



CERUDEB, Uganda - Summary Sheet

Imp-Act is a global action research programme designed to improve the quality of microfinance services and their impact on poverty.

This summary sheet provides an overview of CERUDEB's work with the *Imp-Act* Programme, detailing the process of developing a social performance management system that responds to their institutional needs, as well as the needs of their clients and other stakeholders.

The summary reviews CERUDEB's organisational context, research objectives and activities, findings and lessons learned as they relate to the key messages of the *Imp-Act* Programme.

These key messages are:

MFIs are improving the lives of many of their clients.

A concern with both social and financial performance enables MFIs to improve the lives of poor people.

Experience of *Imp-Act* partners shows that MFIs are managing their social performance cost-effectively.

Impacts of microfinance go beyond clients.

Further information about CERUDEB and the *Imp-Act* Programme is available at the end of the summary.

The objective of **CERUDEB** (Centenary Rural Development Bank) as a fully licensed nation-wide, commercial bank, is to provide appropriate financial services to all Ugandans in a sustainable manner. It aims to provide financial services to meet the needs of low-income clients and farmers as a part of its mission.

One of the recommendations of an earlier impact assessment (IA) exercise undertaken by CERUDEB was that IA should be done on an on-going basis. Therefore, in its work with the *Imp-Act* Programme, it aimed to modify its MIS to collect IA information in order to fulfil four basic priorities:

- To assure the Bank's shareholders that the MFI's mission is being achieved;
- Analysis of product performance and the development of new deposit and credit products;
- Develop a system for credit scoring in order to identify and track clients;
- Access new sources of donor funding to support the Bank's future growth.

A monitoring and evaluation programme was initiated, which could be used by bank staff. Evaluation aimed to collect data on changes in well-being status, develop bank profiles and collate the results of interviews with bank staff and clients whose performance was noteworthy.

Table 1: CERUDEB Key Indicators

	Jan 2001	Jan 2002	Jan 2003	Jan 2004
Clients	16,925	21,821	33,095	44,903
Loan portfolio (USK\$)	9,954	13,221	24,939	34,721
Avg. Loan Size (US\$)	588	605	753	773
OSS (%)	136%	135%	143%	138%
PAR >1 day	2.92%	9.80%	2.68%	5.52%

Source: CERUDEB, MiX Market

Background

CERUDEB is the only commercial bank within the 30 organisations in the *Imp-Act* programme. Globally, it is uncommon to find commercial banks involved in microfinance, partly because of a misperception among for-profit organisations that microfinance cannot be profitable. However, CERUDEB is a commercial bank with a strong sense of social purpose, having been established in 1982 as a trust company by a consortium of Catholic bishops, business people and bankers. It is a large bank, with 300,000 depositors and 40,000 borrowers, governed by standard business principles. It is also the most profitable locally-owned bank in Uganda. As such, it is in a position to give a lead to other organisations within the *Imp-Act* consortium on:

- Strategies for achievement and maintenance of profitability, and the contribution which impact assessment can make to these
- Strategies for the mobilisation of voluntary savings and the assessment of the effect of this savings capacity on depositors
- The development of specialised financial products for poor people, and the impact assessment of such products
- The development of information-management systems which NGOs lack the resources to develop, and the contribution they can make to impact assessment

Objectives Under *Imp-Act*

The original plan was to use funding from *Imp-Act* to contribute towards the development within the bank of a comprehensive client information database which would provide, in particular, the information required for impact monitoring and credit-scoring of applicants for bank loans. The death of the bank's Chief Executive, who had spearheaded this idea, led to a serious lack of momentum within the bank within the information-gathering and processing part of CERUDEB. Furthermore, the Bank's decision to spend most of the *Imp-Act* money on a two-man consultancy resulted in little more than the reconfiguration of its loan application form to encompass the extra information required for monitoring, and no field testing of the form. The project was rescued in 2003 by focusing on impact assessment of the Bank's agricultural lending programmes. These programmes are of particular interest to other microfinance providers because:

- Microfinance still has to prove itself in the agricultural field, which is notoriously difficult to work in because of problems such as climatic uncertainty and irregular income flows
- The microfinance profession has a great deal to learn from the experience of an MFI such as CERUDEB which is successful in the agricultural area
- This is especially true because in most countries of the developing world, improved agricultural productivity is a fundamental condition of exit from poverty; and many poor people are unable to access the new seeds, fertilisers etc they need to increase productivity, because they cannot borrow

Activities

A monitoring and evaluation programme was developed, which could be used immediately by bank staff. As a result, in all of CERUDEB's six agricultural branches an impact monitoring system is now operating, which assesses and seeks to improve the link between branch-level inputs and a range of impact indicators, including several alternative measures of poverty. This has produced validation that agricultural lending to small and, in many cases, poor operators can be both profitable and have a powerful social impact.

Methodology

Evaluation work began late in the programme, in August 2003, and used a three-part methodology:

- Collection of data on standard well-being indicators (income, assets, poverty, vulnerability, health status, acquisition of physical assets, investment in school fees, membership of social networks, employment, productivity) for established borrowers and a control group of new borrowers;
- The assembly of 'branch profiles' describing the inputs provided by and performance of particular branches; and,

- A set of in-depth interviews with Bank staff and 'outlier' clients whose performance was in some sense noteworthy (e.g. very high or very low observed impact).

Given the late date at which data collection started, it has not been possible to monitor performance over as long a period as would have been desirable, and for this reason dissemination of results and ideas within the Bank has had to be compressed into a short period. However, some baseline information on welfare status of some clients within the Mbale branch did exist for 2000, and this has been used to provide a longer period of assessment for that region.

Findings

Impact data collected through *Imp-Act* suggests:

- Very substantial loan impacts (almost a tripling of client income in real terms over three years)
- Variable loan impacts between branches, which can be traced to aspects of institutional design (practices of appraisal, follow-up on customers in arrears, grace periods, and availability of devices for loan protection)
- Impacts which, if anything, are even higher for women than for male farmers, and are more than adequate for low-income farmers
- Substantial fungibility of loan proceeds into school fee payments and 'social capital creation' (i.e. payments of subscriptions to affinity groups)

The need for certain further improvements in procedure, including the more extended use of flexible repayment patterns and the introduction of an insurance scheme to protect the Bank's portfolio against drought, flood and personal health risks

Lessons Learned

- 1. The investigation of 'outliers', i.e. clients with especially good or bad performance in relation to the branch mean.** Experience suggests that information gathered from outliers is valuable for understanding what contributes to high impact and what changes in policy and practice need to be adopted to improve matters. For example, the study revealed that clients who had experienced difficulties with loan repayment badly needed a short-term emergency loan product that could compete on interest rate with loans from traditional money lenders. The Bank's analysis suggests that such a product could be viable at an interest rate of just under 50 per cent – well below the moneylender rate.
- 2. Choice of poverty indicators:** in its main report, CERUDEB works not only with standard indicators of poverty (income level, poverty gap etc), but also with an indicator of vulnerability, which relates to the instability of respondents' incomes, their subjective fears about the future, perceived risks attached to entrepreneurial behaviour, self-esteem and asset levels which protect them from potential risks.
- 3. Choice of other performance indicators and impact on profitability:** no measure of product performance other than portfolio-at-risk was available before the impact assessment system was initiated under *Imp-Act*. Therefore participation in the programme has opened up the possibility of including a wider range of performance indicators, including entertainment expenditure as an indicator of the spare cash a household possesses.
- 4. Inference from impact measures to required institutional reforms:** CERUDEB's approach to impact assessment has not only been as a diagnostic tool to determine where in the system reform might be needed, but can also be used to specify what the reforms might be. The IA exercise conducted through *Imp-Act* has provided the informational underpinning for the following proposed reforms:
 - **Repayment periods:** the IA exercise revealed better repayment rates and higher impacts among those with similar rather than unequal repayments. On the basis of this evidence, it is proposed to move to an equal-installments basis wherever possible within the Bank.
 - **Interest rates:** on the basis of the Bank report's analysis of the costs and returns of loans of different size, it is clear that large-scale, experienced farmers are paying too much, the smallest farmers are paying too little, and an insufficient discount is being given for a record of on-time repayment. The proposed three-part loan tariff proposed in the Bank report

emerges directly from this analysis.

- **Complementary financial products:** the qualitative interviews which complement the survey make it clear that clients regarded the Bank's operational procedures as too inflexible and not giving them sufficient protection against risk. Accordingly, the Bank report proposes two new financial products: an *emergency loan* product to be adapted to the needs of customers struck by extraneous shocks (including over-indebtedness) and an *insurance* product designed to anticipate and protect against such crises.

This concept of impact assessment as a *prescriptive*, as well as a diagnostic, tool, and as a trigger for creativity in institutional design by Bank staff, may also extend to other organisations.

Organisational Change

Changes in Policy

- **Interest Rates:** The interest rate on agricultural loans was rather high compared to the interest charged on other microfinance loans in the same loan size bracket. The Bank charged a uniform interest rate regardless of loan amount, number of loans taken or credit history. Interviews conducted with outliers sparked off concerns over the rates of interest and incentives to farmer clients who have established a good relationship of trust with the Bank. The matter was presented before the Executive Committee (Exco), the top management decision making body in the organisation. Exco then directed the Finance and Credit departments at Head Office to make an analysis of the costs of borrowing for new clients, recurrent clients and clients with a good repayment history. The analyses revealed better repayment rates in all the three aforementioned categories of clients. Management quickly adopted the three-part interest rate structure proposed by the *Imp-Act* study. A high rate is charged for first-time borrowers in the Shs.100,000 to Shs.5 million bracket but it is reduced on the fourth loan for clients with very good credit history. A much lower rate is charged for first-time borrowers in the Shs.5 million to Shs.15 million. The interest rate is even much lower for clients who access loans above Shs.15 million.
- **Emergency Loans:** It was discovered during interviews with clients in default that enabling them to re-invest in a new season can be a means of releasing them from the arrears trap. This is especially true for clients in default due to events beyond their control (e.g. drought, hailstorms etc). Almost all the farmers interviewed in Kasese branch were genuine clients who had arrears caused mainly by the collapse of maize prices in 2001. They still possess the assets required for investment (i.e. land, ox-ploughs etc). What they lack is the working capital required for labour, seeds and inputs. The *Imp-Act* research recommended very cautious reconsideration of some of these farmers to empower them with much-needed working capital for re-investment. Management was reluctant to take on such a 'risky' arrangement. However, the agricultural clients in Hoima branch were adversely hit by drought during the first season of this year (2004). An on-the-spot assessment revealed that these clients had genuinely defaulted because of the prolonged drought in the first season and that they had excellent repayment behaviours. As an emergency measure, management agreed to refinancing of the Hoima farmers. This emergency measure has now been embraced as a policy of emergency loans aimed at rescuing genuine clients from an arrears trap.
- **Crop Insurance:** This policy has not yet been adopted. There will be a diagnostic review of the Bank's agricultural lending scheme sometime in November by a consultant from Latin America. Crop insurance is one of the major areas to be tackled during the review and, depending on the recommendations, it may be adopted as policy.

Changes in Practice

- **Grace periods:** The practice of awarding very long grace periods to farmer clients has all along been a source of debate. Some loan officers contend that long grace periods are necessary to allow thorough crop maturity, hoarding/speculation and sale of crops while others think that long grace periods cause default because of the accumulated payments at the end. Variable loan impact studies between different branches strongly supports the latter view. The rate of default was higher in branches that offered long grace periods. The reverse is true for branches

that offered shorter grace periods. Long grace periods led to huge payments during the short repayment period because of interest accruing during the long grace period. It was also discovered that long grace periods caused clients to be "detached" or lose contact with the bank to the extent of reducing the obligation to pay.

- **Size of instalments:** Farmers' incomes tend to vary within seasons and between seasons because of the seasonal nature of crop harvests. The amount of crops harvested and sold at the end of the season also tends to vary between different months which in turn leads to irregular incomes. The bank had responded through awarding of irregular payments tailored to the farmers' incomes. However, the *Imp-Act* study shows a relationship between regularity of instalments and the rate of default. It was discovered that payments that varied in size between months led to high default rates in part due to the failure of the Bank to project instalment sizes and the farmers' inability to recollect the instalments awarded to different months. This practice has been greatly discouraged in all the branches and loan officers are now urged to regularise loan payments as much as possible.
- **Income diversification:** Rural farmers have to resolve two fundamental problems; On the one hand: resolve the conflict between the seasonal nature of their revenues and the relatively constant need for funds to meet minimum subsistence needs of their families and also to maintain their agricultural production operations. On the other hand they have to search for mechanisms that can help them stabilise their income and consumption to reduce the severity of risks they face due to climatic and market fluctuations. The *Imp-Act* study revealed that farmers who had diverse income sources had better repayment histories vis a vis those with only one income source (farming). Diversification of incomes has the effect of spreading the risk and stabilising incomes. The bank has now adopted the practice of advising farmers to either engage in different agricultural activities or set up non-farm enterprises. Farmers who have only one source of income are considered high risk and may as a result be rejected.

Changes in Products

- **Emergency Loan:** The emergency loan facility described above may soon be adopted as a distinct product or sub-product under the agricultural production loan. Plans are under way to pass it through the Bank's product development guidelines after observation of the performance of the emergency loans extended to farmers in Hoima branch.
- **Crop Insurance:** The bank is in the process of introducing a warehouse receipts lending scheme as a sub-product for smallholder farmers. Farmers will hence be required to deposit part of their produce in designated warehouses and only sell it after successful repayment of their loans. The stock in the warehouse will act as an insurance of sorts. This scheme is still in its early stage of development.

Institutionalising Social Performance

The benefits of social performance have been largely illustrated by the three-year *Imp-Act* study. Right from inception, the bank had plans to modify its MIS to capture data on client impact monitoring and credit scoring on a regular basis. The software vendors that supplied the MIS have been contacted and the ground work made. However, aspects of costs related to these modifications are yet to be ironed out.

Challenges for the future

The challenges that lie ahead for CERUDEB are:

- To extend the monitoring system from the agricultural operations of six branches to all operations of all branches;
- To ensure that information from the monitoring system is fed back to CERUDEB management, particularly managers of agricultural operations and the financial (and especially the microfinance) community; and,
- To ensure that the information is used effectively to enhance the Bank's various social objectives, of which poverty reduction is key.

Imp-Act

Imp-Act is a global action research programme designed to improve the quality of microfinance services and their impact on poverty.

The **Imp-Act** programme promotes the development of reliable social performance management systems, which include impact assessment. These systems reflect and respond to client needs, as well as the priorities of microfinance institutions (MFIs) and their stakeholders.

Imp-Act is also working to improve understanding of how MFIs can sustainably work with very poor and excluded people, as well to consider wider impacts, beyond those on individual clients or their families.

Imp-Act is a collaboration between 30 MFIs in 20 countries, as well as a team of academics from three UK Universities (IDS Sussex, Bath and Sheffield). *Imp-Act* was initiated, and is funded by, the Ford Foundation.

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Further resources on CERUDEB:

- Becker, W.S. 1970 *Agricultural credit and Colombia's development*. PhD diss., Louisiana State University, Baton Rouge, La., U.S.A
- Braun, J.von 1989. *Credit for the rural poor in Sub-Saharan Africa*
- Bhaduri, A. 1977. *On the formation of usurious interest rates in backward agriculture*
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