Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

Banking Sector Liberalisation in Uganda: Process, Results and Policy Options

Lawrence Bategeka and Luka Jovita Okumu
December 2010

In a case study about the financial sector in Uganda, major developments in the banking sector over the past two decades are critically examined. In particular, the study provides an overview of banking sector liberalisation policies that were initiated since the early 1990s and their outcomes. The major impacts and consequences of market-led banking reforms on the economy, development and poverty eradication are being assessed. It also deals with recent developments in the Ugandan banking sector in the aftermath of global financial crisis.

The study has a special focus on the entry of foreign banks. From a host country perspective, it provides new insights into the role of external actors such as foreign banks, including their involvement in the pushing of financial deregulation and liberalisation policies in Uganda.

The study examines the large presence of foreign banks with particular attention on access to credit to poor people, small and medium enterprises, and impact on the rural and informal economy. It finds out whether the entry of foreign banks leads to increased financial stability, technological upgrading, higher investments and better access to credit.

Some of the key findings of the study are following:

- Foreign banks dominate the domestic banking system in Uganda. As much as 87 percent of existing banks in the country are foreign–owned. Of late, there is growing trend towards mergers and acquisitions in the banking sector.
- The banking sector reforms have not led to reduction in the gap between formal and informal sectors of finance.
- The foreign banks are predominantly located in Kampala (capital city) and urban areas.
- The majority of rural population is under-banked. The rural households are largely dependent on informal sources of finance to meet their consumption and investment needs. The microfinance institutions serving the rural population charge very high interest rates and other transaction costs.
- To some extent, local banks have performed better than foreign banks in terms of providing financial services to SMEs and low-income rural households.
- The loan portfolio of banks has not witnessed sufficient diversification over the years.
- Since 2006, there is a considerable decline in lending to the agricultural sector.

- Interest rate spreads have remained very high, despite the implementation of the financial liberalisation policies.

- Foreign banks have a tendency to "cherry pick" the most lucrative bank transactions. They provide bank services to a niche market consisting of big corporations and high income households located in urban areas.

- The foreign banks have hardly passed on management skills and knowledge to the local banking system.

- The large presence of foreign banks has serious implications on the conduct of monetary policy and exchange rates.

- The government should play a major role in providing access to banking services in the under-banked rural areas through tax and other policy measures.

The findings of this study are relevant in the light of increased foreign ownership of domestic banks and financial institutions in many poor and developing countries.

From a host country perspective, the study raises several policy-oriented issues related to the entry of foreign banks in the developing world. It highlights several adverse impacts of foreign bank entry which are not given due attention in policy and academic circles. This study could serve policy debates and stimulate discussions about the benefits and costs of market-led reforms as well as increased presence of foreign banks in the poor and developing world. Comments and inputs on this study are welcome.

Authors: Lawrence Bategeka and Luka Jovita Okumu, senior research fellows at Economic Policy Research Centre, Makerere University, Kampala, Uganda.

Editors: The studies are jointly edited by Kavaljit Singh (Madhyam, India) and Myriam Vander Stichele (SOMO, The Netherlands). Comments and inputs can be emailed to: m.vander.stichele@somo.nl

This study is a part of research and policy studies initiated by SOMO (Netherlands), in cooperation with Madhyam (India), to examine the experiences of banking sector liberalization in developing countries, starting with Asia and Africa. It was financially supported by the Dutch Ministry of Foreign Affairs. The content of the study is the sole responsibility of SOMO and Madhyam and can under no circumstances be regarded as reflecting the position of the Dutch Ministry of Foreign Affairs.

The full version of the study can be requested at the SOMO address and is available for download at <http://somo.nl/publications-en/Publication_3646/view>