

Announcing the **Consolidation Challenge Fund** For Ugandan MFIs

Almost every microfinance institution dreams of a future of growth, expansion and prosperity, offering its products to increasing numbers of customers, who loyally and regularly save and pay back their loans on time, only to take additional, and larger, loans later when they need them. In fact, many institutions are finding that the best way, sometimes the only way, to attain that goal is through some sort of consolidation.

MFI consolidations are becoming increasingly frequent, and are motivated by several factors:

- In some cases, there are too many organisations offering the same services to the same customers. The market cannot support all the MFIs, and rather than simply fail, some MFIs choose, or are forced, to join with others.
- Sometimes, the best and simplest way to growth is through mergers or acquisitions, especially when two strong organisations have complementary products and services.
- Sometimes, regulatory constraints lead MFIs to think about partnerships as a way to meet minimum capital, profitability, size, or system requirements.
- And, other times, organisations simply want to get out of the competitive financial services field so they can concentrate on other things.

Competitive Uganda

Any of these factors might apply to some Ugandan MFIs. Certainly, this is a famously crowded market, with more than 1000 microfinance institutions of all types and sizes. Many are large and have national ambitions. With a number of commercial banks now providing services to the same customers as the MFIs, competition is stiff and increasing.

Some fortunate institutions find the formula for attracting and retaining customers, but others find that their products and approaches seem old fashioned and no longer “sell”. Not all the Ugandan MFIs that are here today will be in business ten years from now.

Some MFIs are already reporting flat growth in the big cities where they make most of their money. A recent study¹ of the Ugandan competitive environment showed that customers have little loyalty to their financial service providers, but are shopping around to find the best deals. Older credit products are losing their attraction, and customers are demanding new products – savings, transfers, insurance and individual loans – that many MFIs are not able to offer. Some MFIs have turned to salary-guaranteed lending, but that market is limited.

Market leaders have advantages that often enable them to entrench their lead. An MFI with 100,000 clients is inherently more efficient than one with 10,000 or 1,000 clients, and will be able to take advantage of that efficiency to invest in new products, branding and promotion, more attractive branch offices, better customer service, more staff training, better performing MIS, new technologies like ATMs, lower prices and other features that will enable them to attract still more customers. Scale matters, and it is difficult to attain enough scale through organic growth in a competitive market.

¹ *The Competitive Environment in Uganda: Implications for Microfinance Institutions and their Clients*, by Graham A.N. Wright and Paul Rippey, Kampala, 2003.

Consolidation is Inevitable

Consolidation seems to be the rule in almost every industry, not only financial services. In the United States, for example, there were 108 automobile manufactures in 1927. Today, although the market for automobiles is much larger, the U.S. has fewer than a dozen manufacturers. Similar consolidation has happened in the airline, alcoholic beverage, motion picture, agriculture and steel industries. Even young sectors like software and computers are seeing dramatic and rapid consolidation. There is no reason to think that the Ugandan MFI industry will escape this trend, nor should it: there is too much to be gained through consolidation.

In the worst-case scenario, consolidation will occur because of the failure and closure of MFIs. But no one wants that. Strategic planning carried out well in advance of crises can lead to other solutions, like merger, friendly take-over, strategic partnership, and shared services. These solutions can make consolidation a positive thing for MFI staff and customers. There is no ignominy in merger or partnership in a crowded market – the only shame is to allow catastrophic failure, with the pain it inevitably causes to customers and staff.

Consolidation Helps the Poor

Larger MFIs will have greater efficiency, and the Ugandan microfinance industry will be able to serve more people, and at lower cost to the consumers. The large number of MFIs in Uganda has had to duplicate systems and infrastructure, at high cost to themselves and ultimately to the consumer. Larger organisations are better able to attain the exponential growth that so far has eluded all but a few Ugandan MFIs.

International experience suggests that merged institutions often follow a J-curve, with their growth initially slowing whilst they merge their systems, procedures and cultures, and then growing rapidly, often faster than either partner could have grown separately.

Investments by donors or others in institutional strengthening are not lost in the case of merger; on the contrary, strengthening the internal capacities of an MFI is often necessary to prepare it for merger.

Support for Consolidation

The Government of Uganda and its development partners understand the need for consolidation:

- The latest suggested revision to the Poverty Eradication Action Plan (PEAP) states that “...at the same time as new MFIs are still being created, it is certain that the industry will see significant consolidation over the coming years. There will be mergers, partnerships, and inevitably some failures. Orderly consolidation that protects the interests of clients, staff and other stakeholders is essential for the customers’ welfare and to protect the financial health and reputation of the industry.”
- The Strategic Plan of the MicroFinance Outreach Plan has as one of its key elements “Increased inter-linkages among MFIs and other institutions in the four tiers of the financial system in Uganda, leading to consolidation of the Microfinance segment of the system and linkages between tiers.”
- DFID’s Financial Sector Deepening Project has made assistance to orderly consolidation one of its priorities for the next two years.
- AMFIU, SPEED/USAID, EU/SUFFICE and GTZ have all expressed their strong support for the concept.

What does Consolidation look like?

No two consolidations are exactly alike. Some of the forms that consolidation can take are given here, with international examples.

Sometimes, companies share services but keep their institutional identity. This sort of cooperation is sometimes called *programme* or *non legal merger*. As an example, the four leading MFIs of Jordan have agreed to share an MIS, using a common data format but having customised front ends for each MFI.

There are numerous examples of programme mergers, particularly between formal financial institutions and networks of community based institutions. *Banque Populaire* of Morocco and the *Fondation Banque Populaire* share some administrative services and staff, although the first is a commercial bank and the second an NGO. *AfriLand First Bank* of Cameroon has a similar arrangement with the MC2 network of SACCOs; this is a prime example of a *link bank* arrangement, in which a commercial bank shares its expertise with non-regulated institutions.

More often, there is a change in legal personality, or a fusion of corporate identity. This occurs when two (or more) firms agree to a *merger*. Sometimes, in an *acquisition*, one party disappears as an entity and its activities continue with the organisational personality of the other. An example from the US was the absorption of *Working Capital* by *ACCION*.

Sometimes *both* (or *all*) organisations disappear and create a new entity. A well-known example is the merger of five MFIs into the *FORA Fund*, in Russia. A particular sub-category involves fusion of many small institutions with simultaneous *upgrading of institutional status*; this occurs particularly when groups of financial community based organisations merge into a formal regulated financial institution, ideally retaining the strengths of local sense of ownership whilst gaining the advantages of legality, professionalism, and regulated status. CRS has been a leader in orchestrating this sort of new structure. HOFOKAM in Western Uganda is an excellent local example.

The easiest fusions appear to be *mergers* between two strong partners with complementary products or markets. For instance, in a well-known case, *XAC* in Mongolia, a licensed microlending company, specialised in very small loans, and wanted to get into SME lending. A small SME lender, *Govin Edhlel*, was looking for massive growth. The two merged to form a new bank, *XAC Bank*, able to offer a broader product line to more people.

Sometimes, a microlender's programme disappears altogether with no transfer of assets, as was the case in Tanzania, when the *Menonite Economic Development Association* (MEDA) for internal reasons wanted to divest itself of one of its microfinance programmes. The borrowers – more than 1000 – in MEDA's programme paid back their loans to MEDA, and then applied for their next loans to the *National Microfinance Bank* (NMB). NMB hired MEDA's loan officers and some other staff. No financial assets were transferred. The bank was willing to consider the credit history of the customers with MEDA, and continue to provide good MEDA clients with services. The transfer helped NMB grow quickly, while providing MEDA with a way of winding up that particular programme, at the same time protecting the interest of its good customers.

About the Consolidation Challenge Fund

The Consolidation Challenge Fund offers initial small initial grants to MFIs to help them investigate consolidation options. These can include feasibility studies, asset valuations, legal reviews, market studies, or other options. FSDU has reserved a fund of £75,000 for this activity, and will make grants of a maximum of £25,000 to any one institution or group of institutions.

If an initial grant reveals clear opportunities for substantial gains through consolidation, FSDU may make additional funding available, or work with other donors to mobilise additional funding, necessary to support the costs of carrying consolidation through to its successful conclusion.

Application requirements (Provisional)

- As its name suggests, the Consolidation Challenge Fund is designed to challenge MFIs to examine consolidation possibilities themselves. Therefore, we urge MFIs to be **creative and self-reliant** in thinking of the way forward. We will provide a maximum of **50% of the total cost** of any assistance given under this fund.
- Requests must come from a group of **two or more MFIs** that have agreed to explore consolidation options together.
- Candidates for support under the Consolidation Challenge Fund must include at least one **regulated institution** (Tiers 1, 2, and 3), or there must be a firm and realistic intention to **transform** into a regulated institution.
- MFIs should demonstrate an open mind and the **corporate commitment** at the governance level to consider all options.

Procedures (Provisional)

Applicants should submit a brief concept note, maximum four pages, with the following information:

- Names and addresses of the MFIs submitting the request.
- Cover letter(s) signed by the chairperson of the board at each institution expressing the serious intention to investigate consolidation.
- Descriptions of the institutions, including the following information: Name; address; legal status and date of creation; geographical zone of operations; products offered; numbers of branch offices, staff and customers; operational and financial sustainability (percentages); and name, email and telephone of contact person within the institution.
- Description of the type or types of consolidation that the applicants are considering.
- Nature, estimated cost, and source of the assistance solicited.

After examination of the concept note, FSDU will respond within one month, either rejecting the application, requesting additional information, or inviting applicants to submit longer applications.

MFIs not now ready to submit concept notes but wanting to discuss options, in complete confidentiality, are invited to contact FSDU at CCF@FSDU.OR.UG or PO Box 11086, Kampala.

NB: We believe that it is good business practice for MFIs to investigate all options for the future, including consolidation, and that the willingness to explore all options is an indicator of management strength. Therefore, **enquiries to the Consolidation Challenge Fund will in no way be prejudicial to any other initiatives the MFIs may eventually have with FSDU.**