style-type: none"> <li>become a "company limited by shares";</li> <li>have unqualified audit reports for at least the last two financial years;</li> <li>demonstrate at least 90% operational self-sufficiency with an upward trend;</li> <li>command subscriptions – including the requested grant – over required and acceptably apportioned paid-up capital for qualification for the tier it aims at; and</li> <li>be and remain compliant with BOU's performance guidelines.</li> </ul> <p>Approval will be based on the submission of:</p> <ul style="list-style-type: none"> <li>business plans that differentiate between activities (and costs) for graduation and those for other activities such as expansion or new business approaches;</li> <li>realistic physical and financial projections that demonstrate financial self-sufficiency within the following three years; and</li> <li>evidence of an adequate rural dimension or potential of the MFI operation.</li> </ul>	<p style="text-align: center;"><b>MFI Upgrading Scheme</b></p> <p>For performance of the grant facility:</p> <ul style="list-style-type: none"> <li>number of grant requests received;</li> <li>number of grant requests approved;</li> <li>number of upgrading agreements signed;</li> <li>total grant amount of the signed upgrading agreements;</li> <li>total grant amount disbursed (separate: directly/indirectly);</li> </ul> <p>For performance of participating MFIs:</p> <ul style="list-style-type: none"> <li>remaining percentage of the paid-up capital that MFIs plan to devolve to other entities to be capital compliant;</li> <li>portfolio at risk (outstanding loan balance for over 30 days divided by total outstanding balance of loan portfolio);</li> <li>loan loss reserve (as a percentage of the portfolio at risk);</li> <li>operational self-sufficiency;</li> <li>the MFI's ability to produce timely reports adequate for delinquency and financial management (yes/no);</li> <li>percentage of female clients; and, finally, number of participating MFIs attaining the desired tier.</li> </ul>	<p>The managing agency will manage a "virtual fund", i.e. a bank account held and operated by PAU based on the administrative work and disbursement requests of the managing agency to PAU. Any disbursement of an upgrading grant will be conditional upon:</p> <ul style="list-style-type: none"> <li>a request from the implementing agency;</li> <li>receipt of complete quarterly reports; and</li> <li>receipt from the MFI of receipts for goods and services acquired from the proceeds of the grant.</li> </ul>





