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TREASURY MANAGEMENT SUPPORT TO MDIs & SACCOs

FINAL REPORT

March 2007

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Rural SPEED

Rural Savings Promotion & Enhancement of Enterprise Development

TREASURY MANAGEMENT SUPPORT TO MDIS & SACCOS

FINAL REPORT

Rural SPEED
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EXECUTIVE SUMMARY

The first four micro deposit taking institutions (MDIs) were licensed by the Bank of Uganda and have continued successfully mobilize voluntary savings from the general public. Carrying a significant proportion of demand liabilities was the main reason that the MDIs had to transform from micro credit NGOs into true financial intermediaries who face all the classic management issues of banking. On the other hand, SACCOs mobilize savings from the public who are members. Hence, liquidity and vault cash planning, capital adequacy and interest rate risk have come into sharp focus and have put the spotlight on the treasury management skills of the emerging MDIs and SACCOs.

Rural SPEED retained Bankakademie International to take stock of the state of treasury management practice at the MDIs and 8 partner SACCOs and provide expert mentoring in key areas of treasury management that have a direct impact on prudential viability, efficiency and sustainable rural service delivery.

The core of the assignment consisted of a two-week consulting program carried out on site in Kampala and South-western Uganda by Dr. Joachim Bald from March 7th to March 22nd, 2007. The program included a three days Asset Liability Management (ALM) review of three selected SACCOs (MAMIDECOT, Shuuku and Muhame), followed by a three days treasury review function of three MDIs (UML, FINCA and U-TRUST), which had received training and mentoring in 2006.

The on site reviews were followed by a one day refresher course for MDIs targeting their short comings in the treasury functions, and a two days training for the 8 SACCOs. A simple ALM manual was prepared to work as a guide to the SACCOs in training and going forward in their treasury functions. During the training of SACCOs, one MDI participated, which worked as a beginning link of MDIs to SACCOs especially in the area of capacity building.

The assignment confirmed that all three participating MDIs (U-Trust, FINCA, and UML) had gone a long way to implement the recommendations of the previous training and interactions through the benefit of a competent, amply qualified financial management staff and head office treasury function. It was also established that the SACCOs needed the kind of assistance which had been accorded to the MDIs, to equip them with the necessary skills to run the institutions in accordance with recommended standards.

As next steps, the three MDIs are to continue implementing the specific enhancements recommended in regard to account management, vault cash planning, treasury risk reporting and liquidity contingency planning. The SACCOs will develop outlines of the treasury policy documents for their institutions individually to be reviewed by the Rural SPEED Savings/Treasury Management Specialist.

After treasury management courses for the MDIs, the next major topics in MDI financial management are performance measurement and management accounting. Here, the objective is to develop profitability measures for business units, products and possibly even individual clients. Associated topics are profit centers, product costing, funds transfer debits/credits, margining and customer pricing. From the limited observations during this assignment, management accounting is deemed a largely new frontier, which will require substantial process changes and systems investment, but promises a significant return on investment from better product pricing, a more refined customer segmentation and improved resource utilization.
For the case of SACCOs there is need to have further mentoring and on site interactions to enable them implement the recommendations as out lined in the appendices.

SECTION I

BACKGROUND

Introduction

Over the last 10 years, Uganda has made impressive progress towards a viable, dynamic financial services sector. Financial services play an important role in poverty alleviation as an engine for economic development and as sponsor of entrepreneurial activity. Fifteen commercial banks, seven commercial credit institutions, four licensed micro-deposit taking institutions (MDIs), and numerous smaller microcredit and cooperative organizations are now active in the country. Nonetheless, effective outreach to the rural areas of Uganda remains a challenge. Only 10 percent of the rural populations have access to basic financial services and the formal and informal financial sectors still require some structural changes in order to provide the range of services that individuals and businesses require.

The USAID/Uganda strategy for 2002-2008 calls for expanded sustainable economic growth in the rural sector, promoting a connection between productive strategies by the private sector and the expansion of rural financial services. The Rural Savings Promotion & Enhancement of Enterprise Development (Rural SPEED) program was designed to address this challenge and to deepen and strengthen financial services.

In addition, interest rates remain high, adequate forms of collateral do not exist due to continuing disorganization within the land registry system, and there is little accountability of Tier 4 institutions such as savings and credit cooperative organizations (SACCOs) and savings and loan associations. To stay true to goals set in the GOU's Poverty Eradication Action Plan (PEAP) to achieve an economic growth rate of seven percent to eight percent and reduce poverty to 10 percent by 2017, all citizens, especially the poorest, must benefit from economic growth and have access to financial services.

Early in 2006, Rural SPEED provided MDIs training and on site mentoring in treasury management. With enhanced skills in asset liability management, the MDIs were better positioned to further mobilize rural savings (lowering their cost of funds) and have consequently started lowering the costs of financing for both urban and rural clients. While this is a positive development, the MDIs themselves still have limited experience with managing relatively volatile low cost liabilities. Further, they also lack the capacity to forecast the impact on their operations of clients shifting from borrowing (their traditional business) to saving for their needs (their new product line). To ensure that the MDIs are implementing the recommendations from the earlier training and mentoring and as well continue to strengthen their treasury management function, a follow on consultancy is required.

Additionally, Rural SPEED's partner SACCOs, which also mobilize deposits, have never received any formal training in asset-liability management. This type of sophisticated management was largely out of reach for these SACCOs until Rural SPEED completed assisting them with accounting, financial management and delinquency management. This training has now been completed and as such, it is further relevant to provide Rural SPEED's top performing SACCOs with basic training in treasury management.

Carrying a significant proportion of demand liabilities adds a challenging new dimension to the business model of the MDIs and SACCOs. MDIs have had to transform from conventional NGO-style providers of microcredit into true financial intermediaries, who face all the classic management issues of banking. Liquidity and vault cash planning, capital adequacy and interest rate risk have come into sharp focus and have put the spotlight on the treasury management skills of the newly licensed MDIs and the people owned SACCOs.

The MDIs have previously received valuable training in treasury management that helped address the readiness requirements of the MDI licensing process. Now that MDIs are over year and half into large scale deposit mobilization, and having been exposed to treasury management skills, Rural SPEED saw a clear need to take stock of the state of treasury management practice and further provide expert mentoring in key areas of treasury that have a direct impact on prudential viability, efficiency and sustainable rural service delivery. This time partner SACCOs had to be brought on board and get introduced to key issues of treasury management functions.

Objective of the Assignment

Rural SPEED retained Bankakademie International for this short-term technical assistance mission in treasury management benefiting the MDIs FINCA Uganda, Uganda Microfinance Limited (UML), Uganda Finance Trust (U-Trust) and partner SACCOs Muhame, Shuuku, Bugongi, Kitagata, Rubabo, Ikongo, Kyamuhunga and Masaka Micro finance and Development Trust (MAMIDECOT) . The objective of the consultancy was to provide a general review of key concepts of treasury management which was introduced to MDIs the previous year and review the key concepts of the treasury management functions specifically for SACCOs, conduct a gap analysis for one model SACCO, comparing current staff skill-sets, systems and processes against best practice, and the development of a capacity building program in conjunction with the institution to address any shortcomings identified in the gap analysis.

Methodology

Bankakademie advises a broad perspective on treasury that encompasses the management of the entire intermediation function of a microfinance organization. Treasury therefore encompasses what is often called asset-liability management (ALM). Depending on its interpretation, ALM is often largely synonymous with treasury, but one also still finds ALM definitions that are very narrowly focused on just interest rate management.

The common denominator of all treasury activities in the broad sense that we advocate is risk: measuring it, controlling it, diversifying it, hedging it. In its essence, treasury management is risk management.

Our treasury methodology is structured along a conventional taxonomy of financial banking risks. All of the classical financial banking risks also apply to micro-deposit taking institutions. The only exception is equity price risk, as MDIs would rarely hold traded equity shares as investments and certainly do not actively trade in equities as a part of their business model.

The SOW

This SOW has two related purposes geared toward improving the treasury management functions of both MDIs and SACCOs (both lawfully engaged in deposit mobilization targeting small depositors).

The first purpose of this SOW is to mentor three of Uganda's MDI's as follow up to earlier treasury management trainings and present all MDIs with a brief course covering opportunities for improvement identified through the mentoring. The second, related, purpose of this SOW is to survey three of USAID/Rural SPEED's partner SACCOs to establish strengths and weaknesses of their treasury functions then to develop a basic treasury management manual, present the manual through training and then mentor local professionals to follow up the training.

Tasks:

- Based on previous work, meet directly with FINCA, UML and U-Trust (MDIs) to follow up the progress on their treasury management frameworks developed last year and assist them where relevant.
- Present a one day refresher course for all MDIs (maximum 15 participants) targeting any shortcomings identified in the previous task.
- Conduct a field survey of three SACCOs (MAMEDICOT, Shuuku and Muhame) to review their current practices in asset liability management.
- On the basis of the previous task, develop a simple manual covering SACCO asset-liability management.
- Deliver a two days training workshop on key concepts to the SACCOs using the manual.
- Mentor MAMEDICOT with local assistance from an MDI (to develop the assistant's mentoring capacity)

SECTION II

ACTIVITY SUMMARY

The core of this treasury assignment consists of a two-week consulting program carried out on site in both Rural and Urban areas in Uganda by Bankakademie International consultant Dr. Joachim Bald from March 6th to 22nd 2007. The program was opened by a day on site review of ALM to each of the three partner SACCOs (MAMIDECOT, SHUUKU and MUHAME) treasury functions. This was followed by preparing a simple ALM and training manual for SACCOs.

The consultant and Eldard Ssebbale of Rural SPEED then conducted a one day review session for treasury functions to each of the three MDIs (UML, FINCA, and U-TRUST) with the financial managers and treasury teams at each MDI. Then one day refresher training was conducted to the MDI managers and treasury officers.

Later in the process a two days training session was conducted to the 8 partner SACCOs, attended by financial managers and treasury staff and Board of Directors. The workshop served to set out the conceptual framework, highlight typical issues in microfinance treasury and to take stock of concerns raised by the financial managers that cut across all the eight institutions. This was followed with a one to one discussion with the individual SACCOs, which was followed by a one day mentoring session to MAMIDECOT.

In the course if the assignment , the consultant was developed and printed a simple ALM manual to be used and followed by the SACCOs. During the course of trainings and interactions the following risks were identified as crucial to each category of institutions

Most Relevant Risks for MDIs

Financial Banking Risks

Liquidity Risk

Credit (Portfolio) Risk

Components of Market Risk

Interest Rate Risk

Most Relevant Risks for SACCOs

Financial Banking Risks

Liquidity Risk

Credit (Portfolio) Risk

Operational Risk: People, processes and systems.

SECTION III

CONCLUSIONS AND RECOMMENDATIONS

MDI Treasury Management

- Streamlining of correspondent accounts: All three MDIs have drastically reduced the number of decentralized bank accounts overall. All regularly sweep funds from remaining "receipts-only" accounts and have implemented a central accounts payable queue. all three retained and no more than three vault cash provisioning accounts.
- Improved purchasing power vis-à-vis the core banks retained has allowed the MDIs to lower their funding costs on (partially secured) overdrafts 18%-19% a year ago to 14% -15% today.
- All 3 MDIs have put in place a weekly vault cash planning framework involving branches. Vault cash procurement is now done as pay-against identification instructions or via pre-issued buffer cheques. no more emergency cheque couriers.
- MDIs have reduced average vault holdings by at least one third since last year and have been able to pay down overdraft utilizations. UML vault: UGX 1,1 billion to 750 million average.
- Special efforts have been made particularly at UML and FINCA to reduce un-allocated receipts. Reconciliations are a priority and are tracked closely. Next step is to implement batch posting of receipts from machine-readable bank statements.
- All three MDIs have begun measuring and reporting their open forex position. UML is currently looking at hedging a pre-existing EUR 500k exposure to incofin.
- Recommended updates to treasury / liquidity policies have been adopted at all three MDIs. Regular liquidity status meetings and board level ALCO meetings are being held.
- Liquidity contingency planning, stress test scenarios and interest rate risk analysis require further elaboration. FINCA treasurer is keen to do pilot for net income simulation based on basis risk assumptions.
- Portfolio credit risk naturally continues to dominate the risk landscape at all MDIs. Recommended to upgrade portfolio risk reporting by using vintage analyses with additional segmentation by product and by branch.
- All MDIs report difficulty in reconciling IAS 39 requirements and impairment provisions prescribed by bank of Uganda.

TREASURY MANAGEMENT SACCOs

First impressions

- SACCOs impress with competent and very professional full-time management staff.
- Rapid growth and successful savings mobilization.
- High incidence of operational risk: fraud, theft, burglaries
- Relatively high loan delinquency, PAR(30):10%-20%.
- Presentation and content of financial information and committee reporting not optimal.
- Vulnerability to governance problems:
- Weak supervision & monitoring by elected officials
- Pocket Boards motivated by cost allowances, compromised independence
- Connected party loans
- Interference by board members in proper process and controls

Key treasury management issues

- Cash handling procedures, safeguarding of assets, internal controls
- Planning vault cash: storage costs, shipment costs, forecasting flows.
- General liquidity management: minimizing opportunity loss on idle cash, short-term investment options, determining appropriate size of reserve holdings.
- Seasonality in loan demand and deposit supply
- Need to cultivate short-term borrowing opportunities
- Profitability, margin management, budgeting.

- Managing credit portfolio risk.

In essence, somewhat smaller scales than at MDIs, but fundamental issues are identical: the classic challenges of managing a financial intermediary.

SACCOs: Organizational and Governance risks

Independence of elected officials

- Independence of elected board members vis-à-vis full time staff and management is critical to be effective in controlling and supervising management:
- Elected board members should have financial technical skills roughly on par with management.
- SACCOs must emphasize education for elected officers. active duty should only be assumed after an initiation period that assures adequate training.
- Financial compensation for elected officers and committee members should be a reimbursement of incidental costs only, not a financial incentive or quasi-salary.

Staff risks and mitigating factors

- **Shortage of skilled staff:**
- In hiring, training and retaining staff, budget for growth and some natural attrition. Some trained staff will inevitably move on to greener pastures.
- Allow for staff rotation between positions and branches. this is excellent training provides a staff pool to cover for contingencies and is an effective tool for reducing fraud risk.
- Make it mandatory that all staff take at least one week of contiguous annual leave.
    - This forces the training and readiness of deputies and stand-ins.
    - Excellent way of deterring and detecting fraud.