Case Study

Agribusiness: Vendor Financing in Input Markets

Case Study of DFCU LEASING COMPANY - UGANDA

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(DFCU Leasing Company)

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I.0 Background

DFCU Leasing

Uganda Leasing Company Limited was established in 1994 by the Development Finance Co. of Uganda (DFCU), Nile Bank, the IFC, the CDC, and the DEG, and commenced leasing in 1995. DFCU Limited acquired Uganda Leasing Limited in 1999 to form DFCU Leasing, the leading leasing finance house in Uganda. DFCU Leasing facilities target Small and Medium Sized Enterprises (SME), which comprise over ninety percent of all Ugandan businesses, provide fifty percent of the jobs, and contribute two-thirds of the national income. SMEs are DFCU Leasing's focus because of their contribution to bottom-up development, poverty reduction and potential for formation of a middle class.

DFCU Group Structure

DFCU Leasing is a subsidiary of DFCU Limited, which was incorporated in 1964 to provide long- term finance for the country's economic development. It is owned by the following four shareholders:

	Mar. 31, 2003
CDC Capital Partners (formerly Commonwealth Development Corporation)	35.3%
Deutsche Investitions- und Entwicklungsgeselschaft mbH (DEG)	24.7%
International Finance Corporation (IFC)	21.5%
Uganda Development Corporation	18.5%

DFCU's role has evolved over time into a commercially focused organization that charges market rates, while still being committed to the country's economic development. DFCU Group comprises DFCU Limited (long term lending); DFCU Leasing (Asset financing); DFCU Bank (Commercial Banking); Rwenzori Properties (commercial properties); Housing Finance Company of Uganda Limited (Mortgages). Over the last four years, (1998-2002), DFCU Group has grown from the eleventh largest financial institution in Uganda to the fourth in terms of assets.

1.1 Leasing Industry in Uganda

The Ugandan leasing industry is still in its infancy. Leasing represents less than one percent of private sector capital formation (approximately 5% of total private sector credit) in Uganda as compared to the average of 14% in emerging markets and 31% in USA. DFCU leasing controls over 85% of the Ugandan leasing market. The Company recognizes the growth potential of leasing and acts as a catalyst to grow the entire industry by:

- Expanding its own profitable operations;
- Educating the marketplace;
- Creating a more effective legal and fiscal environment;
- And, promoting financial sector development by lobbying for new instruments.

There are considerable benefits to making leasing available in a developing economy, as well as challenges. The rationale for leasing is highlighted in the following table;

Table 1: The Case for Leasing

Benefits to SMEs	
Accessibility	Leasing can allow new businesses with limited capital and credit history or small businesses without a history of financial statements to quickly boost their operations, as long as the cash flow from operations is sufficient to cover the lease service payments. It is not a direct substitute for lending since it does not directly increase operating capital, but whenit enables the borrower to avoid using operating capital to purchase an asset, it can have similar results.
Security	Since lessors own the assets and use the leased asset as the primary security, SMEs can still be eligible for the lease financing when bank loans would not be available.
Duration	SMEs often have no access to long-term financing (over one year). Leases can provide longer duration financing, often with terms from one to five years.
Payment terms	Lease payments can be structured to mirror individual cash flow patterns of the lessee in contrast to bank loans, which have standardized repayment schedules.
Process time	Owing to the collateral-backed nature of the financing, less analysis is required of the customer's credit worthiness, assets or capital base; less time is needed for assigning other collateral; and, simpler documentation can be used. (This may be countered by the time it takes to acquire the assets, usually from foreign vendors).
Benefits to Lessors	
Security	Since lessors own the assets and can repossess them immediately upon non-payment, the security is easier to claim than when the financier has to chase after a client's collateral, often through poorly developed court systems.
Funds usage	Because the lessor purchases equipment and then leases it there is no opportunity for the lessee to use the funds for other purposes.
Benefits to Financial Sector Development	
Cash flow based lending	Moves the financial industry to rely more on cash flow based lending than on credit history and formal historical financial records.
Diversification	Broadens product range and competition in financial services, which should lead to lower cost financing.
Capital markets	As leasing companies seek new funding via loans, bond offerings or securing their lease receivables, they help to deepen and broaden domestic capital markets.[1]
Macroeconomic Benefits	
Technology transfer	Finances the import of more advanced equipment
Productivity	Increases use of more efficient equipment.

1.2 Mission Statement

The Company's mission **is to maximize shareholder growth while maintaining and building up its capacity to support development –related activities.**

All DFCU Leasing activities are therefore focused on both 'profit and development'.

3.0 DFCU Leasing Activities and Donor Programs

3.1 Financial Leases – Middle Ticket Transactions

DFCU Leasing's core activity is the provision of finance lease products to SMEs i.e. middle ticket transactions in the range of $25,000 – 250,000. Transactions outside this range are however, handled via special schemes designed to increase market penetration. Some basic information on DFCU's standard financial leases is indicated in Table 2 below.

Table 2: DFCU Finance Leases – Overview of Terms

Size of Leases	Ush 50 – 500 million (~ $25,000 – $250,000); average is about Ush 70 million (~$35,000)
Repayment Period	2-5 years; average is 3 years
Interest Rate	16-26% on local currency transactions; average is 18% for transactions > $50,000 and higher for lower lease amounts (forecasted to drop as cheaper funding is obtained)
Deal Processing Time	Maximum of 2 weeks
Lease Currency	US$ or Ush to match lessee income
Nature of Equipment	Any durable asset, plant, equipment, machinery, commercial vehicles, business cars, computers (Excludes nuclear or military equipment or equipment that supports illegal or industries such as pornography, prostitution, illicit drugs, businesses based on tax evasion or which employ forced labor of any kind.)
Cash Down Payment:	10-15% of equipment cost
Asset Ownership:	DFCU as the lessor maintains full ownership of the asset throughout the lease period
Option to Purchase:	Exercised by lessees at the end of the lease at up to 5% of cost
VAT:	Charged on rentals, both capital and interest costs, where applicable
Insurance and Maintenance:	DFCU insures assets and passes on the cost to the lessee; maintenance is the lessees responsibility

3.2 Special Donor funded programs

In order to increase its market penetration and support to small businesses in the rural areas, DFCU Leasing is working in partnership with three donor agencies on the programs summarized here below;

3.2.1 Small Unit Leasing under the DFID Challenge Fund Grant

- Launched in January 2002,
- Total fund GBP 2m (comprising GBP 1m grant from DFID and DFCU matched funding).
- Objective: poverty alleviation and modernization of production in the rural areas.
- Methodology: provision of leasing facilities to small and rural based businesses – minimum transaction size: GBP 1,000.
- Target – 1,000 commercially viable businesses over a three-year period (including 30% women sponsored).
- Market driven interest rate charged to beneficiaries.
- Total commitments to 31.03.03 – GBP 2.4 billion to 560 beneficiaries (includes 180 bee keepers).
- Commenced pilot program for bee keeping and mushroom growing in rural areas for small amounts (minimum $300 each), targeting 1,000 farmers over a two-year period.
- Support for training of DFCU Leasing credit officers in processing small unit transactions
- Sponsorship of market awareness campaigns; leasing handbook, seminars, establishment of the Uganda Leasing Association.

3.2.2 Uganda Energy Fund –Shell Foundation US$ 4m

- Launched in January 2003.
- Partnership between DFCU Leasing and Shell Foundation.
- Total Fund: US$ 4m (comprising $ 2million grant from Shell Foundation and matching funding from DFCU).
- Purpose: to increase the availability of modern energy services in rural areas.
- Methodology: provision of lease facilities to SMEs that: wish to acquire modern energy generation/utilization technologies; manufacture, distribute and sell energy services/products; or distribute energy efficient products.
- Technical Assistance Fund - $250,000 for business skills training and co-funding of feasibility studies, securing consents.
- Funding targeted at commercially viable enterprises/ventures. Market interest rates.

3.2.3 USAID/SPEED (Support for Private Enterprise Expansion & Development) *Project: Rural Leasing Centres.*

- Offered support for establishment of three rural Leasing Centers.
- Total Funding US$ 300,000 (to cover CAPEX and two year operational costs on a matching basis with DFCU Leasing)

- Purpose: to increase on market penetration of leasing facilities in the country
- Leasing Centers established in Eastern, Western and Central regions of the Country
- *Grow your business centers* sponsored by SPEED provide BDS to potential lessees at two Leasing Centres in Lira and Mbarara.
- Has offered tremendous support in advocating for a conducive leasing environment - tax, legislative and regulatory issues i.e. sponsored the African Leasing Convention in Kampala, Sponsored a study on required tax reforms.

3.2.4 Insurance Premium Financing

Introduced in June 2002, the DFCU Leasing's Insurance Premium Financing (IPF) facility allows the SMEs to meet their insurance obligations associated with their own assets while making payment installments over ten months. SMEs who chose to use this facility obtain premium quotations from insurance underwriters. DFCU Leasing pays the full premium to the underwriter and the insured repays the premium in monthly installments ranging from four to ten months. The facility benefits the lessees by providing them an alternative source of working capital and ensuring they maintain insurance on their own assets. The facility benefits the underwriter by giving them more secure receivables, which increases their liquidity and capacity to settle claims. However, this product constitutes only three percent of its activities.

3.3 Table 3. Five-year (1998-2002) statistics as ofDecember 31, 2002

	Particulars	**Nos.**	**Million US$**
1.	Total disbursements – 1998-2002	1,587	$ 52.4m
2.	Portfolio Quality: Performing NPA	94.5% 5.5%	- -
3.	Direct job creation (est.) – 1998-2002	5,000	
4.	Average sustainable profits– 2001,2002		$1.5 m
5.	Average profits after tax – 2001,2002		$2.2m
6.	Lease awareness/education contacts	3,600	

3.4 *Sectorial and Regional Analysis*

Tables 4 and 5 indicate the regional and sectorial spread of leasing transactions as of December 31, 2002. DFCU Leasing facilities apply across all sectors and types of equipment. The transport sector is still the most dominant accounting for over forty percent of all leased equipment.

Based on the regional spread, activities in the rural areas (outside Kampala) account for forty-three percent of the total business volumes at the end of2002. This is forecast to grow to 50% by the end of 2003.

Table 4: Market penetration by region

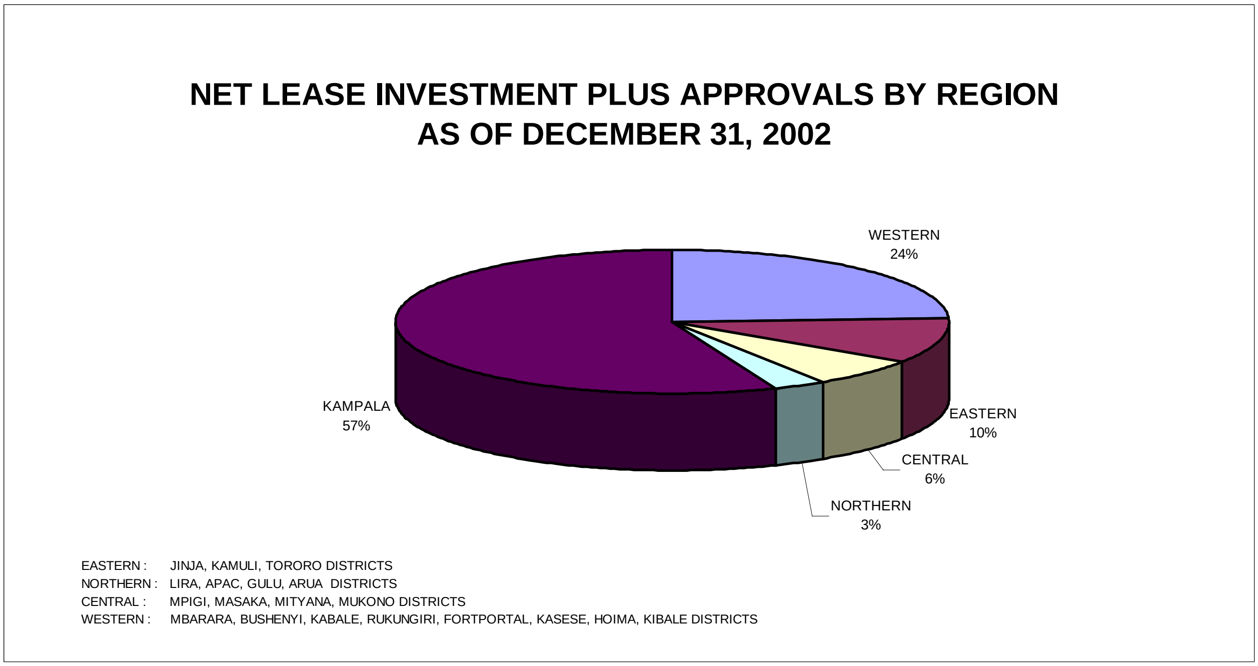
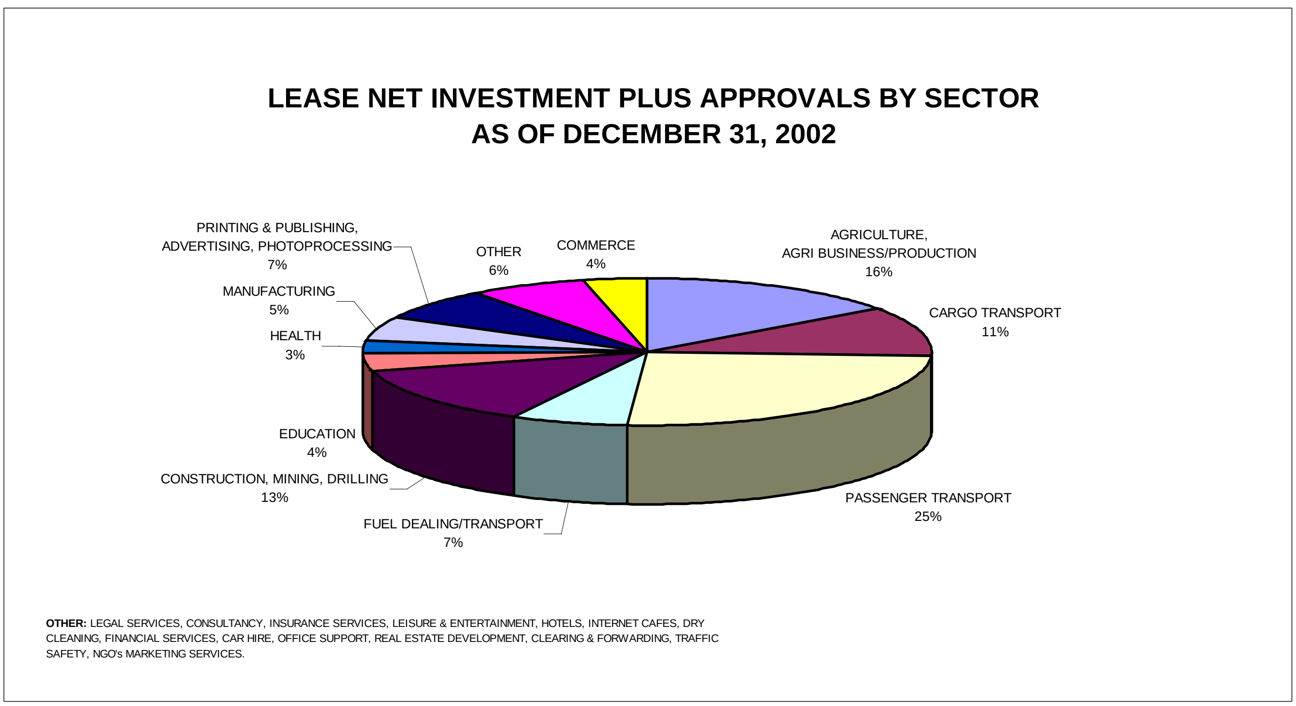


Table 5: Market penetration by sector



4.0 Results and Impact

Leasing is an effective credit delivery tool and has a strong developmental impact on the economy by providing commercial and industrial equipment to smaller scale business enterprises. It is helping to bridge the current funding gap for business enterprises that fall within the *'missing middle'*, i.e. too big for the Micro Finance Institutions (MFI) and unattractive for the traditional Commercial Banks. The MFI normally provide funding in very small amounts and for short periods that may not be sufficient to acquire productive inputs while the latter will only deal with well-established businesses with good collateral. Thus, the special donor programs have enhanced DFCU's capacity to increase its market penetration by broadening its services outside its current market niche (loans of $25,000-$250,000) and to the rural areas.

Small businesses are becoming accustomed to using banking and insurance services and creating savings due to the need for cash contributions for things such as mandatory insurance on leased equipment and using postdated checks to settle rents. This is especially true among the rural population.

Leasing is playing a major role in the modernization of the economy via technology transfer, efficient marketing and production methods especially in the areas of transportation, primary processing and cottage industries. Increased production, improved efficiency and value added processing of agricultural commodities lead to improved incomes. Support to small enterprises will result in increased production, the creation of value added products, especially those related to agriculture, and reduce wastage and loss through increased efficiency. The resulting improvement of primary product producer, most often women in rural areas, incomes will stimulate economic growth and better living standards.

Following the establishment of rural Leasing offices with the assistance of USAID/SPEED, DFCU Leasing has gradually extended its activities outside Kampala and rural financing currently accounts for 47% of the total business volume. The regional offices have also improved service delivery and efficiency of monitoring and processing small transactions.

Modernization of production methods not only saves time (especially for women in rural areas), but also improves the safety and quality of processed food. For example, the use of milk coolers and stainless steel cans for dairy farmers, sinking of bore holes for easier access to drinking water, the use of tractors for farming, mills for grinding grain, LPG Gas for cooking instead of firewood, maize shellers and driers all improve food safety and quality when. compared to the existing rudimentary practices.

Possibly the most noticeable impact of Leasing on the economy is on the transformation of the transport sector. Provision of 'appropriate transport' via leasing has enabled producers of primary and often-perishable products to access markets in the urban centers and reap competitive prices for their products. Furthermore, the availability of affordable and reliable passenger transport has improved communication and the movement of goods in all parts of the country.

As equipment is subject to wear and tear, general growth in the service industries and mechanic shops used to maintain the equipment has also occurred. This growth creates more jobs and sources of income.

The Uganda energy Fund and DFID Challenge Fund programs are focused on poverty alleviation and modernization of the economy especially in the rural areas. The former is assisting in increasing access to modern energy services for commercial activities while the latter has made it possible for DFCU Leasing to consider small lease facilities that the rural population can afford. Of particular importance is the pilot bee-keeping project that has a strong potential to improve the household incomes of the rural poor.

5.0 Sustainability of DFCU Operations

5.10 Funding

As highlighted above, DFCU Leasing has the twin objective of profit and development. This policy is intended to enable the Company to leverage its capital and continue its activities on a sustainable basis.   The following is a summary of its major funding sources.

5.1.1 Debt Finance – Lines of Credit

DCU Leasing sees funding as its main constraint to further growth. At present, the Company's major source of funding (accounting for over 65%) is from International Financial Institutions such as, FMO, IFC, KFW, DEG, EIB that provide long term funding. This is occasionally supplemented by short- term facilities from Commercial Banks and Insurance companies by way of 'bridge financing'. The average cost of DFCU Leasing's borrowings is about 12%.

5.1 .2 *Cash Guarantees*

In addition to debt financing, DFCU Leasing's cash deposits collected from lessees is over US$ 2 million and represents interest-free financing.

5.1.3 Proposed Bond Issuance

DFCU Leasing plans to issue a bond so as to mobilize funding from the local market on a sustainable basis. Arrangements are at an advanced stage and subject to the stability of the Treasury bill rates. However, it should be possible to issue the bond in the third quarter of 2003.

5.1.4 Factoring and Securitization

DFCU Leasing is exploring other innovative avenues of financing including factoring and securing lease receivables. The current legal and regulatory environment does not support factoring so DFCU is working with the Bank of Uganda to gain support to develop the appropriate legislation and procedures.

5.1.5 Donor Grants

Donor support from USAID/SPEED, the Shell Foundation, and the DFID Challenge Fund has been instrumental in broadening the range and coverage of DFCU Leasing activities. DFCU will continue to work in partnership with Donor agencies to implement projects that have a high development impact, but require soft funding to mitigate the risks.

DFCU Leasing, therefore, has the potential and good will to mobilize funding to sustain its activities provided that it continues to operate profitably.

*5.2 **Operational Efficiency***

DFCU Leasing is the market leader in Uganda with over 80% market share. DFCU faces competition from the East African Development Bank (EADB) in the form of leases and from the European Investment Bank's (EIB) "Apex" loans in the form of very low interest loans channeled through local banks. As the banks look for low-risk, credit-worthy clients, they target DFCU's larger clients and lure them away with lower interest rates. DFCU has lost some of their bigger clients to the banks and has been forced to look further down market for new customers.

In order to counter this competition and continue operations on a profitable basis, DFCU Leasing has introduced several innovations aimed at reducing monitoring and processing costs and standardizing of products. A description of these innovations follows:.

5.2.1 Deal Flexibility

DFCU has the ability to offer customers customized financing packages that suit their business needs and cash flow stream. The staff and sophisticated software used by DFCU allows for structuring customized rental schedules for lessees. This flexibility also allows DFCU Leasing to finance customers who are credit worthy but would not be able to comply with rigid bank loan terms, thus reaching a broader customer base.

5.2.2 Responsiveness and Branch Net Work

DFCU Leasing generally processes deals within two weeks. This is a much shorter period than its competitors and allows it to process an increasing volume of leases. The existing branch network has enhanced the processing of upcountry transactions both in terms of cost and time. Thequick response time and high level of customer intimacy has resulted in strong customer loyalty
and is exhibited by the level of repeat business and introductions from existing lessees and suppliers. Consequently, the company has built a substantial base of clients which allows it to grow primarily through repeat business and businesses linked to current clients. This repeat business eliminates much of the risk that accompanies an expanding client base and minimizes marketing expenses.

5.2.3 Cost Management and Procurement

DFCU Leasing has developed a range of suppliers for both new and used equipment. Approximately 60% of the equipment leased by DFCU is used which leads to considerable cost savings. It is vital that the financed equipment is of good quality and is fairly priced as this forms the basic security of the transaction. Financing of used equipment has been especially popular among SMEs, which tend to suffer high production costs and a low capital base. Used equipment also tends to offer more acceptable technology compared to more recent sophisticated technologies that are both too expensive and difficult to maintain in the local environment.

5.2.4 Equipment Preservation & Lease Monitoring

DFCU has invested in staff and technology in order to monitor their leased assets. In-house engineers regularly check on the assets; vehicle-tracking software allows management to know where all their trucks are at any time; and, lease officers and management use regular reporting and client visits to supervise any clients who are delinquent in their payments. DFCU insures all of the leased assets and provides insurance premium financing to clients to help them insure their own assets.

5.2.5 Deposit Requirement

As mentioned earlier, the cash deposit provides DFCU Leasing with interest-free financing for further asset purchases and also confirms the customer's commitment to the lease transaction.

5.2.6 Risk Management & Credit Control

DFCU Leasing has adopted a careful portfolio of management policy that encompasses among others; limiting exposure to single companies, building up the portfolio cautiously, seeking extra security for riskier or large leases, maintaining good Management Information Systems, regular visits to lessees, fair pricing, selection, regular inspection and close monitoring of the leased assets. These policies have enabled management to assess and mitigate risks at an early stage.

6.0 Challenges of Leasing in Uganda

Leasing is a fairly recent concept in Uganda and hence there are a multitude of challenges that have to be overcome to ensure the sustainable development of the Leasing Industry. Below is a summary of six major challenges and how DFCU is navigating through them;

6.1 Creating a Conducive Leasing Environment (tax, regulation and legislation)

Following several years of misrule and insecurity, leasing was reinvigorated in1994 with the establishment of DFCU Leasing as the first independent leasing company. The current legal framework has enabled leasing through guidance of the Income Tax Act (1997), VAT statute and Common Law.

Whilst these laws have supported the re-vitalization of the leasing industry in Uganda, there are some specific aspects of the legal, regulatory and fiscal environments that are being assessed for revision in order to promote growth in both leasing and financial services. These are:

- The current tax legislation allows the lessees to claim capital allowances on the leased assets. Unfortunately, most lessees are 'tax exhausted' and hence the tax benefits are lost. Changes in tax laws allowing this tax benefit to the lessors would provide an incentive for rapid growth of the industry (new entrants).

- Value Added Tax (VAT) is assessed on the entire leasing transaction and is passed onto the lessee, but the majority of lessees cannot claim credit on their VAT expenses since they either fall beneath the VAT registration thresholds or are in the exempt category. As a result, leasing transactions cost even more for those businesses least able to afford it. There is need to provide training to SMEs on the benefits and facts of VAT registration and VAT administration and if possible waive VAT on rentals to SMEs below the minimum threshold.

- There is no Leasing Act in Uganda that stipulates the rights and obligations of lessors and lessees towards each other. Many developed countries have avoided specific leasing legislation and expanded leasing operations through common law, accounting guidelines, precedent and practice. However, given the state of development of these supporting industries in Uganda, leasing legislation may prove more effective in providing conclusive direction on the rights and obligations of lessors and lessees.

- Leasing legislation is not currently flexible enough to support a range of diversified products such as operating leases, contract hire and plant hire. There may be a need to define an appropriate framework for the introduction of additional financial products such as operating leasing and factoring.

DFCU Leasing is working closely with USAID's SPEED project to provide a private sector perspective on these and other issues related to leasing legislation, regulation and tax treatment.

6.2 Dispute Resolution and Court Systems

In addition to the above legal framework issues, improvements in the operations of the commercial courts would facilitate the enforcement of legal contracts and reduce time and costs associated with contract disputes. The courts need to be automated to allow for faster and cheaper processing of cases and the arbitration services need to be buttressed with more and better trained arbitrators.

USAID/SPEED is sponsoring CADER (Center for Alternative Dispute Resolution), a project under the Ministry of Justice, to speed up dispute resolution of commercial transactions. In order to expedite resolution of disputes especially with respect to small transactions, DFCU Leasing is revising its documentation to allow for arbitration.

6.3 Increasing Market Awareness of Leasing

DFCU Leasing continues to educate the market place on the benefits of leasing via several mediums namely; leasing seminars held throughout the country; provision of educational materials such as the Leasing Handbook for Uganda; sponsorship of events and advertisement in the local dailies. By being an advocator for leasing and a source of information, DFCU not only increases its business prospects but also improves SME's understanding of financing options.

In addition to the general campaign described above, DFCU Leasing is working closely with USAID/SPEED, to educate and engage business leaders and government officials on issues pertaining to the leasing industry. The African Leasing Convention, which was held in Kampala in September 2002, was attended by several policy makers and provided an excellent forum for sharing experiences of leasing practices and the nuances in Sub-Saharan Africa.

A follow up of the recommendations of the convention has resulted in the formation of the Uganda Leasing Association, an Apex body for lessors and stakeholders in the leasing industry. This will allow collective action in advocating for a conducive leasing environment.

6.4 Building Capacity and Local Expertise in Leasing

One of the major constraints to the growth of leasing in Uganda is the limited or absence of local leasing expertise in the market. Consequently, DFCU has adopted a policy of recruiting new employees (trainees) from universities, targeting graduates with degrees in engineering, agriculture, accounting, statistics and economics. To train the new staff members, DFCU Leasing provides training workshops (conducted by Euro money twice a year), mentoring and on-the-job training.

DFCU Leasing staff numbers have painfully but steadily grown from four to thirty people since 1998. As the company has grown, its leaders have expanded the compensation package to be more reflective of employee performance. Senior employees are also eligible for financial support for continuing education, mortgages, and car loans, which helps employee retention, growth and morale.

6.5 Mobilizing Suitable Funding

As indicated in 3.5 above, having access to funding is key to the continued growth of leasing. DFCU Leasing has so far been successful in attracting competitive funding to develop the business.

6.6 Operational Competencies

DFCU Leasing has devised a number of innovative solutions so as to effectively service the SME market and small lease transactions. Some of these processes are described below;

6.6.1 *Customer Assessment and Approval*

Customer assessment is broken into two processes, initial Screening and Credit Appraisal.

During the initial screening, applicants are logged into a database and the loan officer spends time assessing the applicant’s character and making judgments without formal financial statements. The officer documents the results of this meeting and circulates them to a senior manager to decide whether to proceed with the credit appraisal. In some cases where clients do not have good financial records or understanding of leases but are near either the Lira or Mbarara business development centers opened under the SPEED project, the DFCU officer will refer them to the center for training. The business centers help get the clients ready for leasing by assisting them with the development of cash flow statements and with the operational and accounting details of financial leases.

The credit appraisal process includes a more rigorous review and completion of a Credit Proposal that reflects an assessment of the client; business type, financial position, legal structure and ownership, management set up, competition, sustainability, customer base, export potential, technical aspects, environmental practices (DFCU only approves leases with clients who comply with the World Bank's environmental standards). The appraisal also focuses on the cash flow and adequacy of the leased equipment as security for the transaction. While DFCU Leasing's main security is the leased asset itself, it may in some cases seek additional security to control for risks associated with the lessee's reputation, financial situation, the nature of the leased asset and the amount of investment at stake.

For smaller transactions, techniques such as credit scoring, mutual guarantees, peer pressure, and group lending are often practiced in order to strengthen the transactions.

6.6.2 Committee Approval

DFCU Leasing Credit Committee (CREDCO) comprises four Senior Executives and is headed by the GROUP Managing Director. CREDICO meets at least once every week to consider deals above $50,000. The General Manager approves lease transactions of up to $25,000 while those above 50% of his limit require post approval ratification by the Managing Director. DFCU's main competitive advantage lies in its flexibility and speed of approving transactions.

6.6.3 Supply Linkages

Understanding the supply chain and unblocking constraints is critical to the success of small businesses. DFCU Leasing has therefore worked in several cases to facilitate supply chain linkages in situations where the entrepreneurs are too small to compete or lack technical know-how. One example was in linking small milk suppliers to a large DFCU funded dairy plant to improve the market for their products. Another example is the bee keeping project where DFCU has developed a model to address the bottlenecks in the honey industry, which include poor quality, lack of expertise, low volumes, lack funding for the bee hives, and poor marketing of honey products.

6.6.4 Equipment Procurement

DFCU Leasing will only purchase equipment after ensuring sufficient resources are available. While the selection of the equipment is the responsibility of the lessee, DFCU Leasing only leases equipment that is clearly identifiable, removable and which can be leased or sold in the event of repossession on default. Special care and conditions are applied when leasing specialized or limited use equipment or equipment which can rapidly become obsolete (e.g. computers).

However, one issue that DFCU faces is that there is rarely a sufficient stock of the assets on hand, which requires the leased items to be imported, taking three months on average. Because DFCU's demand is spread thinly across a variety of assets, the low stock of assets held by local suppliers will remain until there is increased demand either through increased leasing or outright purchasing.

6.6.5 Prudential Guidelines

DFCU Leasing prudential norms dictate that the company diversifies its risks across industry, equipment types, regions and client exposure. In general, DFCU Group's commitment to any one client does not exceed 50% of the total assets of the client, and DFCU Leasing's exposure to any one industry should not exceed 25% of its lease portfolio.

DFCU Leasing makes a general provision of 2% on the Uganda Shilling denominated finance leases and equipment stock and 3% on dollar denominated leases and stock. Directors also make specific provisions on the outstanding capital costs of leases which they consider doubtful, which are leases more than ninety days in arrears.

To minimize arrears and ease collection of rentals, DFCU Leasing requires lessees to make out post-dated checks or standing orders for payment of the gross rentals due over the lease period. DFCU discourages bounced checks and late payments by charging penalties.

6.6.6 Lease Pricing

DFCU Leasing prices its leases based on its cost of funds plus: risk associated with the lessee, their business and the type of equipment; market and competitor lease rates; lease term; size of security deposit and value of additional security; currency risk and loan loss provision.

6.6.7 Reporting and Monitoring

DFCU Leasing has implemented comprehensive monitoring and reporting procedures, managing predominantly by exception. Management generates daily arrears reports and monthly reports to monitor their portfolio of leases. The monthly reports include a report on each lessee, an arrears aging analyses, and summaries of the lease principles, income and bad debts provisions. As soon as DFCU notices a missed payment, they will investigate the client's situation via a call or visit. At least annually, credit officers complete an investment review for each lessee. These credit reviews are reviewed by their managers and include third party feedback, macroeconomic factors and any additional information that they can obtain on the client.

DFCU Leasing uses a risk rating system to determine which customers need to be closely monitored. The review indicates whether the credit risk is improving, stable or deteriorating. DFCU Leasing will not offer facilities to borrowers classified as non- performing.

6.6.8 Equipment Inspection

DFCU Leasing engineers inspect leased equipment at least annually and leased vehicles every six months to ensure that the equipment is well maintained and in sound condition. Leased vehicles are also installed with a car-truck monitoring system to be able to track their whereabouts at all times and minimize on theft and ease repossession.

Repossession

DFCU Leasing repossesses equipment and vehicles as soon as arrears exceed three months, except for accounts for which reasonable circumstances can be verified. DFCU Leasing may repossess assets at any time. DFCU staff carry out most of the repossessions, only calling on auctioneers when their staff fail to trace the assets or when they are in dangerous or inaccessible locations. All expenses accruing as a result of the repossession such as for towing, parking and repair will be charged to the lessee. DFCU Leasing has been successful in working directly with their clients to repossess their assets, only having complications in two cases wherein the clients took DFCU to court for asset repossession.

Repossessed assets are either re-leased or disposed of to recover the termination sum. Due to high resale value of most of the equipment, DFCU leasing normally recoups 99% of the book value when the asset is sold or re-leased.

7.0 Management Capacity

DFCU Leasing has a strong management team committed to the development of leasing in Uganda. The General Manager, Juma Kisaame, has developed a high level of expertise in leasing during his two years of training provided by two expatriates from England. By adopting a 'hands on' and a teamwork approach, management has been able to build the leasing operation. The company has been turned round from a loss making position in 1998 to a profitable operation (annual profits above $2m over the last two years) today.

In addition, the Group CEO, John Taylor, has brought expertise and strong leadership to DFCU Group. He has reinforced the organization's commitment to ethical business practices by having the board adopt the Ethical Business Code of Practice which requires that DFCU and its clients meet standards with respect such to factors as the minimum wage rate, health and safety conditions, use of child labor, and maximum number of hours worked. He has also devised bonus and incentive schemes based on employee performance, which have had a strong impact on employee motivation.

8.0 Recommendations and the Way Forward

DFCU management wishes to share some of their recommendations for the way forward in regards to the leasing industry, the financial sector in general, and SMEs. These recommendations build upon the legal and tax recommendations cited earlier in this report but highlight important corollary work that needs to be done.

- Provide fiscal incentives to attract financing to SMEs, in the case of leasing, this can be achieved by allowing lessors to claim the capital allowances on finance lease transactions. Leasing is a proven credit tool with a high development impact.

- Develop the capital markets and legal framework to enable the mobilization of local funding for SMEs. This could be achieved by instituting legal reforms that;

    - Ease initial Public Offerings (IPOS) for SMEs that wish to mobilize venture capital on the local market (to overcome low capital base).
    - Facilitate mobilization of funding via innovative techniques like security factoring, and bond issues by reputable finance houses.
    - Establish an Apex wholesale finance body through which donors can channel funding for development activities to be accessed by participating financial

institutions on a commercial basis. This would eliminate market distortions funding costs that are often caused by offering of direct subsidies to the beneficiaries and ensure an even playing field. The body could be further developed to offer risk support to selected areas/sectors that need special consideration.

- Develop business associations to increase market knowledge (local and international via the Internet) and advocacy for SMEs so as to improve on their competitiveness in the global market. The Apex bodies would help their members harness the supply chain to their advantage. This would also facilitate skills and technology transfer through supply chain linkages, and adoption of appropriate technology.

- The Finance Institutions need to adopt efficient processes that are responsive to the needs of their targeted clientele. This will inevitably require adequate investment in appropriate technology and being within easy reach of the target market.

- Rationalize business laws to make them modern, consistent, understandable and conducive to business growth and market evolution. There is a need for simple processes and lower costs for business registration and licensing.

- Encourage donors to assist with the development of local sustainable consulting and business support services. The BDS centers would provide business support to the SMEs as well as equip credit officers with the pertinent information in dealing with small transactions in the rural areas.

These recommendations are helpful in creating a road map for moving forward. They are also representative of the issues faced by many other developing countries.