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Bank Privatization in Sub-Saharan Africa: The Case of Uganda Commercial Bank

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Summary. — Because large state-owned banks are often the only financial service providers in remote areas of low-income countries, policymakers worry that even if privatization improves performance, it might reduce access. We study this issue through a case study: the privatization of Uganda Commercial Bank (UCB) to the South African bank Stanbic. Though market segmentation remains a concern since Stanbic faces little or no direct competition in many remote areas, some innovative aspects of the sales agreement have enabled the bank to improve its profitability while maintaining, or even improving, access to financial services for some hard-to-serve groups.

Key words — bank privatization, Uganda, Africa, access to finance

1. INTRODUCTION

Although the theoretical advantages and disadvantages of state ownership have been debated, empirical studies have mostly found that private firms perform better than similar state-owned firms (Megginson, 2005b; Megginson & Netter, 2001; Shirley & Walsh, 2000). Empirical studies looking at private and state-owned banks have reached similar conclusions. Credit growth, portfolio quality, profitability, and productivity are higher in systems dominated by private banks. [1] Comparisons between private and state-owned firms suggest that privatization should improve performance. But critics have noted that privatized firms do not always act like firms that have always been private (Caves, 1990; Cook & Kirkpatrick, 1988; Kay & Thompson, 1986). Limits placed on privatized firms, such as limits on layoffs, price controls to keep products affordable and, for banks, lending requirements and restrictions on branch closings might harm performance. Moreover, if problems in the institutional environment mean state-owned enterprises perform poorly, then the privatization process—and regulation after privatization—might be as flawed as public ownership. Privatized banks might therefore be unable to act like private banks would.

Although the empirical evidence on the effect of privatization on bank performance in developing countries is mixed, outcomes are not random. Performance improves more when the government fully relinquishes control; when banks are privatized to strategic investors rather than through share issues; and when bidding is open to all, including foreign banks (Clarke, Cull, & Shirley, 2005; Megginson, 2005a).

The impact of privatization on access to credit, payments, and savings services has been studied less than the impact on bank performance. Clarke, Cull, *et al.* (2005) and Megginson (2005a) note that credit growth might be slower after privatization to foreign owners if foreign banks lend more prudently than state-owned banks. Other researchers have found that foreign banks tend to lend to different types of customers and base their lending decisions on different criteria than domestic banks (Mian, 2006; Petersen & Rajan, 1995).

The empirical evidence also suggests reason for caution. Clarke, Crivelli, and Cull, (2005) find credit growth of provincial banks in Argentina was slower after they were privatized. Other private banks, however, increased their lending meaning that the overall level of real credit was on par with pre-privatization levels within a few years of privatization. Haber (2005) finds that although the privatization of most of the Mexican banking sector to foreign owners coincided with improved bank performance, loan growth was slower. In part this was because of poor enforcement of contract rights. Bonin, Hasan, and Wachtel (2005) also find that credit growth was slow in banks privatized to foreign owners in Central and Eastern Europe. It seems possible, therefore, that there is a tension between the pursuit of profits and the extension of outreach for privatized banks, especially when contracting environments are poor.

These tensions are likely to be pronounced in Africa where few private banks have rural networks and where banking sectors are concentrated and often dominated by state-owned banks (see Table 1). [2] Because state-owned banks are the main providers of financial services in remote areas, access to services might get worse after privatization even if performance improves.

We study these issues looking at a specific case: the privatization of a majority stake in Uganda Commercial Bank (UCB) to Stanbic (South Africa) in late 2001. This privatization satisfies all three features of successful bank privatizations discussed above, making it a likely candidate for success. This case study is therefore a test of whether elements of best practice apply in a concentrated, under-developed banking sector—a situation not unique to Uganda.

UCB's dominant position before privatization makes this an especially interesting case. [3] Since Stanbic did not close any of UCB's 68 branches after privatization, it maintains the most extensive branch network in Uganda. Only one other commer-

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cial bank, the agriculturally-oriented Centenary Rural Development Bank had more than four branches outside Kampala (see Appendix, Figure 9). Stanbic, therefore, faces little or no competition in most areas, something that is uncharacteristic of the privatizations studied to date. Although the privatization of a dominant public bank in a small sector makes this case different from those in previous studies, many recent privatizations in sub-Saharan Africa and other low-income countries are likely to be similar. Admittedly, Stanbic occupies a unique position in Uganda, but, were it not for this it might have been difficult to attract a credible strategic investor.

UCB's importance might have also affected how the government treated privatization. [4] Privatization of a large bank with a dominant rural network is politically difficult. Political accommodations that make a deal palatable to the government might affect profitability.

The government had reason to be concerned about post-privatization access in rural areas. Had there been competition, privatization might have affected prices of banking services. In remote areas, however, it was not so much price of service as whether service is available at all. Stanbic is the only option for access to the payments system in many places. [5]

Lack of reliable data has made it difficult to explore profitability-outreach tensions and only the extraordinary effort of Bank of Uganda (BOU) staff in collecting, cleaning, and organizing the data has made it possible in this case. In addition to financial statement data, the BOU provided branch-level financial information for Stanbic. This allowed us to test whether geographic factors such as population density and income affected Stanbic's activities after privatization.

To analyze profitability-outreach tensions, we first test whether UCB/Stanbic's performance improved after privatization relative to other banks using bank-level indicators such as return on assets, share of non-performing loans, and the ratio of operating costs to assets. Next, on outreach, we perform similar tests using bank-level indicators for credit growth and

Table 1. *African banking sector development*

Country	% Banking assets, three largest banks (2003)	Deposit money bank assets/GDP	Private credit/GDP (deposit money banks plus other financial institutions)
Angola	.88	.02	.02
Benin	.87	.12	.11
Botswana	.82	.18	.16
Burkina Faso	.76	.15	.14
Burundi	.93	.21	.20
Cameroon	.94	.11	.08
Central African Rep.		.07	.05
Chad	1.00	.06	.04
Congo, Dem. Rep.	.89	.01	.00
Congo, Rep.		.06	.05
Cote d'Ivoire	.81	.23	.18
Ethiopia	.95	.28	.24
Gabon	1.00	.12	.08
Ghana	.71	.11	.07
Guinea-Bissau		.06	.06
Kenya	.58	.33	.26
Lesotho	1.00	.23	.13
Liberia		.14	.09
Madagascar	.76	.11	.08
Malawi	.81	.08	.07
Mali	1.00	.17	.15
Mauritania	.93	.23	.22
Mauritius	.74	.68	.56
Mozambique	.86	.13	.15
Namibia	.79	.40	.44
Níger	1.00	.05	.05
Nigeria	.44	.17	.13
Rwanda	.90	.11	.10
Senegal	.67	.21	.19
Seychelles	1.00	.94	.25
Sierra Leone	.92	.08	.02
South Africa	.75	.77	.72
Sudan	.82	.03	.02
Swaziland	.92	.14	.13
Tanzania	.57		
Togo (1998)	1.00	.19	.16
Uganda	.65	.05	.04
Zambia	.69	.13	.07
Zimbabwe	.64	.25	.27
Average	.82	.20	.15

Sources: Bankscope for column 1. Financial structures database for columns 2 and 3. Data in columns two and three for Chad and the Democratic Republic of Congo are for 2001; data for Togo are from 1998. The remaining data in all columns are for 2003. For Liberia and the Central African Republic, there were fewer than three banks in the Bankscope sample, and thus we could not compute a three-firm concentration ratio.