Norfund

DEVELOPMENT IMPACT
CASE STUDY

DFCU BANK

INCREASING ACCESS TO FINANCE IN UGANDA

ABOUT NORFUND

Norfund is Norway's Development Finance Institution and our mandate is to support the building of sustainable businesses in poor countries, thereby contributing to economic growth and poverty reduction. Norfund's strategy is to invest in the sectors and countries in which we can have the greatest impact; where the private sector is weak and access to capital is scarce. We concentrate our investments in sectors that are important drivers of development: Clean Energy, Financial Institutions, and Food and Agribusiness.

FINANCIAL INSTITUTIONS

DEVELOPMENT RATIONALE

Financial institutions contribute to economic growth by promoting access to finance, encouraging enterprise growth and innovation. Access to finance tends to lead to higher employment growth, especially among micro, small, and medium enterprises, and also helps to reduce poverty.[1]

INVESTMENT NEED

Financial institutions need access to debt and equity for extending loans to clients. Capital helps finance business development, enables banks to develop products and increase their market reach. One of the targets of the Sustainable Development Goals set by the United Nations is to "strengthen the capacity of domestic financial institutions to encourage and expand access for all to banking, insurance and financial services". Access to finance is often more of a constraint for small companies than for large companies. According to the IFC, more than 200 million micro- to medium-sized enterprises in developing economies lack access to affordable financial services and credit.[2]

NORFUND'S STRATEGY

Norfund invests in banks, microfinance providers, and other financial institutions that target SMEs, the retail market and clients that have not previously had access to financial services. Our investments are mostly in locally-owned institutions that have good growth potential and are suited to developing and delivering services. Financial institutions account for 30 percent of Norfund's total investment portfolio, and as of 31 December 2016 our investments in this sector totalled USD 586 million.

CASE STUDY

DFCU

Investment year: 2004
Sector: Financial institutions
Instrument: Equity and loans
Deal type: Privatisation
Ownership: 55 % (through Arise B.V.)

INCREASING ACCESS TO FINANCIAL SERVICES IN UGANDA

The government of Uganda has identified micro, small and medium enterprises (MSMEs) as central to achieving growth and reducing poverty. DFCU Bank – a Norfund investee company – is increasing access to credit and financial services for MSMEs in Uganda, supporting business growth, and creating employment.

ALIGNMENT WITH NATIONAL PRIORITIES[3]

To grow MSMEs, the Government of Uganda aims to

- provide an enabling environment
- promote research, innovation and value addition
- support access to markets and business information services
- increase access to credit and financial services
- strengthen capacity building for entrepreneurship
- enhance gender equity and inclusiveness

Uganda is classified as a Least Developed Country (LDC) by the United Nations and its income per capita in 2016 was only USD 615. The government seeks to accelerate growth in the country, achieve middle-income country status and reduce poverty to 14 percent by 2020[4].

MSMEs play an important role in Uganda's growth strategy as they constitute 90 percent of the country's private sector production. However, MSMEs face challenges which impede their growth and development[5]. According to the Government of Uganda, inadequate financial services are a key development constraint, particularly for women-owned enterprises and agriculture-based enterprises[6].

The country's banking penetration is among the lowest in Sub-Saharan Africa. According to the World Bank Group's Enterprise Surveys, only 10 percent of firms in Uganda have a bank loan or line of credit. This proportion is less than half of the average for countries in Sub-Saharan Africa[7]. Small and medium enterprises (SMEs) in Uganda face particularly constrained access to finance because large foreign-owned banks focus on corporates and high net-worth individuals. The funding offered by financial institutions to SMEs is mostly short-term, making firms more exposed to rollover and interest rate risks, and discouraging them from making longer-term fixed investments. To address the lack of capital available for MSMEs in developing countries, Norfund has prioritised financial institutions as a separate investment sector.

Branch in Entebbe Town

DFCU – A UGANDAN SME BANK

DFCU is a Ugandan bank that offers a variety of products tailored to the needs of SMEs. Established by the Ugandan government and CDC (the United Kingdom's Development Finance Institution), DFCU began its commercial banking operations in 2000. In 2004, DFCU issued shares in an Initial Public Offering (IPO) as a part of the Government's efforts to reduce its direct role in the economy and to promote the role of the private sector in Uganda. Norfund participated in the IPO.

Norfund's assessment

We recognised that there was a clear need to develop the financial sector in Uganda. In 2004, the ratio of credit to GDP was only 8 percent – far below the regional average of 53 percent. The majority of the population was financially excluded, and 48 percent of small firms identified access to finance as a major constraint to business operations.

High levels of risk discouraged commercial investors: the country's credit rating (B) was below investment grade, corruption levels were high, and Uganda scored poorly on democracy ratings. The sum of total foreign direct investment in 2004 was only USD 295 million, or 3.7 percent of GDP[8].

DFCU's profile appealed to Norfund. It fitted well with our strategic priorities and with our mandate to be additional – that is, to provide capital beyond what is otherwise available in the market place. DFCU was one of the few banks in the country that targeted the SME segment, providing commercial banking services, term finance, mortgage finance and leasing. The bank's management planned to grow these product categories further and to increase its presence in the retail-banking segment. DFCU's status as a local bank with a professional and dedicated management was also attractive to us.

Norfund supported the privatisation of DFCU. Our purchase of a 10 percent share in the bank in the 2004 IPO was Norfund's first equity investment in the financial sector.

NORFUND'S ROLE IN DFCU

Norfund's objective is to increase the availability of finance for SMEs in Uganda by growing the DFCU bank into a sound, sustainable financial institution.

Providing finance

We are committed to being the bank's long-term partner, and continue to offer financial support for its expansion. In 2007, we provided a subordinated loan of USD 3 million to support the growth of DFCU's retail and SME lending operations. We also provided a local currency loan equivalent to USD 3 million to support DFCU's new local currency lending facility.

In 2010, DFCU considered the idea to extend longer-term loans to its clients. However, it had limited access to long-term local currency loans. Norfund provided a local currency loan equivalent to USD 10 million with a maturity of 8 years. This credit line strengthened DFCU's capital base, specifically for the financing of SMEs and mortgages. In 2013, Norfund invested an additional USD 20 million in DFCU, increasing our equity share to 27.5 percent.

Mobilising private investors

In 2013, Norfund developed NorFinance, a vehicle for co-investments in the financial sector with Norwegian private investors KLP, Perestroika AS, Skagen Kon-Tiki and Solbakken. Norfund raised a total of USD 68 million and the total capital committed was USD 136 million. This was the first time that private Norwegian investors committed significant capital to support financial institutions in Sub-Saharan Africa. DFCU and one other bank were subsequently transferred from Norfund's portfolio to NorFinance, thereby releasing funds for new investments.

Offering expertise

Norfund is an active owner, and our project team provides continuous support to DFCU to help the bank achieve its growth ambitions. We have been represented on DFCU's Board of Directors since our first equity investment in 2004 and take an active role in the bank's development.

Helping companies achieve good standards of governance and strong environmental and social policies is

Figure
DFCU has become a sustainable and well-performing bank. Financial indicators, 2016

Aspect	Indicator	DFCU	Ugandan banks[9]
Profitability	Return on Average Equity (ROAE)	20 %	16 %
Efficiency	Cost to income ratio	55 %	68 %
Liquidity	Loans/assets	50 %	58 %
Loan quality	Non-performing loans/loans	7 %	11 %
Capital adequacy	Tier 1	21 %	19 %

integral to our work. DFCU and its clients are required to comply with the rules of the EDFI exclusion list and comply with all relevant local, environmental, health and safety, and labour laws and regulations. DFCU is also required to comply with the IFC's Performance Standards.

The bank has developed an Environmental and Social Management System (ESMS) to identify and manage environmental and social risks and opportunities in the loan appraisal and management process. Norfund has provided specialised training and assistance to personnel in DFCU and has helped the bank to identify and better manage transactions with high environmental and social risks. DFCU is required to report annually to Norfund on how it manages such risks.

Supporting capacity building

Norfund offers business development and support through our Grant Facility scheme. This Grant Facility enables us to co-finance improvements and to enhance the development impact of our investments. To date, Norfund has provided five grants, totalling USD 184,000 to support DFCU's learning and development initiatives, including funding for training senior staff in banking and development, and leadership training for women.

DEVELOPMENT EFFECTS

When Norfund invested in DFCU, the bank was the eighth largest bank in Uganda, representing a market share of seven percent of banking assets. DFCU has experienced solid growth during Norfund's ownership and is now one of the top three banks in the country. Key financial indicators show that DFCU's growth has been sustainable.

The bank contributes to realising the Ugandan government's development ambitions of providing finance to SMEs, creating jobs, and generating tax revenues.

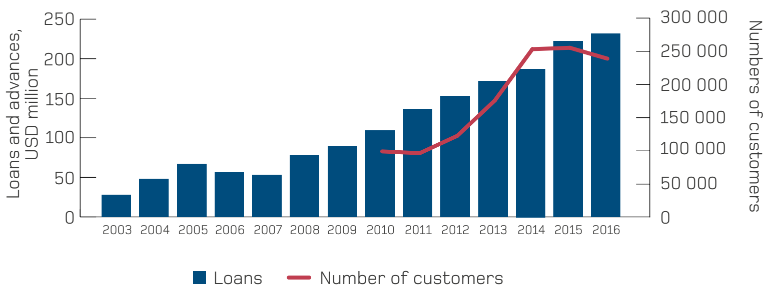
Increasing access to finance for SMEs

One of the key barriers to financial inclusion is the distance that clients must travel to bank branches. When Norfund invested in 2004, DFCU had only 7 branches in Uganda. Today, the bank has 67 branches and reaches customers throughout the country. The bank's loan book has increased from USD 28 million in 2003 to USD 360 million in 2017.

The bank prioritises SMEs, a segment that in mid-year 2017 accounted for 89 percent of the bank's total loan book. DFCU provides a diverse set of products to meet the savings, transactional and borrowing needs of SMEs. On the borrowing side, the bank offers business growth loans for companies seeking to expand, fulfil supplier contracts, or buy goods and stock. Trade financing is also offered to clients in the trade and services industry. Leasing services are offered to those wishing to acquire plant machinery, commercial vehicles, or business cars.

Funding from Norfund has contributed to the growth of DFCU's long-term loan portfolio. At the end of 2016, 47 percent of the bank's loan book was long-term finance (i.e. credit facilities where the tenor is 5 years and above).

Figure
DFCU has increased the availability of finance for SMEs in Uganda



Agriculture is a priority sector for DFCU

Supporting women entrepreneurs

Women own 40 percent of the SMEs in Uganda but face barriers when trying to access finance. Limited land ownership means that many are unable to provide loan collateral. Low financial literacy among women also means that some find it challenging to document their businesses, or to articulate their plans and projections. To address these issues, DFCU established the Women in Business (WiB) programme in 2007. The programme includes business training, financial advice, networking opportunities, a range of banking products at preferential terms and mentorship programmes. Products are tailored to the different needs of three client segments: professionals, traders and women in agribusiness. Close to 19,000 women are currently registered in the programme, and more than 3,000 women have benefited from WiB loans.

In 2012, DFCU became the first institution in the Ugandan market to initiate and launch its own Women Business Advisory Council. The Council is mandated to assist the DFCU Board and DFCU Management in addressing the specific needs of their female customers and female employees more effectively. In 2015, the bank opened a Women Advisory Centre which serves as a one-stop shop for the provision of business and financial advisory services to women.

Lending to key sectors

The bank's lending activity supports national priorities: 54 percent of its loans were provided to sectors defined as 'primary growth sectors' by the Government of Uganda[10]. Agriculture, for example, engages more than 70 percent of Uganda's working age population. DFCU is focused on increasing its lending to the agricultural sector and has established a dedicated agribusiness unit. Rabobank, one of the world's leading banks in the field of food and agribusiness, is a DFCU shareholder and is helping to strengthen DFCU's involvement in agriculture. DFCU's products take the specific characteristics of the sector into account, such as seasonality, price fluctuations, and climate disruptions. Loans to this sector now account for 16 percent of the bank's loan book.

In a bid to reduce the challenges farmers face with providing collateral, DFCU designed specific products that use alternative security mainly based on group deposits and guarantee. The products were rolled out in June 2015 to 22 farmer groups of 30 – 40 people. By December 2016, DFCU was providing finance to over 128 farmer groups.

Financial literacy

Over 5.2 million bankable Ugandans do not have access to banking services partly due to lack of knowledge. In 2014, DFCU rolled out the financial literacy programme. The programme has benefited over 84,000 investment clubs. In addition, DFCU has set up the Agri-business Development Centre with an objective to train mainly smallholder farmers to enhance their bankability.

Creating jobs

The bank has grown from 217 staff at the time of Norfund's investment, to 756 employees in 2016. 48 percent of the bank's employees are women, and 47 percent of its managers are women.

Uganda's banks compete for a limited pool of skilled banking professionals. DFCU has implemented several family-friendly policies, including additional paid maternity leave and paternity leave, and staff training programmes. These initiatives have helped to increase staff retention.

Meeting with agri customer

Financial literacy training for female engineers.

Increasing public revenues

DFCU is a profitable bank, and pays annual corporate income tax to the Ugandan government. Since Norfund first invested in 2004, DFCU has paid close to USD 28 million in corporate income taxes.

DFCU: THE WAY FORWARD

In 2016 Norfund, FMO and Rabo Development established Arise – an investment company whose objective is to strengthen financial service providers in Africa. DFCU is one of the 10 banks included in Arise's portfolio. In 2017, Arise provided DFCU with a bridging facility of USD 50 million to fund the acquisition of Crane Bank, a local bank which had recently defaulted on its liquidity requirements. The acquisition helped DFCU to become one of the largest banks in Uganda. At present, only 60 percent of MSMEs in Uganda are using commercial banks[11], and DFCU has an important role to play in expanding access.

Going forward, Arise will help DFCU's efforts to achieve the following strategic priorities:

- expanding retail operations
- consolidating its position as a key player in the SME market segment
- supporting its digitalisation strategy
- becoming a leading player in the banking sector (including the provision of services to the agri-business sector) ■

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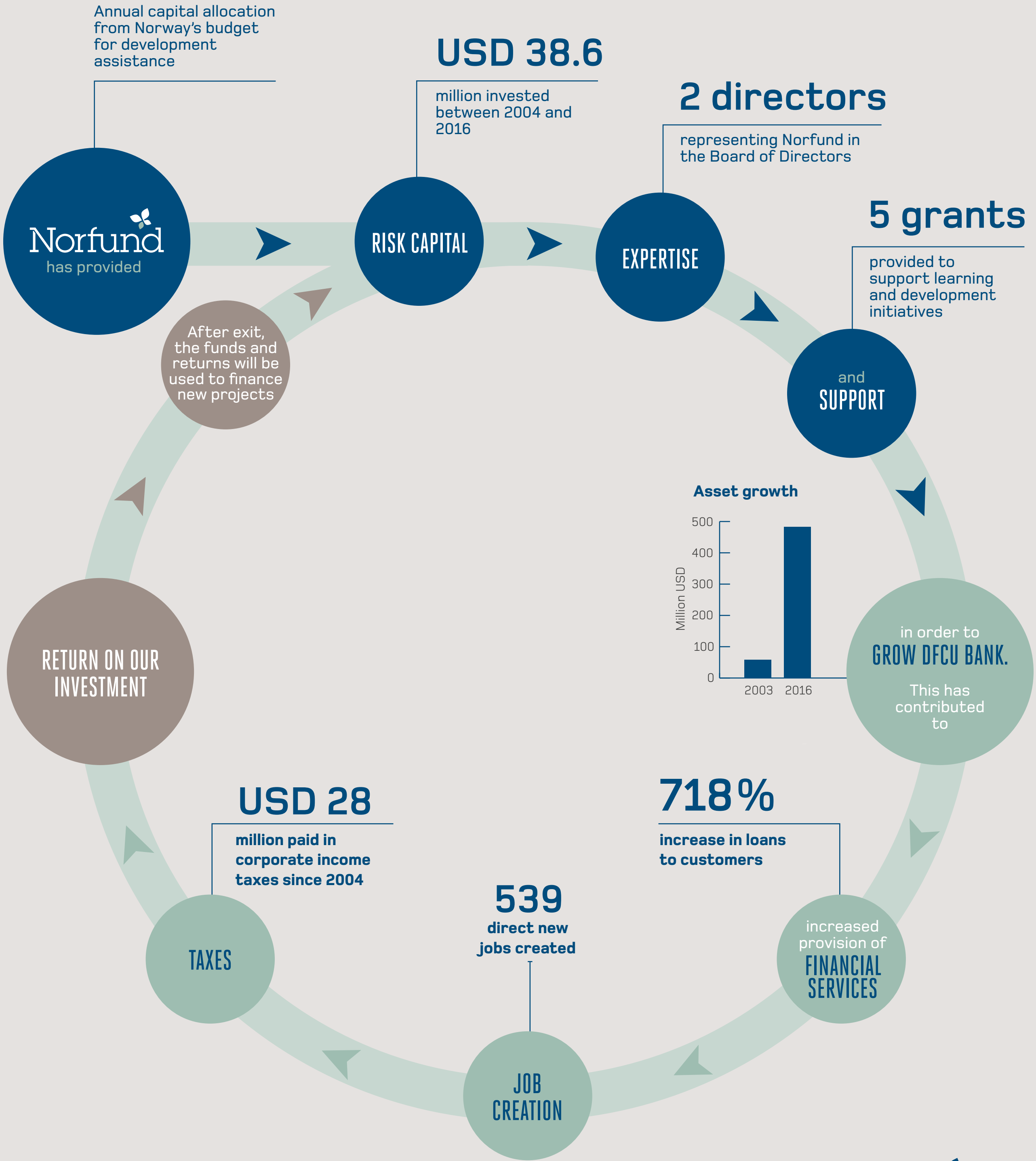
NORFUND'S INVESTMENT IN DFCU



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