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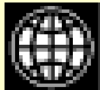
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Uganda's Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy



Author's Note

The paper provides a review of the public postal operator within the postal sector and the broader context of the Communications sector. Subsequently, the roles of the postal network and the Postbank are reviewed in the perspective of the financial sector development, with particular focus on payments systems development and micro finance.

This paper has been prepared from desk research in 2004. Field visits were not scheduled, but nevertheless interviews were held with some of the key managers of Postbank, and data was exchanged through conference calls and e-mails. Previous working experience with Posta Uganda and Postbank were useful in preparing the paper. There was limited data available regarding the financial sector (e.g., branches, outlets, ATMs) and the postal operator's annual reports.

While this country case on Uganda can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (*Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam*) and 5 regions (*Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa*).

Glossary of Abbreviations and Acronyms

BOT	build-operate-transfer
EDI	electronic data interchange
EFT POS	electronic fund transfer at point of sale
GDP	gross domestic product
IMF	International Monetary Fund
M1	transferable deposits and cash in circulation
MFI	microfinance institution
NGO	non-governmental organization
PERD	Uganda Ministry of Finance
PTSP	private telephone service provider
SWOT	strengths, weaknesses, opportunities, and threats matrix
UCB	Uganda Commercial Bank
UCC	Uganda Communications Commission
UNDP	United Nations Development Programme
UGS	Uganda shilling
UPL	Uganda Post, Ltd.
UPOSB	Uganda Post Office Savings Bank
UPU	Universal Postal Union
USD	United States dollar
VSAT	very small aperture terminal
WAN	wide-area network

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Summary

SWOT Analysis of Uganda Postal Service

<table>
<tr><th>Strengths</th><th>Opportunities</th></tr>
<tr><td>
Dense network with 320 post offices throughout the country
Growth in mail volume
Modern legal and institutional framework and postal sector policy being addressed by Uganda government
Relatively good level of awareness of rural and remote communities
On-going stream of visitors to pick up or bring mail, or to make a phone call
Informal, familiar setting of postal network
Relatively small operation (320 offices with less than 600 staff) presumed to break-even on operational revenues against operational expenditure
Positive connotation by the elderly generation of a tradition of a post office savings bank before 1980
</td><td>
Has used privatization as a means of attracting funding, human capital, and new services and applications to provide competitive postal services and transform post offices into a nationwide chain that provides access to ICT, telecommunications and basic financial services
If restructures or upgrades its network could fill in voids in access to diverse financial services, payments, inter-national remittances, savings, small credit, and insurance.
Given the small size of the organization and operation, a turnaround should be feasible in the short-term through relatively small-scale investments and new services and applications.
</td></tr>
<tr><th>Weaknesses</th><th>Threats</th></tr>
<tr><td>
Narrow menu of services: mail, parcels, and express only; very low demand for these services
Very poor quality of services: no delivery of mail to home, shared letter boxes, theft of mail
Poor quality of postal network: minimal capital expenditure to maintain or improve the post office for more than 20 years
Low pay scales leading to poor quality of staff
Financial services through Post Office Savings Bank (POSB) and Postbank basically terminated
No strategic alliances with retail trade or communications suppliers
Technology and management information systems not available
No access to funding or finance to upgrade services
</td><td>
Policy and privatization process for the public postal operator is not clearly determined, and is dependent on the Uganda Communications Commission and Uganda Ministry of Finance (PERD) which have to deal a wide range of other priorities; also risks a protracted, unresolved restructuring process.
Valuation of assets and current business volume is likely to be very low or negative, and therefore not generating adequate private sector interest.
There is continued resistance and interference from politicians, trade unions, and public opinion.
</td></tr>
</table>

1— Postal Sector Development

Uganda faces many challenges, but the main ones include restoring peace to parts of northern or north-eastern Uganda, combating HIV/AIDS, and eradicating extreme poverty. Despite many reforms and advances, Uganda remains one of the poorest nations in the world. For the rural people, particularly women and small-scale farmers, supporting themselves and their families remains a daunting task. Lack of sufficient access to appropriate financial services is one of their largest problems, and there remain many improvements needed to facilitate outreach to the population of Uganda, which is considered to be one of the most severely under-banked societies in Africa.

Origin of Modern Postal Services in Uganda

As in other parts of the world, written messages in Uganda were conveyed by mail runners stationed at various points along a given route until 1895 when Rev. Earnest Miller of the Church Missionaries Society introduced modern postal services in the country. He designed and produced the first postage stamp on his typewriter (the only one in the country at the time). Postal services were then mainly used by the colonial government to distribute documents to and from the various administrative centers inside and outside the country.

In 1933 the postal and telecommunications services of Kenya, Uganda and Tanganyika were merged with the establishment of the East African High Commission. In 1948, the Posts and Telegraphs Department became a High Commission service. When the East African Community (EAC) was established in 1968, the East African Posts and Telecommunications Corporation (EAP & TC) was formed to manage postal services in the region. EAP & TC maintained the services until 1977 when the EAC collapsed and a caretaker organization, Uganda Posts and Telecommunications Corporation (UPTC),[1] was formed by Decree No.15/1977, to take over EAP&TC affairs in Uganda. Postal sub-sectors started opening up when UPTC licensed DHL and other international couriers as early as 1987.

In 1987, under its Economic Recovery Program, the Uganda government recognized the need to comprehensively reform its public sector, in order to reduce the financial and administrative burden of managing state-owned enterprises. The objectives behind this policy were:

- To reduce the direct role of government in the economy;
- To promote a greater role of the private sector in the economy; and
- To improve the efficiency and performance of private enterprises.

Following this liberal policy, in 1993 the government set up a multi-sectoral, inter-ministerial committee on investments in telecommunications, which was charged with the primary responsibility of making recommendations to the government on what reforms were needed in the communications industry. The report of this committee was adopted by the government in 1994 and was the precursor to the subsequent reform program in the communications sector. In 1996 a World Bank-funded program helped the Ministry of Finance's Public Enterprises Reform and Divestiture Unit prepare a postal sector development strategy, and a business plan for UPL, the postal network, and the Post Office Savings Bank. This led to inputs for a new communications bill, the Uganda Communications Act No. 8/1997, which provided for:

- a legal and policy framework for the development of the communications sector;
- the creation of an independent regulator, the Uganda Communications Commission; and
- the unbundling of the Uganda Posts and Telecommunications Corporation and creation of three new enterprises, Uganda Telecom, Ltd., Uganda Post, Ltd., and Post Bank, Ltd.

Since the liberalization of the communications sector, one national postal operator, Uganda Post, Ltd. (UPL), and several private operators have been licensed to operate in the postal sector. In spite of growing interest by private operators in the industry, there seems to be no clear policy on postal sector development. From 1996 to 2003, total licenses for private international and regional couriers, and domestic post (including UPL) increased from 8 to 17. The bulk of postal services are still being offered by UPL, which is wholly owned by government and still enjoys an extensive monopoly on the market.

Liberalization of the Postal Industry in Uganda

UPL was incorporated in 1998 as a limited liability company (renamed as Post Uganda) and now holds a major operator's license with the mission "to provide universal, efficient, competitive, viable, and customer-oriented postal services at affordable charges"[2] along with 16 licensed private courier companies. The three-year,

[1] It is important to note that from the time of its formation, UPTC was not only a monopoly postal operator but also the regulator. The same monopoly and regulatory powers were also bestowed upon the new UPTC that was established in 1983 by the Uganda Posts and Telecommunications Act to take over from the existing caretaker corporation.
[2] UPL business plan, 2002.

renewable major license issued to UPL not only sets out service standards and universal service obligations for the company, but also protects customers among other things. The minor licenses issued to the private operators restrict them from rendering reserved services and do not impose universal service obligation.

Reserved Services

The major operator's license issued to UPL gave it exclusive rights to deliver letters up to 1000 grams (at affordable and uniform tariffs) throughout Uganda, and a monopoly to issue postage stamps, pre-stamped envelopes, aerogram forms, and international reply coupons. UPL is also required to accept, convey, and deliver all postal articles weighing up to 10 kilograms countrywide. Mandatory services also include serving private letter boxes, as well as remittance and philatelic services. The other services included in the major operator license include express mail, registered mail, parcel services, courier services, e-mail, Internet, and other agency services. Except for these "other" services, postal services are reserved or qualified as mandatory in the Uganda Communications Act[3] to enable UPL defray some of the costs associated with providing universal service. The scope of the reserved area appears to be very broad and extensive and to formally limit the liberalization of the postal sector.

Private Courier Services

The need by customers for faster, more secure, and more efficient distribution and delivery of goods has become more demanding. Whereas a substantial volume of mail is still delivered via the traditional postal system, customers expect same-day or overnight door-to-door delivery services. In order to fill this void, a number of private courier operators have been licensed and more are expected to be licensed. The courier license authorizes operators to carry and convey articles by land, air, and water within Uganda for local licensees, and beyond Uganda for regional and international licensees. The articles include time-sensitive business documents, data and legal documents, financial and accounting information, cancelled checks, construction plans, specification tenders, shipping documents, samples, spare parts, computer tapes, films, advertising data, and small parcels and letters above 1 kilogram.

Outreach of Services

Services of the private couriers are mainly centered within and between the major urban centers, while UPL covers a much wider area of the country. Currently UPL has a network of 11 regional head post offices, 51 departmental post offices, 255 sub-post offices, over 1623 stamp vendors, and 70,865 installed "private" post boxes. While only a small proportion (less than 5 percent) of UPL mail is delivered to home or office addresses, the rest of the deliveries are made through private letter boxes located at post offices. This situation is opposite that of most industrialized and medium-developed countries where more than 90 percent of mail is delivered to individual homes or company/agency offices.

Although it is normal for a private letter box to be shared by several individuals or households, installed capacity gives an average of approximately 300 inhabitants per letterbox (this compares 207 for Tanzania). There are many parishes without a single private letter box; implying that their residents do not access to postal services. The limited availability of letter boxes does not only occur in rural areas but also in Kampala, where demand for letter boxes by the private business sector cannot be met. This increases the demand for services from private courier firms.

Potential for Expansion

There is a big challenge for Uganda not only to improve the postal infrastructure but also the ratio of mail per capita, which is 0.59 letters per inhabitant, compared to 8 for Africa. Domestic mail demand is only 0.33 letters per capita. While the total mail volumes for Uganda are comparatively very low, the average annual growth

[3] Uganda Communications Act, Sections 85 (3) and 86.

rates are encouraging when compared to Africa and the rest of the world. Given sustained economic growth coupled with improved access to the services, the mail growth rates in the country should continue rising.

The mail volume statistics also indicate that composition of the mail flows is very different from that in industrialized and medium developed countries. The international mail flow accounts for more than 60 percent of total UPL mail volume. The growth recorded by UPL does not include the mail volume processed by private operators, so overall growth rates in the postal sector may have been more impressive. International mail, in particular business-to-business, increasingly belongs to the liberalized domain of the postal sector, and private global operators. The heavy dependency on growth of international incoming mail also implies that the major factor in growth is not a result of domestic marketing management or of management in general. The growth in the domestic service lags somewhat behind the growth rate of GDP and does not therefore hint of a particularly strong marketing effort to grow mail volume.

Justification for Postal Policy

Public sector reforms have transformed numerous inefficient, unprofitable public enterprises into dynamic businesses in Uganda. While economic reform has reached nearly every public enterprise, intervention in Uganda's postal sector has been limited. The lack of institutional progress and reform along with a changed environment within the postal sector has inevitably led to retarded growth in postal services in Uganda, at the very time when the rest of the communications market experienced explosive growth and expansion. Furthermore, the absence of effective competition has encouraged little innovation and diversification of services in the postal sub-sector, which has adversely affected service delivery to the public.

In order to reverse these trends and ensure that the postal sub-sector responded to the changing environment, it was critical for the government of Uganda to set strategic objectives, guide key players in the industry, and develop appropriate policy to facilitate the development of a strong and dynamic postal sector that provides effective support to other sectors of the economy.

Drop-in domestic letter-post traffic did not begin until 1998 in Africa, and the volume of international mail had been falling for years. It was also noted that the large declines in mail volumes in Africa occurred in countries suffering from social and political crises. In comparison with the majority of both African and low-income countries, in the Universal Postal Union (UPU) mail trends study, Uganda recorded positive growth in both the domestic and international service. This is mainly attributable to steady economic growth and international trade that led to corresponding demand for postal services in the country during the period of the UPU study. Putting an appropriate postal policy in place should further enhance development in the sector.

It appears that the postal services have a very limited outreach and penetration as a form of communications. The government of Uganda, through its Uganda Communications Commission, is optimistic about the development of mail per capita demand. For the medium term, it has set as a policy objective to increase the mail per capita up to 4 items per year. This would imply a strong growth, and it remains somewhat unclear what factors would support the increase in demand of domestic mail in rural areas. Market research data that explain the rationale for such increase are not available. A priori, in view of the level of poverty and illiteracy, and substitutes available, one would expect low mail demand, but on the other hand a relatively strong demand for affordable access to telecommunications and the Internet.

Post Offices and Services

Although the postal network is relatively small to some other African countries, Ugandan post offices appear to be an integral part of the basic communications infrastructure. The network has been slightly changed in the past few years and eight post offices have been added.

Many post offices are basic outlets without special equipment, information and technology communications, data communications, or security facilities. In 1994 a report of the then-UPTC stated that 47 post offices were non-operational. The current number of post offices actually in operation is not known. Several post offices have been upgraded in the past 10 years and equipment has been added, but precise data on the quality of the post office network are not available. Nevertheless, within the network of rural sub-post offices, one may

encounter postal buildings with damaged walls, broken windows, leaking roofs, disconnected from any power supply.

The average number of staff per post office is 1.7. This is considerably lower than in many other countries, where staffing ranges between 3 and 6 per post office. This can be explained by the fact that the most labor-intensive part of the mail process is not executed by the UPL: less than 5 percent of mail is delivered to homes or offices of the addressees. The last mile of mail delivery tends to absorb 60 percent or more of staffing in industrialized and developing countries.

Quality of the postal work is elementary. Post office staff is mainly occupied with pre-sorting mail, filling mail boxes, etc. Salaries are very low, and staff is qualified if they have completed "O-level" secondary education. The staff received skills and job training at the UPL training center. In some cases, morale plummets and mail and parcel fraud and robbery—particularly from mail coming from abroad—occur occasionally. In addition, letter boxes make it difficult to prevent individuals from stealing each other's mail.

The post offices provide a range of other services at the counter, but this volume tends to be small. The most frequent service is providing access to the telephone (in booths) and selling telephone tokens to users. The second is the sales of "aerograms," and financial transactions are the third largest transaction flow. This volume has declined, however, to less than 200,000 transactions per year. Mail productivity in Uganda seems relatively good, with 31,000 items handled per staff member per year, but this does not take into account that most mail is not delivered. Current staffing level is high if this fact and low mail volume are taken into account.

Telecommunications and Information Communication Technology

Uganda's telecommunications market is also regulated by the UCC. There are two national network operators, Uganda Telecom, Ltd., the historic incumbent operator, which is now partly privatized and operates both fixed-line and mobile networks; and MTN Uganda, a South African-owned company implements its national network license through GSM wireless technology. A third mobile operator, Celtel, is also operational. There are 59,729 fixed-line subscribers, more than 320,000 MTN mobile lines, approximately 75,000 UTL mobile lines, and more than 100,000 Celtel mobile lines—a total of 565,000 telephone subscribers.

Uganda's telephone service provision is largely and increasingly supplied by mobile networks using GSM technology (which is less suitable for the Internet than fixed lines). The fixed-line network has poorly penetrated Uganda with access to telephones and the Internet; and MTN's GSM network offers most of its coverage around Lake Victoria and more inhabited areas. Most of Uganda has no access, especially in the northern and southern-central areas.

The government of Uganda included universal access targets in licensing both UTL and MTN, but the target figures have been easily exceeded through mobile service. A rural telecommunications development fund has been established, derived from a levy on operator profits and World Bank support, to provide subsidies for telephony and internet network roll-out into areas that cannot provide sufficient economic return for operators at present. This fund made its first tranche of allocations through a reverse auction process.

Tele-density in Uganda

Individual tele-density measures the level of ownership, rather than usage, of telephony and is therefore closely correlated with per capita GDP. In most societies, average household expenditure on telecommunications (ownership and/or usage) is between 2 percent and 4 percent of income. In the context of universal access, therefore, individual tele-density gives evidence of the propensity to purchase private access to telephony rather than rely on public facilities.

Tele-densities of Fixed-Line, Mobile, and Public Pay Telephones

Telephony Tele-densities	Botswana	Ghana	Uganda	Average (unweighted)

Fixed-line tele-density	9.3	1.2	0.3	3.6
Mobile tele-density	12.3	0.7	0.9	4.6
Fixed + mobile tele-density	21.6	1.8	1.1	8.2
Mobile/fixed tele-density	1.33	0.55	3.04	1.3
Public pay phones (per 1000 inhabitants	1.86	0.16	0.06	0.069

Research from a June 2003 study by Gamos, Ltd., funded by DFID.

Fixed and Mobile Telephone Use

According to the table below, an average of 82 percent of all respondents in the three countries use a telephone on a regular basis. This is a high percentage of respondents, reflecting the sample's weighting in favor of locations with better access, but suggests that, if telephone service is accessible, some four out of five potential users will use a telephone on what they consider a "regular" basis. Although the statistical basis of the research is insufficient to suggest this 80 percent has general applicability, it nevertheless indicates likely substantial demand for telephone usage in most communities.

Usual Phone Use by Technology

	Botswana	Ghana	Uganda	Average
Any type of phone	78%	87%	81%	82%
Fixed-line phones	67%	85%	36%	63%
Mobile phones	45%	20%	68%	44%
Mobile/Fixed ratio	0.67	0.24	1.89	0.70

Research from a June 2003 study by Gamos, Ltd., funded by DFID.

Fixed and Mobile Telephone Use in Rural and No-Access Areas

Respondents living in rural areas and in areas without coverage will use public access points almost as regularly as respondents from the whole sample. It suggests that a significant percentage in unserved areas will take the time and spend the money to travel to public access points outside of the areas where they reside in order to make and receive telephone calls.

Usual Phone Use in Rural and No-Access Areas

	Botswana	Ghana	Uganda	Average
Any type of phone	76%	80%	73%	76%
Fixed-line phones	76%	79%	29%	61%
Mobile phones	29%	6%	63%	33%
Mobile/fixed ratio	0.38	0.08	2.17	0.54

Research from a June 2003 study by Gamos, Ltd., funded by DFID.

Given the relatively low fixed-line and mobile phone tele-density, it is not surprising that the table below shows that public access booths and "tele-shops" (private telephone service providers, or PTSPs) are the main points of telephone access. In this context, the term "booth" refers to public facilities provided by the

telecommunications company; and tele-shops are facilities provided by an intermediary reselling access. Post offices are considered public booth facilities.

Means of Access to Telephones

	Botswana	Ghana	Uganda	Average
Public booth	77%	52%	46%	57%
Public tele-shop	51%	76%	58%	59%
Home	29%	11%	31%	23%

The Gamos research shows that the quality of a public telephone facility is important to consumers. Respondents in Uganda expressed a strong preference for intermediated tele-shops over public telephone booths because the former offered greater privacy or a quieter calling environment. These findings also point to post offices as being less preferred as public telephone facilities. Strategies to increase PTSPs are likely to be more successful than those increasing the number of booths (especially in post offices), unless new booths can be designed to provide a greater degree of privacy and placed in quieter locations.

Email and Internet Usage

In contrast to the widespread regular use of telephones, email, and Internet use is very low. The total number of people with regular access to Internet is estimated at less than 100,000. The level of education, the high cost of Internet use, and its slow speed (mainly due to the use of satellite connections with the rest of the world rather than submarine cables) appears to be a particularly significant barrier to 25–40 year olds in Uganda.

Postal Network Development

Ugandan telecommunications pose several implications for development of the postal sector and the postal network as a delivery channel for financial services. The ICT and telecommunications infrastructure is very weak. In the short-term, the impact of e-mail may be limited, but as the rollout of GSM and mobile phone expand this will likely effect domestic mail demand. Even though facilities are limited, the strong preference for privately managed tele-shops (and better service and privacy) may also impact use of post offices as telephone access points. Too few of Uganda's post offices have been transformed into tele-centers or internet access points. These limitations in ICT and telecommunications will also slow attempts to roll out financial services, particularly money transfer services. Moreover, the policy of UCC for ICT and telecommunications does not seem to include using the postal network as a basic infrastructure to provide access to ICT and phones. A rural communications development fund, with participation of the World Bank, was set up to help improve access to ICT and telecommunications in remote areas through private agents. These are some of the deep and complex issues that the UCC must deal with to ensure universal access to communications and to close the digital divide.

Even though these issues could have entirely absorbed the UCC, the UCC recognized that the absence of a national policy for the postal sub-sector as an issue it must address. In 2003 the government of Uganda, through the UCC, initiated a consultative and participatory process including key stakeholders to draft a postal sector policy centered on these objectives:

- To encourage private investment to improve the postal services and infrastructure
- To encourage and support the commercialization of UPL to improve the company’s efficiency and effectiveness
- To promote competition in the sector to improve quality of services through innovations, and introduce new postal products

- To increase accessibility to postal services in rural areas by locating at least one postal service outlet per sub-county
- To increase the annual per capita mail demand

The ultimate goal is to stimulate growth in the postal sub-sector comparable to other countries in the region within the next five years.

In order to achieve the above objectives, the UCC drafted strategic guidelines for each objective. The guidelines address a number of shortcomings in the postal sector. After reviewing the sector and market, it will adjust and redefine universal postal services, and issue new legislation to encourage competition and further liberalization. The reserved area is likely to be redefined, and financing universal service should be supported by the rural communications development fund, in which both public and private operators will have to participate. Critical issues will be the definition of the levy mechanism, the tariff policy of the public postal operator, and the measurement of revenues and cost. In addition the UCC would set clear quality standards for the postal sector and introduce periodic measurement of finances, performance, and quality. It also would support strategic alliances both among postal operators and between postal operators and other entities, to create healthy, strong operators that can indeed provide quality.

The guidelines suggest that the national postal operator be restructured and privatized (phasing out government subsidies), with the necessary management autonomy and financial flexibility to operate as a successful commercial enterprise while meeting the universal service obligation. They encourage entry of more private operators by issuing more operator licenses, and opening up the industry for competition by removing tariff and non-tariff barriers. They support extending remittances and other postal services into the rural areas to improve accessibility.

These strategic guidelines are a useful starting point for policy making, but it remains difficult to qualify them as a medium term sector strategy. The process of restructuring the public postal operator, providing it with more management autonomy, access to technology and finance, is not necessarily the most effective option. It actually might not lead to the desired economically viable operator, which acts transparently in a level-playing field and could be transferred to the private sector. Because the government intends to finance the considerable restructuring of the Ugandan postal operator from the rural development fund, as well as from other resources, loans, and other agencies (private postal operators, development banks), the requirement of an outwardly transparent business model and strategy become pressing.

The guidelines focus primarily on mail, courier, and parcel services, and do not appear to consider transforming the network into a multi-purpose network that serves a broader set of public and private sector interests, including the rollout of access and awareness of ICT and telecommunications services or retail trade and financial services. An evaluation of the cash-flow (impact on the government budget) and the long-term strategic value gained by such restructuring versus the options of involving the private sector at an early stage (e.g., through a BOT-based concession[4]) should be UCC's first step in determining how it will execute its postal sector strategy.

Moreover, restructuring the postal operator appears to be an issue within the postal sub-sector and ultimately within the communications sector. There appear to be only few links between the ICT policy and the postal sector policy, and no specific market preference in favor of post offices as the front end of ICT/Internet and

[4] Build-operate-transfer (BOT) sometimes is the best option for governments to invite private-sector investments. Under this system, it is the private sector, instead of the government, that designs, finances, constructs, and operates vital facilities. After a specified concession period, the ownership of such projects is transferred to the government. The approach offers private entrepreneurs the opportunity to profit from financing, developing, and managing major projects. The government, for its part, benefits by eventually acquiring ownership of projects in which it has not put money into. The BOT approach is gradually becoming very popular in developing countries. Ghandi Pandit, "Significance of BOT Concept to Infrastructure Projects," *Spotlight* 22, no. 10 (August 30–September 5, 2005): Viewpoint. www.nepalnews.com.np/contents/englishweekly/spotlight/2002/aug/aug30/national11.htm

phone access. A cross-link between ICT development for access to communications and ICT-based financial sector development also does not appear. Such a cross-link may be necessary to achieve commercial and economic viability. Moreover, a privatization strategy that does not consider a fundamental repositioning of the postal network as an access point for ICT services, financial services, and retail trade is likely result in a smaller postal network

3—Postal Financial Services in a Market Perspective

Origin and Overview of Postal Financial Services

The origin of the postal financial services in Uganda dates back to 1926, when the Ugandan Post Office Savings Bank (UPOSB) was established by ordinance as a department of the post office under an agency agreement with the Ministry of Finance. Eleven years later the Post Office Savings Bank Act of 1937 became the statutory basis for postal savings in Uganda for more than 60 years. As in other countries under British rule, the UPOSB's main features were:

- post office savings passbooks, offered through 129 Ugandan post offices (only some of which had a facility for safekeeping cash);
- deposits guaranteed by the government; and
- deposits reinvested under the supervision of the Ministry of Finance in gilt-edged titles.

Postal savings enjoyed great popularity from the 1940s to the 1960s. Low deposit requirements, a simple straightforward product, a government guarantee of deposits, and access to 129 post offices made the postal savings popular. At that time, commercial banks had only small branch networks and set high initial deposit requirements. Because there also were bank failures in which savers lost their money, the UPOSB functioned as a safe and accessible haven for small savers in Uganda.

In the late 1970s, problems in post office operations and administration severely plagued UPOSB, and it was unable to keep its administration up-to-date or to make interest calculations for its clients. In 1982 problems in the operation and management of UPOSB had accumulated to such an extent that it could only accept deposits, and could not honor requests for savings withdrawals until further notice. In exceptional cases, however, requests from clients for withdrawals were honored at UPOSB headquarters in Kampala, and this situation remained until 1997. The UPOSB had channelled only part of its money into Ugandan government securities and had actually re-invested a large part of client deposits in European banks and government securities (where they made substantial gains in foreign currency exchange).

By 1989 UPOSB had become insignificant in mobilizing household savings. Market share (in value) dropped to barely 1 percent. Of the 350,000 postal savings accounts kept on UPOSB books, at most 15,000 passbooks showed new deposits. These were mainly generated by an autonomous demand to keep money safe and the tradition of saving there that was passed on to younger generations, who were ignorant of the fact that the UPOSB would be unable to process withdrawals.

UPOSB reported losses, but these were offset by gains made with its USD 2.5-million off-shore deposits invested in European money and capital markets. These deposits accounted for more than 80 percent of total assets. In the period 1982–96, much of the value of the postal savings deposits was eroded by high inflation rates which were substantially higher than deposit rates. UPOSB became an insignificant division of UPTC, generating less than 1 percent of transaction volumes at postal counters and producing less than 1 percent of UPTC post office revenues.

Under a Word Bank program in 1996, the owner of UPOSB, the Ministry of Finance (PERD), adopted the recommendation of transforming UPOSB into an incorporated entity operating under a license of the Bank of Uganda. Postbank of Uganda incorporated in 1998 as an independent entity following the enactment of the 1977 Uganda Communications Statute, but it operated with the same balance sheet of the old UPOSB. This

meant that no assets and liabilities with the postal services were divided up, and the agency agreement with the UPL was not substantially revised.

Few real changes took place—the old POSB management continued to lead the Postbank—although modern technology introduced at the Postbank head office solved the backlog of administrative problems. Postal savings were again offered through the 129 post offices where UPOSB services had been. (The impact of this improvement was an immediate 50 percent increase in the value of postal savings between June 1998 and June 1999.) Postal savings continued to rise sharply until June 2002, increasing the 1998 deposit balance eight-fold.

In terms of market share, this was still very modest—an estimated 3 percent of the private savings and deposits in local currency—but it was perceived as a highly promising development and put postal savings back on the map of the Uganda financial markets. Further in-depth analysis might have revealed that market share in growth of small deposits was above 10 percent per year. However, after 2002, growth stagnated.

The new Postbank launched ambitious plans, targeting low-income depositors, the majority of whom lived in rural areas. Moreover, Postbank intended to operate where traditional banking was unprofitable, using the post offices through its agency agreement with the UPL. There also seemed to be substantial opportunity to become a main actor in the nation's payment system as the processor of bulk flows of recurrent payments, such as tax, telephone, school fees, electricity, and water. This could make the Uganda payment system more efficient, as well as liquidity management in the main entities that distributed or collected small-value payments. It would certainly benefit the postal network with new transaction flows and higher revenues. A preliminary plan projected that postal network revenues would increase 30 percent within three years.

Postbank was constrained by its low level of computerization, poor communication infrastructure, and a narrow product base. It planned to alleviate some of these constraints by diversifying its product portfolio (e.g., fixed deposits, certificates of deposits, foreign exchange trading, salary accounts, and utilities payments), establishing a country-wide computer network, and introducing a giro account system. The plan was well received by stakeholders (Bank of Uganda, UPL, and others), but unfortunately remained merely a good intention.

Using the postal network did not turn out successfully: the Postbank-UPL relationship went sour through mutual exchanges of disappointment and dissatisfaction. The bank did not invest in the postal network, to upgrade technology, training, advertising, and security, but instead pursued developing a network that would be independent of UPL. Postbank services in the postal network were reduced year-by-year, dropping from 129 in 1998 to less than 20 in 2003.

Postbank did not use the postal network as outreach to rural and remote places. It established its own bank branch network in Uganda's main cities, separate from the post offices. As of 2003, services were provided through post offices on a tenancy basis (i.e., renting space but Postbank staff provided the services). The focus in the branches was on serving companies for credit, payment, and payroll services. The credit license of Postbank was revoked in 2003 due to inadequate credit policy.

Postbank suffered pre-tax losses in 2000 and 2001 due to its heavy capital expenditure on developing a branch network, but regained profitability in 2002 (leading to a return on equity of 19 percent). The profit, however, was lower than the gains made in foreign exchange of its off-shore deposits.

Commercializing Postbank did not lead to the desired results for UPL or for the remote and rural inhabitants. In fact, after the branch networks of StanBic Bank and Uganda Commercial Bank (UCB) closed, many of the inhabitants resorted to keeping their valuables at home or banking with informal entities.

Postbank has now been earmarked for privatization. The preliminary schedule indicated that such transformation might happen in 2006 at the earliest. Until that time, Postbank is not likely to gain access to new funding sources to develop its operations or to regain its credit license. The means of privatization envisaged is sale of a 49 percent stake to a strategic shareholder. This may not be very attractive because the Ugandan government would retain the majority. Interviews with Postbank management indicated that their priorities are still to expand the ATM network and start new with credit.

Reportedly, Posta Uganda has initiated a new launch of financial services through its wide network. It hopes to do this through outsourcing agreements with financial institutions or insurance companies, for example, and has commenced explorative negotiations with both domestic and international financial institutions (including. international money transfer agents).

Postbank's history highlights several weaknesses:

- **Postbank drifted away from its original and unique mission to develop broad-based access to basic financial services through the wide postal network.** Instead, **it attempted to develop into a different commercial branch bank** and left a deep void in the market.
- Key elements that led to this were (a) **the absence of a joint strategy and partnership between Postbank and UPL**; (b) **the absence of committed financial resources** to develop the postal network and its human resources; (c) **weak management structure with political interference**; and (d) **unclear control of capital expenditure**, and **lack of accountability** to meet certain quality standards or performance targets.
- Postbank has set a new course with hardly anything but its name relating to the post. **The relationship between Posta Uganda and Postbank is de facto terminated**, but the pretense has been kept up for 20 years. Postbank's solo privatization may finally and overtly sever the relationship, leaving it to operate in a strategic vacuum.
- **Posta Uganda is contemplating offering financial services independent of Postbank**.

Financial Sector Background

The financial sector in Uganda began developing in 1986 when the Museveni government came to power. Determined to reverse the Amin legacy of limited public confidence, insolvency problems, high inflation, and currency devaluation, the Museveni government began reforming the sector by restructuring weak banks, closing insolvent banks, and strengthening regulation and supervision by the central bank.

Although the formal sector included about 20 foreign and indigenous banks, as well as Postbank, along with numerous insurance companies, foreign exchange bureaus, and a National Security Fund, it has offered very few products and has been characterized by a shortage of building societies, mortgage financing, merchant banking, and discount houses. The banks operate through 144 branches, a low number in comparison to the population, indicating that the formal financial sector does not reach many rural and remote communities. The total of individual clients is estimated to be less than 700,000—more than half of them concentrated in Kampala. The banking sector, with strong presence by South African and British banks, provides advanced services, but requirements for individuals are high.

Several of the indigenous banks, including UCB and the Co-operative Bank, closed many of their rural branches because they were not profitable. Only StanBic seemed be have interest in expanding into the rural-low-income market. Although the commercial banks offer check books, ATMs, credit cards, and electronic payment services,[5] and efforts to bring the payment system up to international standards, the payment system is predominantly cash-based. Access to cashless instruments remains very limited. Additionally, the volume of check payments in Uganda is low, estimated at less than 1.5 million and meaning that they are mainly used for commercial payments and rarely for household payments.

Although the Bank of Uganda records that M1 consisted of UGS 529 billion (USD 293 million) in circulation, and UGS 814 billion (USD 452 million) in private demand deposits, one expects that only a small part of the private demand deposits are *transferable* deposits held by households. For retail payments, Uganda is a cash society.

[5] Electronic payments services (including ATMs, electronic fund transfer at point of sale or EFT POS, and direct debit) were only introduced three or four years ago, and actual transaction volumes are believed to be very low. A central switch for ATMs and bank cards has been developed.

In addition the Bank of Uganda recorded M2 as UGS 596 billion (USD 331 million) in savings and term deposits from the private sector. These figures demonstrate how small the market is, and particularly the potential of the postal banking operation that could convert the relatively large amount of cash (UGS 529 billion) to postal giro and savings accounts.

International remittances to and from Uganda are sizeable compared to the monetary aggregates mentioned. Studies by Bancock Consulting on migrant remittances in Africa[6] estimate the incoming flow at USD 400 million and the outgoing flow at somewhat more than USD 100 million. The cost is relatively high, and few networks, including some MFIs, are active in this field. The postal network's role is insignificant, but it is evident that if the postal network were equipped with on-line EFT POS to process recurrent bill payments, distribute social benefits, and process remittances could revolutionize the payment system in Uganda and help mobilize savings into the formal financial sector.

Informal and Microfinance Sectors

The informal sector in Uganda, by contrast, has been strong, and its role has been critical in serving the rural financial markets. Informal financial institutions consist of non-governmental institutions (NGOs) and microfinance institutions (MFIs), which have been supported by foreign donor organizations. It also includes co-operatives which are very strong, with almost 6,000 registered cooperatives. Most of these are organized under the Union of Savings and Credit Cooperatives of Uganda and Uganda Cooperative Alliance.

Although the microfinance sector is relatively young in Uganda, it is one of the largest and most dynamic in Africa. After the civil war (1981–86), a large number of NGOs were created to support the reconstruction of the economy. These NGOs eventually included microfinance in their programs, frequently transforming these activities into microfinance institutions. At present there are an estimated 500 MFIs operating in Uganda, including NGOs, limited liability companies, co-operatives, licensed commercial banks, and one non-bank financial institution. However, most of the MFIs are far from being sustainable: fewer than 10 are reaching financial self-sufficiency.

Despite the proliferation of informal financial institutions, there is still a highly unmet need for financial services in rural areas. Most MFIs are not regulated institutions, and even with the potential to change into regulated institutions under new legislation, most will remain unregulated. As such, they will not be able to take deposits, and many will continue to depend on funding from donor agencies or specific refinancing arrangements.

Basic Microfinance Data in Uganda

No. of MFIs	500
Outreach	
• **Borrowers**	330,000
• **Savers**	800,000
Loan portfolio	USD 57,360,000.00
Savings	USD 86,200,000.00
Average loan size	USD 175.00
Points of service	n/a

Microfinance in Uganda is highly competitive and viewed by many as nearing saturation in urban areas. Most MFIs use a blend of Grameen and village banking methodologies, providing basic loan products that feature weekly payments, 4–6 month loan terms, group lending, compulsory savings, and a focus on the trade or

[6] Cerstin Sander, "Capturing a Market Share? Migrant Remittances and Commercialisation of Microfinance in Africa," report prepared for the "Current Issues in Microfinance" conference, Johannesburg, South Africa, August 2003.

commerce sector rather than agriculture. With few voluntary savings services, there has been increasing pressure to provide savings services to poorer populations and to provide more services in rural areas. Donors and practitioners alike are concerned about the risks of oversupply and overlap, especially in the urban regions.

The success of microfinance in Uganda is widely attributed to a number of factors, among them:

- The government stopped its initial direct provision and interference in the microfinance market.
- The Microfinance Forum was created and backed by CGAP, practitioners, donors, and the Ugandan government who worked together to effectively develop the sector, establish best practices, etc. This facilitated development of a consensus vision for the industry in the country. Among other achievements, their activities directly led to the establishment of the Association of Microfinance Institutions in Uganda (AFMIU).
- The involvement of a number of international networks helped to give a solid footing to several major MFIs, which are now in the forefront of those seeking regulated status.
- Substantial donor funding flows were directed to the sector, including guarantee programs to encourage commercial bank lending to MFIs.
- The development of a standardized donor-reporting tool in Uganda, which has increased donor collaboration and transparency.
- Uganda has developed a supportive legal and regulatory environment, including regulatory reform that has given some structural options to those MFIs that can qualify.

The issues facing the expansion of outreach by the microfinance sector are derived from the continuing domination of the financial industry by urban-based financial institutions, whose outreach is limited to less than 10 percent of the Ugandan population. Highly liquid (only 26 percent of assets were represented by loans in 2002), and favoring the trade and manufacturing sectors (only 8 percent of loans were to the agriculture sector), the commercial banking sector has not met the general financial needs of the country or the needs of the rural poor. In addition, the Uganda's economy continues to be cash-oriented, with 30 percent of the money supply in cash (compared to 12 percent for Kenya). The result of all of these constraints is that a large unsatisfied need for financial services continues to exist, particularly in the rural areas, which are home to over 96 percent of the poor population of Uganda.[7] Until recently, only CERUDEB among the Ugandan banks reached out to the rural areas. CERUDEB's rural activities have had a high level of donor support, which has permitted them the luxury of "affording" the outreach.[8]

Impact of Donors and International Investors

The microfinance sector has directly benefited from donor activities, particularly AMFIU support, capacity building, and regulatory reform initiatives. NGOs, networks, and other types of facilitators have also played a large and extremely important role in the development of the sector. Networks present include ACCIÓN, CARE, CRS, FINCA, FFH, FTC, Opportunity International, GF-USA, WOCCU and WWB.[9] As the sector has grown and matured, a number of international quasi-commercial and commercial investors have entered the Uganda microfinance sector with debt and/or equity investments.

[7] Data taken from GTZ website, "Uganda –Financial System Development." www.gtz.de/en/weltweit/afrika/uganda/1939.htm

[8] CERUDEB was founded and is largely owned by the Catholic dioceses of Uganda, from which it has drawn support. It also has received substantial international donor support

[9] ACCIÓN, CARE, CRS (Catholic Relief Services), FINCA, FFH (Freedom from Hunger), FTC, Opportunity International, GF-USA (Grameen Foundation-USA), WOCCU (World Council of Credit Unions) and WWB (Women's World Banking).

Regulatory Environment

In December 2002, a new law regulating micro deposit-taking institutions (MDIs) was passed. MDIs can accept deposits from the public and on-lend them, but cannot engage in foreign exchange transactions, operate current accounts, on-lend compulsory savings, or use the word "bank" in their name. For those qualifying as MDIs, benefits will include funding diversification, greater financial viability, and a competitive edge over the non-regulated MFIs, and their clients will gain savings services. For the MFI industry, the presumption is that it will facilitate outreach to the rural areas.

AMFIU, the representative body for MFIs in Uganda, is generally well regarded by donors now, after an overhaul several years ago, which included a new chair and a permanent staff. AMFIU is seen as one example of progress in the Ugandan microfinance industry, providing information and capacity to existing MFIs and linking the sector with important policy makers.

Technological Innovation

MFIs in Uganda critically need to develop technological solutions to reduce operational overheads, to improve business practices, to increase revenue, and especially to scale up and solve rural outreach problems. Given the infrastructure problems that plague Uganda, any systems need to be able to work with limited or no infrastructure, as well as illiterate populations. End-to-end solutions are needed which emphasize client level data collection and industry standardization/access while leveraging existing MIS capabilities.

Three MFIs in Uganda have been participating in a pilot program for a "remote transaction system," with a team of technology specialists and networks. Hewlett Packard is the lead partner in the project. Each of the MFIs requires different solutions: FOCCAS needs to empower loan officers and to capture individual data; FINCA wants to develop a low-cost rural branch office; and Uganda Martyrs University seeks to empower clients and build an agent network. The project hopes to demonstrate the viability of technology in rural environments, build capacity within the partner MFIs, demonstrative a positive business model, and link the MFIs to the Uganda financial systems as they develop (central financial switch, credit reference bureau). The remote transaction system will use mobile devices (personal digital assistants and POS terminals) with wireless connections to the remote transaction server.

4—Options for Development

Uganda has deeps gaps in both in communications and financial services infrastructures. The existing large network of postal offices and the Uganda Postbank should or could have provided an additional delivery channel for outreach to rural and remote (poor) areas. However, the many structural and organization problems that developed have made this less likely in the short term:

- Postbank lacks a workable microfinance strategy or focus, and no longer has a strategic alliance with Posta Uganda.
- Postbank's potential geographic coverage was much reduced when the country-wide agency agreement with Posta Uganda was terminated. Only about ten post offices currently sell financial services, reducing Postbank's total network to 20 offices. Postbank prefers to expand its activities by opening of its own branches and or agency offices;
- Postbank is capital-constrained and its inability to open additional branches or develop adequate products makes it difficult for it to meet the competition posed by the commercial banks.
- Regulations currently constrain Postbank from lending which, combined with lack of a strong credit culture and management capacity, makes them an unlikely candidate to develop credit services for this sector. (Postbank has currently has a restricted license, which prohibits lending activities until it has sufficient and human resource capacity.)

- Postbank has an inadequate technology capacity, and it is focusing on capital-intensive technology (ATMs) in stead of low-cost technology (EFT POS).
- Moreover, Postbank seems to suffer from a paralysis induced by the ongoing pre-privatization process.
- Competition from other regulated institutions is increasing, which poses further problems for Postbank's ability to capitalize on a potentially unique advantage of rural locations. StanBic Bank (which still has 10 percent of its shares held by the Ugandan government) has recently announced that it has revised its urban strategy to include expansion into rural regions. However, it is unclear what that means in terms of a microfinance strategy or how far into more remote regions their expansion will carry them, given their commercial orientation and their past policy of closing non-profitable rural branches.

The most reasonable strategy for Uganda Postbank, given the factors above, would be to develop a strategy developing co-operative ventures with unlicensed Tier IV MFIs to facilitate mobilizing their clients' savings. The most sensible strategy for the owners of Posta Uganda might be to terminate its relationship with Postbank, and replace it with a strong, long-term alliance with one of the larger financial institutions in Uganda, such as StanBic. The strategic partner would have to meet managerial, technological, and financial qualifications to effectively help reposition the post offices as a nationwide channel for convenient, efficient, basic small-value financial services.

A consortium between a strong financial institution and a private ICT/telephone provider with modern Internet facilities might be ideal. This could lead to developing a grass-roots network that acts as a front-end for accessing financial services and communications—two important areas that are underdeveloped in Uganda.

The government and international financial institutions will have critical roles in this process, creating favorable conditions to attract the private sector to step in and to fill in the voids that the public sector has been unable to satisfactorily develop.

One option that the government has before privatization of the postal operator is to separate the postal network from the postal (mail and parcel) operator. It would be highly unlikely that any private *postal* operator would want to continue working with a network of nearly 320 dilapidated post offices. The typical response would be to close down many of the offices and retain only the centers for mail and parcel processing and sorting, and delivery locations for the private mail boxes.

By splitting off the postal retail network from mail and parcel operations, private sector interest for the remaining assets and business flows of the postal (mail and parcel) operator might substantially improve. Prospective investors would not face the political and financial burden of having to restructure the postal network. A privatized postal operator might be better off with a service-level agreement with the separate postal network company to sell stamps, and collect and pick up parcels and registered mail.

This option assumes that the main entity leading the modernization would be a bank or a consortium focused on developing ICT-based basic financial services.

Another option is to incorporate the post office network in a company that either (a) becomes a joint venture (51 percent/49 percent) with a consortium of investors and application providers in the field of ICT and financial services. The alternative to this option is to offer a selected consortium the chance to build-operate-transfer under a long-term concession agreement.

The first step in transforming the postal network into a grass-root front-end for information and communication and basic commoditized financial services would be to link the 62 regional and district post offices in a wide-area network (WAN) connected by the Internet, and offer:

- applications to pay utility bill;
- deposits to savings accounts, payment accounts, and third party accounts; and
- international remittance services by connecting the WAN to international networks.

Capital expenditure for such network technology and communication should be limited (in the range of USD 0.3–1 million), and that revenues from domestic payments and international remittances would generate

sufficient payback on investment within two years. Capital expenditure to ensure that post office buildings meet minimum security standards can not be estimated at this stage, nor can the cost of training staff.

It is recommended that these scenarios be further discussed and that taking the following steps be seriously considered before choosing either option:

- Perform quantitative and qualitative market analyses (including field interviews with representative samples of the adult population) to assess the actual usage of financial services and the potential of ICT-based financial services
- Make a preliminary valuation of the post office network
- Outfit two model post offices
- Detail a business case including a cost-benefit analysis
- Preliminarily explore potential investors or participants