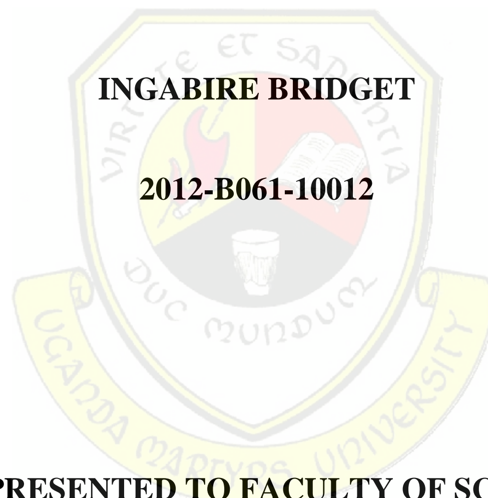
COMMERCIAL BANKING AND FINANCIAL DEVELOPMENT IN UGANDA

CASE STUDY OF BANK OF UGANDA



INGABIRE BRIDGET

2012-B061-10012

A DISERTATION PRESENTED TO FACULTY OF SCIENCE IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF A DEGREE OF BACHELOR OF SCIENCE IN FINANCIAL MATHEMATICS OF UGANDA MARTYRS UNIVERSITY

MAY 2015

DEDICATION

This dissertation is dedicated to my parents Mr. and Mrs. Mwika Gerald and my siblings James, Leonard, Julian, Geraldine and Patience.

ACKNOWLEDGEMENTS

I thank the Almighty God the provider of knowledge and wisdom for seeing me through my studies and for enabling me to undertake my research successfully, without his grace I would not have made it.

I extend my deep appreciation to my supervisor Dr. Mwesigye Feresiano for the guidance and advice provided during the study that made it possible for me to successfully complete this report.

Special thanks go to my lecturers and my friends for their continuous support and encouragement throughout the making of this dissertation.

I wish to express my sincere gratitude to all those who made tremendous contributions to this study: my family Mr. and Mrs. Mwika Gerald and all my brothers and sisters for their unconditional love, moral and financial support and their never ending encouragement.

May the Almighty Lord bless you abundantly!!

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LIST OF ABBREVIATIONS

ATMs: Automatic Teller Machines

BOU: Bank of Uganda

CEM: Country Economic Memorandum

CVI: Content Validity Index

GDP: Gross Domestic Product

SACCOs: Savings and Credit Corporative Organization

SPSS: Statistical Package for the Social Sciences

UMU: Uganda Martyrs University

ABSTRACT

This study investigated the impact of commercial banking and financial development in Uganda. It aimed to discover why the commercial banking sector in Uganda has continued to grow over the years yet the financial development levels of the country still remain low.

The study adopted the correlational study design with quantitative and qualitative research techniques. A total sample size of 36 respondents was used. Self-administered questionnaires and a face to face interview were used to collect data. Data was coded and later processed and analyzed and presented using means and standard deviation. Literature review based on the study objectives was done.

From the study it was revealed that increased commercial bank deposits encouraged financial development through provision of a more diversified and stable funding base and potentially contributed to the stability of the financial system. Increased commercial bank branch networks promoted financial development by increasing access to financial services. It was also exposed that increased loans issued led to financial development through financing production, distribution, investment in businesses, and enabled them to properly allocate and invest much of society's savings.

Finally it was recommended that commercial banks should build more branches, ATMs and mobile banking services and mostly in rural areas in order to make people benefit from their savings and simplify money transfer. It was also recommended that commercial banks should set low loan interest rates in order to encourage people to acquire more loans and also advise them on profitable ways of investing the loans taken. This will increase investment thus growth and development in the country

CHAPTER ONE:

INTRODUCTION

1.0 Introduction

Commercial banking is the traditional banking business of holding deposits, bundling them together as loans and operating the payments mechanism (Howells and Bain, 2005). Also, commercial banks can be defined as financial institutions that provide services such as accepting deposits, giving business loans, mortgage lending, buying and selling foreign exchange and basic investment products like savings accounts. If banking business is properly conducted, savings are collected and invested in growing sectors of the economy, thus increasing returns on investment and employment opportunities, real incomes and tax revenue collected by the government.

Financial development refers to the policies, factors and institutions that lead to efficient intermediation and effective financial markets (Fry, 1995). According to Noureen Adnan (BOU), the higher the degree of financial development of a country, the wider the availability of financial services. With the growth of commercial banks in Uganda, one would expect financial services to be more available thus resulting in financial development of the economy, which isn't the case. The researcher therefore aims to empirically investigate the link between growth of commercial banks and financial development in Uganda.

The contents of this chapter include; background of the study, statement of the problem, general objective of the study, research questions, hypothesis ,justification of the study, significance of the study, scope of the study , the conceptual framework and the definition of terminologies used in the research.

1.1 Background of the Study

1.1.1 Historical Background

During the Keynesian revolution in the 1950s and 1960s, the importance of financial factors was largely ignored (Hossain and Anis, 1996). The predominant Keynesian forced-saving school believed that most developing countries preferred low nominal interest rates and high inflation which resulted in very low real interest rates and yet the financial repression arising from this is the cause of low saving rates and underdevelopment of their financial sectors.

Since early 1970s, the theory that repressive financial policies encourage investment and economic growth have been highly criticized by the prior saving school especially the classic works of McKinnon (1973) and Shaw (1973) who argue that financial repression (low or negative real interest rate) encourages current consumption and thus people prefer holding their savings in real terms rather than in investing in financial assets because real assets are a better hedge from inflation. This results in the financial sector being shallow thus affecting monetization of the economy and general efficiency of transactions. Another criticism is that low real interest rates generate high demand for investable funds which result in problems concerning credit rationing and rent seeking activities. Low real interest rates also result in inefficiency of investment and force investors to make capital intensive investments which are not compatible with developing countries' factor endowments (Hossain and Anis, 1996).

Financial repression is comprised of inflation, reserve requirements and interest rate ceilings. If institutional constraints prevent government from collecting enough normal tax revenue to finance the level of government expenditure it regards as optimal, financial repression may be justified as 2nd best strategy. Given disadvantages of high inflation and high reserve

requirements, the government may turn to interest rate ceilings. Government deficits can be financed at a lower inflation rate and a lower required reserve ratio the more the private sector is hindered from competing for available funds (Fry, 1973; Giovannini and De Melo, 1993; Nichols, 1974). McKinnon (1973) and Shaw (1973) analyze developing economies that are financially repressed. Their central argument is that financial repression reduces the real rate of growth and the real size of the financial system relative to non financial magnitudes. This strategy has stopped or seriously retarded the development process (Shaw, 1973). They therefore aim at removing these distortions imposed by so many governments in developing countries.

In Uganda, the financial policies of pre-reform period which were aimed to control banking markets for developmental and non-commercial objectives greatly damaged the banking system. Financial repression deterred the public from holding bank deposits and a large government owned bank which was operating with little regard for commercial principals ended up accumulating a massive portfolio of bad debts (Martin, 2014). Since commercial banks dominate the financial system in developing countries, measures that repress and so reduce the size of the banking system in relation to the rest of the economy stifle financial intermediation. Therefore there could be financial repression in the country's economy despite the apparent growth of commercial banks, which may be deterring financial development in the country.

1.1.2 Conceptual Background

Financial development and domestic capital formation are principal driving forces behind any country's sustainable growth and effective financial institutions are important facilitators (Ali and Emerta, 2012).Financial institutions such as commercial banks are the key channel between savings and investment and their efficiency is a key determinant of a country's economic growth. Both theory and evidence support the proposition that enhancing financial sector performance

results in higher economic growth. The theoretical argument for linking financial sector development to growth is that a well-developed financial system performs several critical functions to enhance the efficiency of intermediation by reducing information, transaction and monitoring costs. A modern financial system promotes investment by identifying and funding good business opportunities, enables the trading, hedging and diversification of risk and facilitates exchange of goods and services. All these functions result in more efficient allocation of resources, a more accumulation of physical and human capital and faster technological progress which feed economic growth. Thus getting the financial system of developing countries to function more effectively in providing the full range of financial services promotes high sustainable growth.

Over the past 25 years, microfinance providers who reach a wider portion of the population have moved from informal to formal service providers after proving that most poor people are “bankable”. Today, formal financial institutions are absorbing lessons learnt on how to do small transaction banking evidenced by growth of commercial banks through large existing branch networks, vast distribution outlets for example automated teller machines and use of technological techniques such as mobile banking which bring services closer to the poor and other clients in the far to reach areas (Brigit, 2006).

Commercial banks tend to be the first financial institutions to emerge in the process of economic development since they perform the most general functions of providing a payments mechanism and intermediating between lenders and borrowers. Other financial institutions follow to offer more specialized intermediary services (Fry, 1995). Joseph (1939) regards banking and entrepreneurship as the two key agents in economic development. Also, Gerschenkron (1968) suggests that the more underdeveloped a country is, the greater the need for banking to supply

both capital and entrepreneurship. Furthermore, Cameron (1972) points out that where banks are established by and for industrialists, they are more responsive to business demands for medium and long term funds.

The stage of financial development can refer to the evolution of the financial system, to its structural form, to its mode of operations or the type of financial claims it offers (Fry, 1995). Financial conditions include accessibility of branches, variety of products and services offered, information and dissemination by financial institutions, risk taking and liquidity of indirect claims as well as population per bank branch and the real deposit rate of interest.

In that regard, bank performance in developing countries is usually criticized although the criteria on which their performance is found unsatisfactory is seldom made clear. Monetary policy may be a possible measure for performance of banks since it determines many of the constraints under which the banks operate. Assessing performance and implementing monetary policy both require information on bank's activities (Fry, 1995). Under conditions of perfect competition, performance can be based on the profitability of bank because such competition would ensure optimal performance of the banking system which is why the criticisms of banking systems in developing economies trace their grass roots to evident lack of competition. Under uncompetitive conditions, efficiency of banks is evaluated in terms of speed and cost of effecting payments, attracting savings, intermediation costs and allocating investible funds. Efficiency of payments can be measured by percentage growth in demand deposits, ratio of clearings to demand deposits, average time taken to cash a cheque and average time take to process accounts.

Generally, commercial banks dominate financial sectors of most developing countries and their performance has great influence on overall efficiency of domestic resource mobilization and

allocation. Most governments of developing countries viewed financial development in terms of increasing number of specialized financial institutions such as agricultural and industrial development banks which yielded undesirable results because some of the specialized financial institutions performed worse than commercial banks which had been critised in the first place. The approach to financial sector development has now changed by advocating for despecialization, promotion of competition and a broader view of financial development which encourages an important objective of efficient bank operations and robust as well as competitive financial system (World Bank, 1985). Measures to achieve these objectives include promoting a variety of financial intermediaries and institutions which in turn offer a wide range of financial services supported by a reliable financial system, a legal framework emphasizing enforceability of financial contracts and regulatory and supervisory systems which ensure stability of the financial system. There is therefore enough evidence to indicate that financial development programs must address the issues of market structure and management performance of the banking system in order to succeed.

1.1.3 Contextual Background

Poor people want secure, convenient deposit services which can offer them services at low transaction costs and can allow for easy access to their funds. They therefore resort to informal ways of saving by keeping their money under their mattresses, buying animals or jewelry that can be sold off later, joining village savings groups or giving money to friends. Such methods are very risky because the cash can be stolen at anytime or the friends can choose to run off with the money. What these people do not know is that formal institutions such as commercial banks encourage more savings and that their cash will always be available. A study carried out in

Uganda revealed that people with access to formal savings in banks save three times as much as those who rely on informal savings.

Despite the efforts to restructure the financial sector and liberalize regulations concerning financial institutions such as commercial banks, which was intended to provide efficient mobilization and channeling of savings to the private sector investment in order to contribute to the financial development of the country, Uganda's financial development trends still remain elusive. The low performance of financial services is mainly attributed to lack of strong, competent retail-level institutions which limit the coverage of their services to include the poor people (Brigit, 2006).

The central bank is the major player in the regulation and control of commercial banking through supervision, approval of minimum capital of the bank, restriction of range of loans and advances and type of trades engaged in by the banks among others, with the aim of promoting and maintaining adequate and reasonable banking services for the public and to ensure high standards of conduct and management throughout the banking system (Grace, 1998). Bank of Uganda is therefore in position to influence the commercial banks in the country to offer favorable financial services to the entire population regardless of their geographical location or level of income and thus result in financial sector development. It is upon this background that the researcher carried out a study about commercial banking and financial development in Uganda.

1.2 Statement of the Problem

Financial sector development is measured by various factors but for developing countries like Uganda, the financial system is dominated by commercial banks (Fry, 1995). Development in technology has transformed financial service delivery from the traditional physical infrastructure to a system supplemented by other innovative channels such as electronic money (e-money) agents and ATMs with cash in and cash out capabilities as well as mobile money agents and SACCOs which are all helping to increase the access to financial services of underserved and unserved areas in Uganda (BOU, 2014).

Over the years, commercial banks in Uganda have grown as indicated by increased bank branches which increased from 167 branches in 2004 to 658 branches in 2013. The ATM network also expanded from 152 in 2004 to 835 in 2013 thus posting faster growth. The number of deposit accounts held in commercial banks also made a significant improvement from 1,471,146 accounts in 2004 to 5,367,512 accounts in 2013 with deposits increasing from shs.1, 965.3 billion in 2003 to shs.9, 498.7 billion in 2013. Similarly, the number of borrowers of commercial bank loans stood at 560,446 by the end of 2012 while the outstanding loan amount stood at shs.8,095.1 billion at the end of 2012 (BOU, 2014). A case in point is Stanbic Bank which registered a profit after tax of shs.68.43 billion in the 1st half of 2014 which is a growth of 19.23%. This is due to improved loan recoveries and pick up in customer deposits which grew by 13%, according to the half year financial results presented by Mr. Phillip Odera, the bank's CEO. However, with all this growth going on, financial development of Uganda still remains low as it is ranked 77th out of 148 economies compared to Kenya (31st) and Rwanda (57th) according to the World Economies Forum (WEF) financial development report. Also, evidence of uneven distribution is still eminent in the country as access to bank branches is more concentrated in the

central region while 48% of the 112 districts in Uganda lack access to any bank branch, most of which were created in the last decade. The lack of access points in the northern region can be attributed to previous civil war experienced over a decade in the region since distribution of banks is determined by profitability of businesses, cost and business opportunities among others (BOU, 2014).

The 2005 Financial Sector Assessment Program (FSAP) characterized the Ugandan financial system as stable and growing but also small relative to its peers, under developed and not able to fully support economic growth (World Bank, 2009). While recognizing the effort made by Ugandan authorities in implementing recommendations of the 2001 FSAP to lay a foundation for a sound and profitable financial system, the FSAP noted that the key challenge for authorities was to create conditions that would lead to increased intermediation and therefore create a greater role for the financial sector in supporting financial and economic development. The researcher thus seeks to find out whether there is a problem in accessibility to financial services, or if quality of the financial services in the country is low or whether the financial system of the country is simply not sound due to banking products being passive and largely related to the traditional activities of money transfers, deposit and lending services other than adopting innovative services such as loan recovery and management systems, call centers for customer inquiries and agency banking where financial institutions are allowed, under strict regulations to operate agencies through third parties, all of which are measures of financial development.

1.3 Objectives of the Study

1.3.1 General Objective of the Study

To find out the relationship between commercial banking and financial development in Uganda

1.3.2 Specific Objectives of the Study

i. To find out how increased commercial bank deposits affect the financial development of Uganda.

ii. To establish the impact of increased commercial bank branch networks on financial development in Uganda.

iii. To find out the impact of increased loans issued by commercial banks on financial development in Uganda.

1.4 Research Questions

i. What is the impact of increased commercial bank deposits on the financial development of Uganda?

ii. How does the increased number of commercial bank branches in Uganda affect its financial development?

iii. What is the impact of increased loans issued by commercial banks to its customers on financial development of Uganda?

1.5 Justification of the Study

In Uganda, most people have resorted to use of mobile banking which has registered a total number of 17.6 million Ugandans as at the end of June 2014, only 6 years after its establishment in the country. The total number of accounts held by the population in financial institutions regulated by the central bank such as commercial banks, credit institutions and micro finance deposit taking institutions is 5.6 million of the estimated population of 35million people and yet the number of commercial bank branches spread across the country is 545. If no such study is carried out, we shall not be able to account for the growth commercial banks yet their penetration into the country's population is still minimal.

1.6 Significance of the Study

This research will supplement the already existing literature about the impact of commercial banking on financial development in Uganda.

The study will be used by policy makers to formulate financial policies that can improve the penetration of financial services into the country's population in order to achieve financial development.

This study is relevant for the Ugandan economy given the high degree of concentration in the banking sector. It's important to determine the level of competition and how it's linked to concentration and whether it affects the profitability of the banking sector in general.

1.7 Scope of the Study

1.7.1 Subject Scope

The study focused on the impact of growth of commercial banking indicated by increased loans, increased deposits and widespread branch network, on the financial development of Uganda which was measured by the depth or access to financial services, availability and quality of financial services as well as the soundness and stability of the financial system.

1.7.2 Geographical Scope

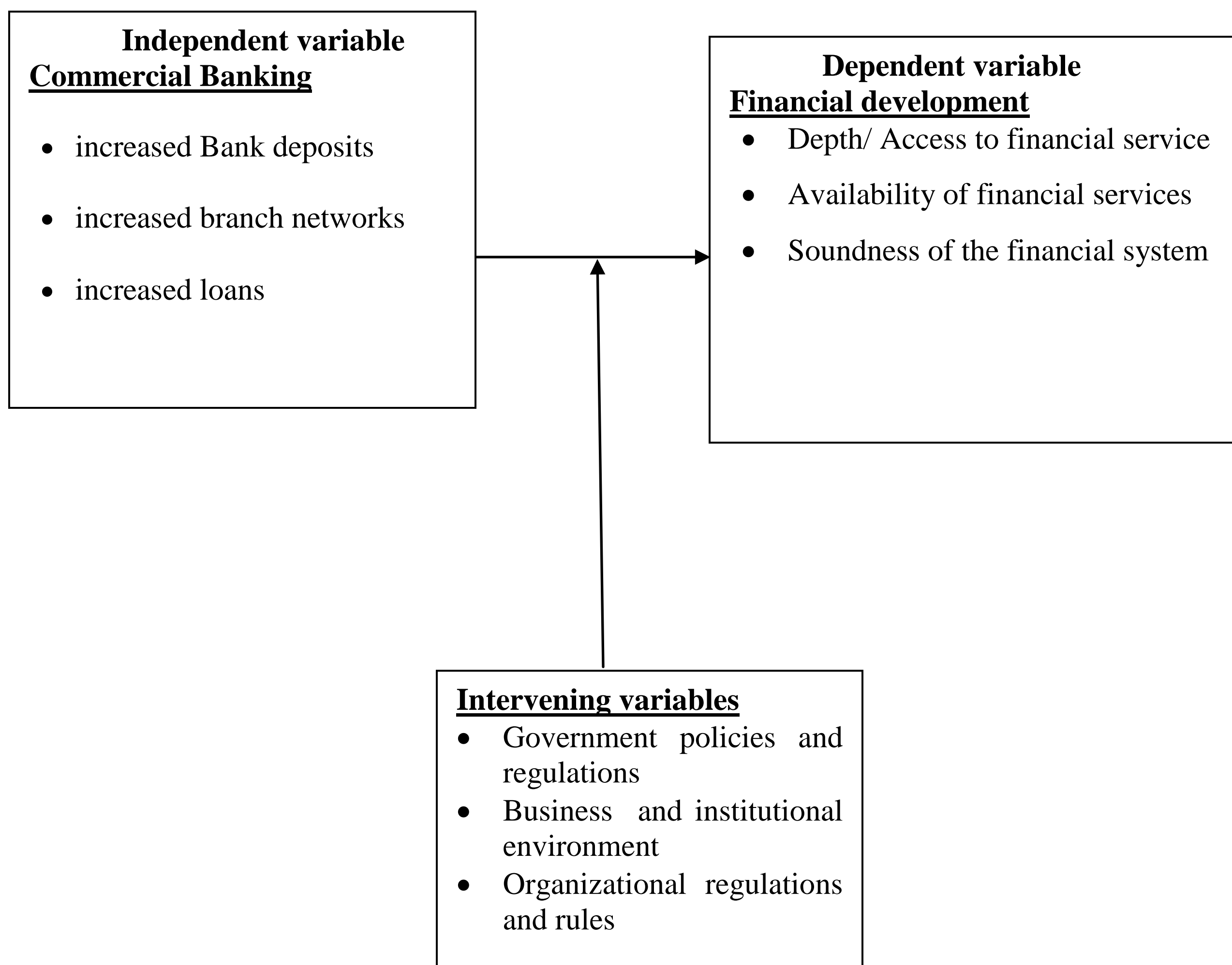
The geographical scope was Bank of Uganda which is located at plot 37/45 along Kampala Road. The researcher used this case study because it is the central bank of Uganda, a banker to the government and commercial banks, and therefore has all the information that concerns commercial banks in the country.

1.7.3 Time Scope

The study was carried out in a proposed period from December 2014 to April 2015 in order to obtain the current information on commercial banks in the country. The researcher believes all the required information was collected during this time frame.

1.8 Conceptual Framework

Figure1.1: Relationship between commercial banking and financial development in Uganda.



Source: Adopted and modified from Kelly and Marvotas (2003)

The conceptual framework describes the relationship between the independent variable and the dependent variable. The conceptual framework above depicts the relationship between the growth of commercial banking on financial development. In this conceptual framework, commercial banking is the independent variable while financial development is the dependent variable. The conceptual frame work is developed and refined basing on Kelly and Marvotas (2003). They substantiate on the role of commercial banking and the intended outcomes which have helped to formulate the study objectives (formulate the predictor independent variables) and outcome variables. In the conceptual framework commercial banking is operationalised into increased deposits, increased loans and increased branch networks. On the other hand, financial development has indictors such depth/ Access to financial service, availability of financial services and soundness of the financial system.

However there are intervening variables that influence the relationship between commercial banking and financial development. These include government policies and regulations, Business and institutional environment and organizational regulations and rules.

1.9 Operational Definitions

Bank of Uganda (BOU): The central bank of Uganda which is a banker to commercial banks and the government.

Intermediation: The extent to which banks convert deposits that they mobilize into loans to the corporate and household sectors. Financial institutions therefore intermediate funds between savers and investors in the process of financial development.

G8: Refers to the Group of Eight countries that meet annually to discuss issues affecting the global economy. Members of the G8 include Canada, France, Germany, Italy, Japan, the Russian Federation, United Kingdom and United States

CHAPTER TWO

LITERATURE REVIEW

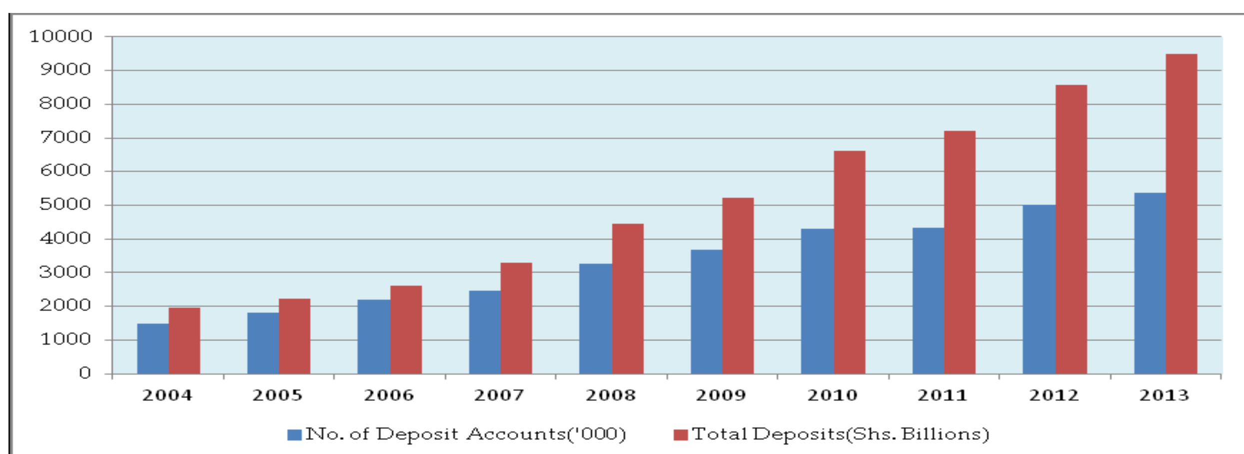
2.0 Introduction

This chapter deals with the review of the related literature on the study variables of commercial banking and financial development. The review then focused on the major themes of the study which are; to find out how increased commercial bank deposits affect financial development, to establish the impact of increased commercial bank branch networks on financial development and to find out the impact of increased loans issued by commercial banks on financial development.

2.1 Commercial bank deposits and financial development

Total deposits held by commercial banks in Uganda have continued to grow over the years from shs. 1,965.3 billion in 2004 to shs 9,498.7 billion in 2013 due to an increase in the number of account holders from 1,471,146 in 2004 to 5,367,512 accounts in 2013 (BOU, 2014) which means an increase in the banked population of the country. The graph below illustrates the trend of growth of deposits in the country from 2004-2013.

Figure 2.1: Number of deposit accounts and total amount of deposits (2004-2013)



Source: Bank of Uganda

At the bank level, focusing on retail deposit generation can produce a more diversified and stable funding base that is less sensitive to changes in market interest rates and a bank's financial condition. In stress times, insured depositors have proven to be a bank's most reliable funding source and, therefore, play an integral role in mitigating liquidity risk (OCC, 2012). The 2007-2008 global financial crisis demonstrated that stable retail sources of funding, in contrast with reliance on borrowed funds, can greatly enhance the soundness and resilience of financial institutions and reduce volatility of earnings (Khan, 2011). Diversified funding base of financial institutions has played a role in cushioning the impact of a global credit (wholesale funding) crunch on domestic financial intermediation (Hannig and Jansen, 2010).

The 2007 Country Economic Memorandum (CEM) noted that Uganda's financial system is still quite shallow and that benefit in terms of higher growth and faster poverty reduction will only arise from increasing the depth and breadth of the financial sector. The memorandum hinted on the fact that the major constraint in the financial system is intermediation rather than low savings

rate. They argue that even if banks are provided with additional savings, under present circumstances they prefer not to lend to the private sector as supported by the large imbalance between increased deposits and increases in lending to private sector borrower (Hannig, et al 2010).

Honohan (2008) noted that one of the most striking features of institutional credit in many countries in the last decade, for example, has been the significant increase in deposit money banks' direct lending to government for building up infrastructural facilities, program backing and meeting recurrent expenditure. Deposit taking banks play an important function in the development and growth of a nation. The principal role carried out by deposit money banks is to ensure there is adequate flow of money to service deficit sectors of the economy and facilitate the movement of funds amongst economic units. This movement referred to as financial intermediation is usually from units of surplus to units of deficit/need (Huang and Lev, 2011).

Supply of finance can retard economic development if it is repressed or stimulate it if it is liberalized. In times of financial stress or crises, depositors get anxious, can run on banks, and withdraw their deposits (Shin, 2009). Large depositors are usually the first ones to run (Huang and Lev, 2011). By the law of large numbers, correlated deposit withdrawals could be mitigated if bank deposits are more diversified. Greater diversification of deposits could be achieved by enabling a broader access to and use of bank deposits, i.e. involving a greater share of adult population in the use of bank deposits (financial inclusion). Based on this assumption, broader financial inclusion in bank deposits could significantly improve resilience of banking sector funding and thus overall financial stability (Cull, Demirguc-Kunt and Lyman, 2012).

At the individual and household level, bank deposits support stability and, given their very large numbers, small savers potentially contribute to stability at the financial system level (Cull, Demirguc-Kunt and Lyman, 2012). Low income savers tend to maintain steady financial behavior through the business cycle. Hence, during crises, deposits from low income clients typically act as a continued source of funds even when other sources of bank financing dry up or become difficult to roll over. Small customers thus provide big opportunities to mobilize stable deposits (Khan, 2011). Greater financial inclusion, including access to savings, can also enhance financial stability indirectly, by providing individuals, households, and small firms with greater access to financial risk-managing tools. This greater access can enhance resilience and stability of the real economy and thus also the financial system that serves it (Khan, 2011).

Banks can invest deposits in a competitive lending market where they earn a return on their funds. This can be thought of as a situation where banks use funds collected in rural areas to support investment in the urban center. Alternatively, banks may have profitable investment opportunities in the rural catchment. For example, some high expected return projects may not be undertaken because they require (relatively) large capital investments and the transaction costs of collecting them through self-intermediation are too great.

Commercial banks hold different kinds of deposits and hold them in a variety of forms and these deposits constitute a majority of money supply. The emergence of new theories of endogenous economic growth has given additional evidence to the relationship between growth and financial development as these models postulate that savings' behavior directly influences not only equilibrium income levels but also growth rates. Thus, the existence of a vibrant and efficient financial sector helps in pooling savings of households and firms and making it available to entrepreneurs (Hossain and Anis, 1996).

Other researchers also hold the same view that financial institutions such as commercial banks play an important role in easing the tension between savers' preference for liquidity and entrepreneurs' need for long term finance and thus with an efficient financial system, resources will be utilized more productively due to the ability of financial intermediaries to identify the most productive investment opportunities (Huang and Lev, 2011).

Increased bank deposits may lead the bank to reduce on the interest rates. The decline in the interest rate as a common rule is most excellent for the economic atmosphere because customers can easily pay for taking loan as they don't have to pay higher interest rate for taking the loans. To regulate the economic development, interest rate is used as a device. As economy developed rapidly it will cause inflation in the economy. In other words prices go up to higher point which reduce the buying power of people which affect the demand of people for goods and services because of the shifting accessibility of bank loans. But on the other hand when interest rates are low, the cost of borrowing decline which increase the buying power of public and as result they tend to make investments and spend in different forms (Chinn and Ito, 2006).

According to Cull, Demirguc-Kunt and Lyman (2012), there are three aspects of the financial development-capital accumulation-growth link and they include: the relation between real deposit rate of interest and rate of savings, relation between real deposit interest rate and financial saving, and the relation between real loan interest rate and efficiency of investment. Economic theory does not offer a clear prediction of how interest rates affect level of savings, but proponents of financial liberalization believe that an increase in real interest rate leads to an increase in level of savings

A rise in real deposit rate promotes financial deepening because people hold their savings in financial rather than non-financial forms (Chinn and Ito, 2006). By comparison with a situation where nominal interest rate is set below the inflation rate, a low real rate of interest arises, which lowers the demand for financial assets because savers prefer real rather than the financial assets. This results in a decline of financial savings, which in turn reduce supply of loanable funds thus a shallow financial sector.

Berglof and Nagy (2009) observed that increased deposits can improve on the financial markets and this plays an important role in the growth process by channeling funds to the most efficient investors and by fostering entrepreneurial innovation. His argument was that financial development leads to economic growth. However, Berglof and Nagy (2009) argued that financial development follows economic growth by responding to the increasing demand for funds due to economic prosperity

Hannig and Jansen (2010) argue that developing countries lack an appropriate financial sector, and in a move to pursue such a financial system, they implement far reaching financial reforms including lifting restrictions on bank lending, provision of market based systems of credit allocation, lowering reserve requirements, easing of entry restrictions to the banking sector and privatization of state owned banks.

The source of bank credit is deposits mobilized by households, private and public enterprises as well as the government. The nature of deposits partly governs the nature of credit that banks can extend to economic agents. The vast majority of deposits in the financial sector is short-term time deposits and demand deposits. The ratio of demand to time deposits is more than 100% in some countries signifying the nature of economies in which clients need to have easy access to

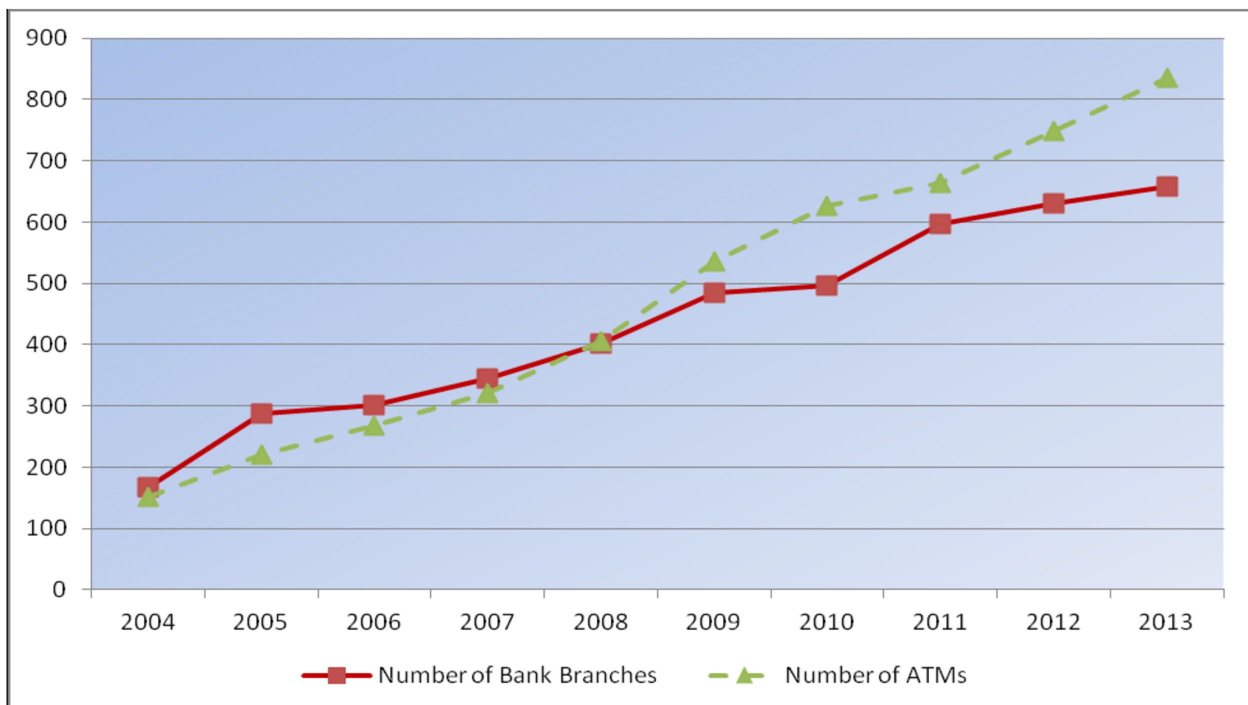
their financial assets. Such short term deposits are not suitable for financing long term deposits due to the maturity mismatches (Chinn and Ito, 2006).

At the current level of development and given their immense needs for financing physical capital accumulation in infrastructure, African countries will benefit from fostering the development of a sound financial banking system. Some scholars have suggested that African countries should explicitly emphasize banking sector development over stock market development. For example, Buncic and Melecky (2013) conclude that for many African countries, pursuing stock market development is a costly irrelevance which they can ill afford.

2.2 Commercial bank branch networks and financial development

On a year to year basis, the commercial bank branches in Uganda have continued to grow from 167 branches in 2004 to 658 branches in 2013. The number of branches for every 10,000 adults in Uganda stands at 0.3 commercial bank branches which compares fairly with its East African counterparts although lower than Rwanda (0.8) and Kenya (0.6) but higher than Tanzania (0.2). This has further led to a higher geographic penetration into the country's population as shown by a rise from 2.0 access points per 1000 square kilometers in 2008 to 3.3 access points per 1000 square kilometers in 2013. The limitation with this however is that it assumes uniform distribution across the geographic area (BOU, 2014). The graph below shows the increasing trend of commercial bank branches in Uganda from the period of 2004-2013.

Figure 2.2: Number of Bank branches and ATMs



Source: Bank of Uganda

The banking sector has grown rapidly over the past years. While Stanbic Bank comprises the largest sector in terms of its overall size and branch network, almost all of its competitors are seeking to provide greater coverage by opening new branches out of Kampala. The major reason for this expansion is the emergence of strong competition in the corporate banking market which has forced larger banks to embark on a search for loan clients who are below the thin tier "blue chip" clients they have always offered services to (World Bank, 2009).

Most people in the developing world do not have access to formal financial services. Very few people benefit from a savings account, loan or convenient way to transfer money (Brigit, 2006). However, commercial banks and other formal institutions are trying to reach larger number of the country's population through increasing their branch networks and automated teller machines as well as mobile banking services countrywide (Hannig and Jansen, 2010).

The G8 endorsed key principles of microfinance that are translated into a framework which recognizes that the large population of financially excluded population can only gain access if financial services for the poor are integrated into the three levels of the financial system i.e. micro, meso and macro as this would gradually open the financial market to a larger population including the poorer people and those in rural areas (Demirguc-Kunt and Detragiache, 2005).

Clients: defined as poor and low- income customers and are at the center of the financial system

Micro: This is the backbone of the financial system which offers direct financial services to the poor and low income clients. The service providers at the micro level range from informal moneylenders to commercial banks.

Meso: This has the basic financial infrastructure that is used to reduce transactional costs, increase the outreach, build skills and foster transparency among financial service providers. It

includes auditors, rating agencies, professional networks, credit bureaus, transfer and payment systems, information technology, and technical service providers among others. These can later spread beyond the national boundaries to include regional and global organizations.

Macro: This involves the central bank, ministry of finance and other government. These are all useful in generating an appropriate legislative and policy framework.

All these levels of the financial system usually obtain their funding from domestic market sources such as deposits from the public or investments in capital market and also from international funding which expands access to financial services and is used to accelerate the process of building domestic systems (Demombynes and Aaron, 2011).

Financial inclusion deals with either supply-side data where information is obtained from financial service providers such as commercial banks and other financial institutions regarding data on bank branches and ATMs or demand side data which is data collected from the actual users of the financial services which gives an idea on the degree of usage of the financial services, client experience and the needs of non-consumers (BOU, 2014).

Professor Njunguna Dung's, the central bank governor of Kenya encouraged Uganda commercial banks to increase their branch networks and embrace mobile money as a way of penetrating rural areas adding that mobile money transfer system is convenient since one can have an account in the bank but deposit from wherever he is without necessarily going to the bank or making long lines (myBank magazine).He added that it makes no sense if a person earns shs.100,000 and yet the minimum bank balance is twice this amount. He urged that banks revise their transaction rates and charges in order to encourage the poor who are capable of bringing business considering they have access to markets.

Also, banks request that clients go to their original banks where bank accounts were opened in case they have a problem with their ATM cards. This may be expensive if this place is far away and therefore banks need to devise means to a better solution otherwise such are the reasons why people opt for other financial institutions other than commercial banks which results in a low level of financial sector development (Bankable, 2009).

2.3 Loans issued by commercial banks and financial development.

Loans issued out to borrowers by commercial banks have continued to grow due to intermediation of funds by the banks. In the 1990s, Uganda was a low intermediation banking system. At the end of 2000, commercial bank credit to the private sector was only 6% of GDP and banks only lent out only 54% of their deposit base to private sector. By the end of 2012, 80% of the deposit base had been lent out to the private sector and private sector credit as a share of GDP had risen to 15% implying that since the end of 2000, bank lending to the private sector had increased fivefold in real terms (Louis, 2013).

Credit to all sectors of the economy increased sharply in 2010/2011. Total loans rose by Shs.1, 977 billion to reach Shs. 6,516 billion, during the year to June 2011, far higher than the increase of Shs. 914billion in the previous year. A significant feature of this loan growth was the accelerated increase in foreign currency loans, reflecting a trend that started the previous year. Banks' exposure to foreign currency denominated loans rose by Ushs.772.7 billion in the period to June 2011, an annual growth rate of 69.6 percent. Consequently, the share of foreign currency loans in total loans went up from 24.5 percent to 28.9 percent (BOU, 2011).

According to Levine (1997) the lending to government and parastatals accounts for less than 1% of total loans which suggests that the relatively low ratios of loans to total assets and total deposits are not caused by the crowding out of the private sector by the state and state owned enterprises. Nevertheless, high real rates of return obtained from investment in treasury bills provide banks with an attractive alternative to lending which consequently sets a high base for other types of lending.

In the work of Laeven and Fabian (2012) local banks tend to have low asset to deposit ratios as they prefer to use their deposits to fund treasury bills and bonds. The larger banks have excessive liquidity which they are willing to deploy in financing medium term assets (5-7 year tenure). However, the loan covenants under such lending can be taxing and given the limited competition within the banking sector loan spreads remain high. While the situation may be improving, Uganda still lags behind its peers with its small financial sector and excessive liquidity. Uganda's ratio of private credit to GDP lags below its peers and so does the ratio of domestic deposits to GDP.

According to Allen, Demirguc-Kunt and Martinez (2012) banks make their profit by primarily issuing bank loans. A loan is a liability for the person receiving it but it is an asset for a bank because it provides income to the bank. Loans are less liquid than other assets because they can't easily be converted into cash until the loan matures. Loans also have a higher probability of default than other assets. Banks in turn earn their highest return on loans due to their lack of liquidity and higher default risk. Bank loans and investments may finance production, distribution, investment, consumption and the needs of government (Anginer, Demirguc-Kunt and Min, 2012). The deterioration of money reduces the extents to which the banking system administers the country's payments mechanism and intermediates between savers and investors.

Anginer, Demirguc-Kunt and Min (2012) mentioned that, the relative attractiveness of holding money as an asset instead of productive capital is the cause of the inadequate level of investment. Keynes recognizes a way to resolve the disequilibrium by changing the relative returns on the two competing assets, money and capital. If the price level is fixed and expectations about future price level are static, expansionary monetary policy could reduce the interest rate and satisfy the increase in liquidity preference. If an interest rate ceiling is imposed by the authorities

investment can be stimulated by the lower imposed interest rate provided an accommodative monetary policy is pursued.

Ang and McKibbon (2005) explain one of the earlier models linking financial conditions and economic growth using Robert Solow's neoclassical growth model. In his model of money and economic growth, economic units allocate their wealth between money and productive capital. He assumes that these economic units are small household producers who make up the business sector. If the return on capital relative to money rises in Tobin's model, households increase ratio of capital to money in their portfolios. This portfolio shift produces a higher capital/labour ratio that occurs after the relative yield on money falls. Hence, reducing the return on money increases welfare which can be accomplished by reducing deposit rates of interest or accelerating the rate of growth in the money stock thereby raising the inflation rate (Beck, Demirguc-Kunt and Levine, /..2009).

Similarly, structuralists and neostructuralists argue that raising interest rates increases inflation in the short run through a cost-push effect and lowers the rate of economic growth at the same time by reducing the supply of credit in real terms available to finance investment. Hence their models provide a reasonable justification for financial repression.

Demirguc-Kunt and Detragiache (1998) challenge the Keynesians and structuralists on low controlled interest rates and financial repression. They advocate for financial liberalization and development as growth enhancing economic policies. Much of their empirical support for the policy recommendations came from financial reforms in Taiwan (early 1950s) and Korea (mid 1960s). They believe that one of the reasons why saving may fall when inflation accelerates or nominal interest is lowered can be analyzed by considering fixed assets which appreciate in

value for example land. Land prices are expected to rise as fast as the general price level. Thus as real interest rates fall, land becomes an increasingly attractive repository for saving compared to deposits thus most households will remove savings from the bank to buy land.

However, Allen, Demirguc-Kunt and Martinez (2012) insist that, it is worth noting that interest rate ceilings distort the economy in 4 ways; that is low interest rates produce a bias in favor of current consumption and against future consumption. This may reduce saving below the socially optimum level; Potential lenders may engage in relatively low yielding direct investments instead of lending by way of depositing money in a bank; Bank borrowers able to obtain all the funds they want at low loan rates will choose relatively capital-intensive projects and the pool of potential borrowers contains entrepreneurs with low yielding projects who would not want to borrow at the high market clearing interest rate.

The policy prescription for financially repressed economy examined by Demirguc-Kunt and Detragiache (1998) is to raise institutional interest rates or to reduce the rate of inflation. Abolishing interest rate ceilings produces the optimal result of maximizing investment and raising still further investment's average efficiency. Demirguc-Kunt and Detragiache (1998) further stress fiscal discipline as a prerequisite for successful financial liberalization because government deficits are invariably financed by taxing the domestic monetary system in one way or another. Use of inflation tax on domestic financial intermediation leads to foreign exchange controls to prevent circumvention of the taxed domestic financial intermediaries. In turn foreign exchange controls need a fixed exchange rate system. Hence large public sector deficits tend to be incompatible with financial liberalization and development.

Furthermore, Buncic and Melecky (2013) show that deposit and loan rate ceilings are likely to worsen the distribution of income. Most of the economic rent goes to large borrowers rather than small savers/lenders when deposit and loan rates are held well below their market equilibrium levels. Also, capital intensive production methods reduce the demand for labour. Consequently, wages of unskilled labour will fall. In practice, bank loans tend to become concentrated to a small number of large and well established customers when finance is repressed. Greater economic concentration reduces economic efficiency.

In addition, Khan (2011) asserted that, among the activities of commercial banks are extension of credit services and mobilization of deposits. Development in these areas explains the development of the industry as well as the industry's contribution to economic growth through channeling financial resources from where they are relatively abundant to where they are scarce (Khan, 2011). With regard to allocation of credit, development in sectorial and clients' distribution of credit are to consider. In relation to the beneficiaries of bank loans, disbursement of more loans to the private sector is assumed to be an indicator of financial development.

Also, Huang and Lev (2011) mentioned that, increased number of loans issued by the banks enables them to easily mobilize, allocate and invest much of society's savings. So bank performance has repercussions on investment, firm growth, industrial expansion and economic development. While there has been growing literature on banking efficiency in developed economies, less attention has been paid to efficiency of banks in developing countries yet there is increasing realization that financial sector development is a top priority to sustain economic growth in developing countries especially those with successful reforms such as Uganda.

CHAPTER THREE:

METHODOLOGY

3.0 Introduction

This chapter looks at the research design, study population, sample study location ,sampling methods to be used, the type of data to be collected and the tools to be used, data processing and analysis, presentation of the research findings, validity and reliability, the ethical considerations and limitations of the study.

3.1 Research Design

The correlational study design was used in the study because it does not involve manipulation of variables, but variables are measured by taking their natural values such as number of existing commercial bank branches, trend of increases in bank loans issued by banks as well as increases in bank deposits. It was therefore be based on known facts about the indicators of commercial banking. Also, the researcher aims to establish the relationship between growth of commercial banking in Uganda and financial development of the economy basing on primary data obtained from Bank of Uganda as well as other secondary sources. Individual level data design was employed whereby variables being studied by each individual were measured and calculation of the correlation between the variables was done on the basis of individual's scores.

The study was both qualitative and quantitative. It was qualitative because it involved views and opinions of the respondents concerning the low levels of financial development yet commercial banks continue to grow. Qualitative approach is an approach designed to reveal a target audience's range of behavior and the perceptions that drive it with reference to specific topics or issues. It aimed to gather an in-depth understanding of human behavior and the reasons that

govern such behavior. On the other hand, quantitative approach is the systematic empirical investigation of observable phenomena via statistical, mathematical or computational techniques. It involved data that was in numerical form such as statistics, percentages. It was quantitative because it involved measurement of factors that have led to growth of commercial banks and those that have kept the level of development low.

3.2 Sample Study Location

The study was carried out within Bank of Uganda is located at plot 37/45 Kampala road with the security reception desk located opposite Grand Imperial Hotel while the entrance to the banking hall is along Kampala road. Therefore it had enough relevant data and information regarding the topic under investigation.

3.3 Study Population

The study targeted the 40 employees of the commercial banking department at BOU which forms part of the supervision function. The supervision function is headed by the executive director operations and is comprised of 3 departments namely; the commercial banking department which is headed by director commercial banking, non-bank financial institutions department which is headed by director NFI and financial stability department which is headed by director financial stability (www.bou.org). However, most respondents were selected from the commercial banking department because the researcher believes they have adequate knowledge concerning the commercial bank practices in the country.

Owing to difficulty in identifying the individuals who have characteristics required for the study, the researcher used the snowball sampling technique. The researcher identified six individuals

who had such characteristics and they in turn identified their colleagues who also identified more until the required number of participants was realized.

3.4 Sampling Procedure

3.4.1 Sample Size

A total of 36 respondents were selected based on Krejcie and Morgan (1970) sampling guidelines using the non-probability method of snowball sampling criteria. All the respondents were provided with questionnaires to be filled.

3.5 Data Sources

The researcher used both secondary and primary data sources. The primary data was obtained from the commercial banking department at Bank of Uganda. Secondary data was obtained from journals, newspapers, internet surfing and text books that were reviewed to elicit related secondary data; the secondary data was related to the topic and objectives of the study. This supplemented data collected from the primary sources.

3.6 Data collection tools

3.6.1 Questionnaire

A questionnaire is a carefully designed tool for collecting data in accordance with the specifications of the research questions and hypotheses (Amin, 2005). Questionnaires were the main data tool used and consisted of closed-ended questions to be answered by selected respondents. The closed-ended questions gave specific alternatives which enabled the researcher

to attain the intended objective. The technique was appropriate because a relatively large number of employees were used in the study making it less costly and less time consuming.

3.6.2 Interview

This refers to a meeting in which the interviewer puts questions to the interviewee and records their responses. It requires prior preparation because it involves deciding on the type of interview to conduct and the sample of respondents. The researcher used the key informant interview (KII) where an interview was held with the principal banking officer. This is because the researcher believed the principal banking officer has adequate information about the area of study. The interview involved in-depth exploration of the relationship between growth of commercial banks and financial development and thus resulted in acquisition of detailed information from the well informed respondent who was the key interviewee.

3.7 Data processing, presentation and analysis

3.7.1 Quantitative data analysis

Raw data was collected, edited, coded for example by use of the 5 likert scale where codes were assigned as follows; strongly disagree-1 , disagree-2, neutral-3, agree-4, strongly agree-5. The outcome was then be analyzed using Statistical Package for Social Sciences (SPSS). Numerical codes were attached to each item so as to give statistical meaning to the items. Measures of central tendency such as mean and standard deviation were calculated for univariate analysis. It was then tabulated into frequencies and transformed into percentages. The data collected was then presented in form of frequency distribution tables, bar graphs and pie charts.

3.8 Validity and Reliability

Reliability is the extent to which the data measuring instruments will produce consistent results when different kinds of written information are repeatedly measured under the same conditions. To measure reliability, the interview questions were subjected to the test re-test technique of assessing reliability of data which involved administering the same tool to the same group of respondents.

Validity is the extent to which the tools used during the study measure exactly what they are intended to measure thus the quality of the research depended largely on the accuracy of the data collection procedures. Calculation of Content Validity Index (CVI) was done.

3.9 Ethical consideration

The researcher got permission from the Head of commercial banking department through a letter of introduction from the university. This provided utmost confidence in the researcher by the respondents since they were aware of what the collected data is to be used for.

Questionnaires were coded to guarantee anonymity as no one of the respondents were named at any time during the research or in the subsequent study, and respondents were selected for their willingness to participate without compulsion and no risks to the respondents were identified at any stage during the research.

3.10 Limitations of the study

The researcher was unable to probe deeper into the subject matter because some respondents might withhold some information because it is regarded as confidential. However, the researcher assured the respondents that any information given would treated with maximum confidentiality.

The researcher experienced a problem of limited finances with respect to this study. Costs regarding this limitation included transport, printing and photocopying of relevant materials. However, the researcher sourced some money from relatives, friends and use it sparingly so as to overcome the cost constraint.

The researcher also faced a time constraint in data collection, analyzing of data and in final presentation of the report. However, the researcher overcame this problem by ensuring that the time element is put into consideration and that all appointments agreed upon with respondents are fully met.

CHAPTER FOUR

PRESENTATION AND INTERPRETATION OF THE FINDINGS

4.0. Introduction

The study was undertaken to find out the relationship between commercial banking and the financial development in Uganda. Data was collected using questionnaires and an interview and this was based on set objectives which were to find out how increased commercial bank deposits affect the financial development of Uganda, to establish the impact of increased commercial bank branch networks on financial development in Uganda and to find out the impact of increased loans issued by commercial banks on financial development in Uganda.

4.1 Background of the respondents

Under this section, efforts were made to document the background information of the respondents such as gender, education qualification, age group and the time spent in service.

4.1.1 Gender of the Respondents

Table 4.1: Showing the gender of the respondents

Sex	Frequency	Percent	Valid Percent	Cumulative Percent
Male	21	58.3	58.3	58.3
Female	15	41.7	41.7	**100.0**
Total	**36**	**100.0**	**100.0**	

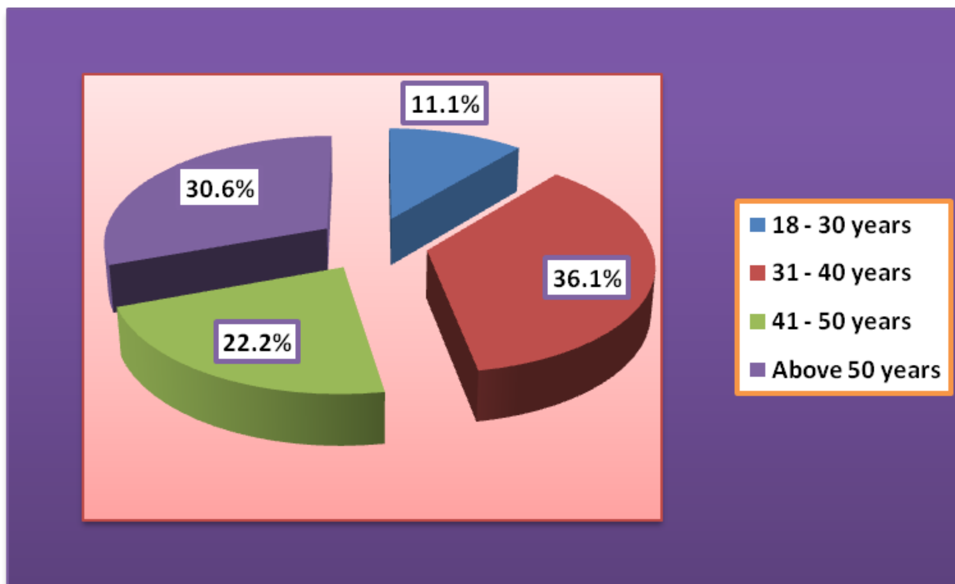
Source: Primary data

Results from the table above, the largest portion of the respondents (58.3%) were males while the minorities (41.7.5%) were females. This shows all kinds of sex were involved even though males dominated. This implied that the organizing was recruiting employees according to the

work scope and most probably Bank of Uganda preferred employing men than women. This also helped the researcher to obtain data from distinct sex thus compilation of a report of unbiased data.

4.1.2 Age group of the Respondents

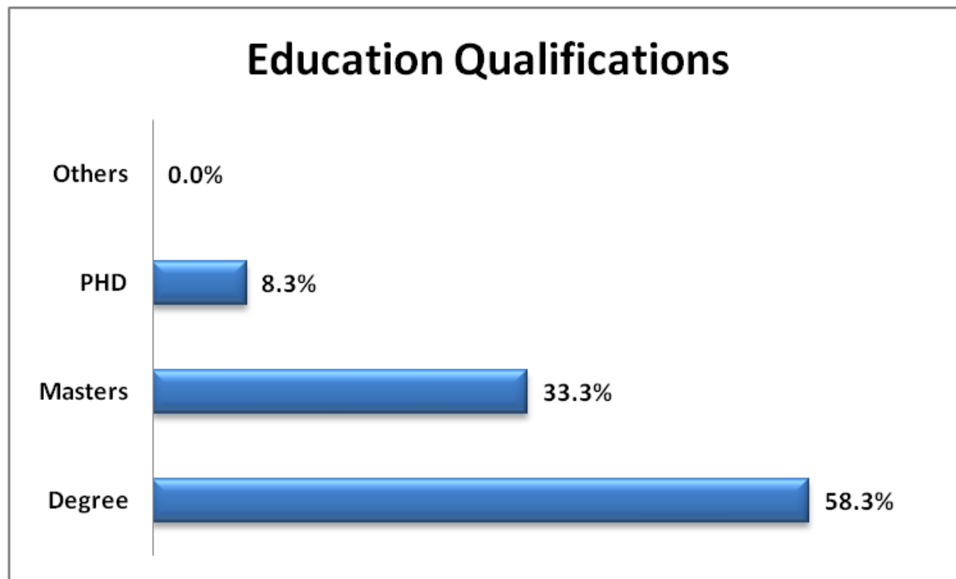
Figure 4.1: Showing the age group of the respondents



Results from figure 4.1 above indicate that a majority (36.1%) of the respondents was in age group (31-40). Most of the people in this category are youths who are still active and energetic therefore they can work with all efforts for the effectiveness of the organization. (30.6%) belonged to the age group (41-50) years, (22.2%) were above 50 years whereas the minority (11.1%) were in the age group of (18-30) years. This implied that the organization rarely employs people in the age group (18-30) because most of the times they are un-experienced and have lower education level while people in the age group (31-40) years are highly educated with experience. This also helped the researcher to acquire information from people within different views.

4.1.3 Education Qualification of the respondents

Figure 4.2: Showing the Education Qualification of the respondents



Source: Primary Data

Results from figure 4.2 show that the majority (58.3%) of the respondents were degree holders, (33.3%) had obtained master's degree, and the minority (8.3%) were PhD holders. This implied that Bank of Uganda employed mostly highly educated personnel which was associated with its recruiting procedures. This also helped the researcher to save time during the data collection since the respondents could easily interpret the questions set in the questionnaires.

4.1.4 Time Spent in service at the Organization

Table 4.2: Showing the time spent by Respondents in service at Bank of Uganda

Status		Frequency (F)	Percent (%)	Valid Percent (%)	Cumulative Percent (%)
Valid	Less than 2 years	5	13.9	13.9	13.9
	2-5 years	12	33.3	33.3	47.2
	6-9 years	8	22.2	22.2	70.4
	More than 9 years	11	30.6	30.6	100
	Total	**36**	**100.0**	**100.0**	

Source: Primary data

According to table 4.2 above the majority (33.3%) of the respondents had been serving at Bank of Uganda, these were followed by (30.6%) who had been working there for more than 9 years, (22.2%) of the respondents had served for 6-9 years while the minority (13.9%) had worked with bank for less than 2 years. This implied all the respondents had experience with Bank of Uganda and they provided detailed information about the bank.

4.2 Increased Commercial bank deposits and Financial Development of Uganda

The first objective of the study was to find out how increased commercial bank deposits affect the financial development of Uganda. The findings were presented, analyzed and interpreted in percentages, frequencies and mean and standard Deviation as indicated below. They are categorized on how the respondents strongly agree, (SA), agree (A), neutral (N), disagree (D) and strongly disagree (SD), Standard Deviation (STD), Frequency (F)

Table 4.3: Increased Commercial bank deposits and financial Development of Uganda

Increased Commercial Bank deposits	SA		A		N		D		SD		Mean	STD
	F	%	F	%	F	%	F	%	F	%		
Increased Deposit generation can produce a more diversified and stable funding base.	12	33.3%	20	55.6%	0	0.0%	3	8.3%	1	2.8%	3.71	0.787
It potentially contributes to the stability of the financial system	20	55.6%	10	27.7%	5	13.9%	1	2.8%	0	0.0%	4. 57	0.787
More small businesses are able to acquire starting capital	14	38.9%	19	52.7%	1	2.8%	0	0.0%	2	5.6%	4. 13	0.911
It also enhances greater access to financial risk-managing tools as commercial banks seek to protect their deposits from risk	20	55.6%	14	38.8%	0	0.0%	1	2.8%	1	2.8%	4.44	1.044
The financial institutions are able to acquire (relatively) large capital investments	15	41.7%	15	41.6%	3	8.3%	2	5.6%	1	2.8%	4.31	0.984

Source: Primary data

Results from the findings show that the majority (55.6%) agreed that the increased deposit

generation produced a more diversified and stable funding base, (33.3%) strongly agreed, (8.3%) of the respondents disagreed with increased deposit generation produced a more diversified and stable funding base whereas the minority (2.8%) strongly disagreed. The mean of 4.71 and standard deviation of 0.787 showed the closeness between the respondents who agreed and those who were not sure that increased deposit generation produced a more diversified and stable funding. This was in agreement with Jansen (2010) who stressed that at the bank level, focusing on retail deposit generation can produce a more diversified and stable funding base that is less sensitive to changes in market interest rates and a bank's financial condition.

The findings also indicate that (55.6%) who were the majority strongly agreed that increased commercial bank deposits potentially contributed to the stability of the financial system, (27.7%) agreed, as evidenced by the mean of 4.57 and standard deviation of 0.787. Further, (13.9%) were not sure whether increased commercial bank deposits contributed to the stability of the financial system while (2.8%) strongly disagreed. This was in line with Cull et al (2012) who stressed that at the individual and household level, bank deposits support stability and, given their very large numbers, small savers potentially contribute to stability at the financial system level

It was also indicated that the majority (52.7%) agreed that more small businesses were able to acquire starting capital, (38.9%) strongly agreed, (5.6%) strongly disagreed and the minority (2.8%) were not sure whether more small businesses were able to acquire starting capital. The mean of 4.13 and standard deviation of 0.911 presented the (52.7%) of the respondents who strongly agreed. This is in line with the findings of the interview where the principal banking officer mentioned that:

> "Due to increased commercial bank deposits, individuals who were not able to solicit a large amount of money at once have been able to acquire starting capital through bank

deposits because there's abundance of funds available for lending which has also reduced the lending rates or cost of borrowing. "

Asked whether increased commercial bank deposits enhanced greater access to financial risk-managing tools as commercial banks sought to protect their deposits from risk, the majority (55.6%) of the respondents strongly agreed, (38.8%) agreed, (2.8%) of the respondents both disagreed and strongly disagreed with it. The mean of 4.44 and standard deviation of 1.044 presented the (55.6%) of the respondents who strongly agreed. This is in agreement with Khan (2011) who stressed that greater financial inclusion, including access to savings, can also enhance financial stability indirectly, by providing individuals, households, and small firms with greater access to financial risk-managing tools

In consideration to the fact that financial institutions were able to acquire large capital investments due to increased commercial bank deposits, the largest portion (41.6%) of the respondents both strongly agreed, and agreed with it. Further, (8.3%) were not sure, (5.6%) were disagreed while (2.8%) strongly disagreed. The mean of 4.31 and standard deviation of 0.984 presented the degree of closeness between the respondents who strongly agreed and those who agreed. This showed the effect of increased deposits on financial development.

4.3 Increased Commercial Bank Branch Networks and Financial Development

The second objective of the study was to establish the impact of increased commercial bank branch networks on financial development in Uganda. The findings were presented, analyzed and interpreted in percentages, frequencies and mean and standard Deviation as indicated below. They are categorized on how the respondents strongly agree, (SA), agree (A), neutral (N), disagree (D) and strongly disagree (SD), Standard Deviation (STD), Frequency (F)

Table 4.4: Increased Commercial Bank Branch Networks and Financial Development

Increased Commercial Bank Branch Networks	SA		A		N		D		SD		Mean	STD
	F	%	F	%	F	%	F	%	F	%		
It increases the number of people who have access to formal financial services.	26	72.2%	6	16.6%	2	5.6%	1	2.8%	1	2.8%	4.77	0.882
It enhances increased outreach, builds skills and fosters transparency among financial service providers.	16	44.4%	17	47.2%	2	5.6%	1	2.8%	0	0.0%	4.23	0.764
Creates a way of penetrating rural areas and providing financial services that are more convenient	17	47.2%	15	41.6%	2	5.6%	1	2.8%	1	2.8%	4.33	1.112
It enhances business operations since it increases the client base.	24	66.7%	12	33.3%	0	0.0%	0	0.0%	0	0.0%	4.62	1.078
It encourages the poor who are capable of bringing business considering they have access to markets	10	27.8%	22	61.1%	4	11.1 %	0	0.0%	0	0.0%	3.43	0.599
Reduces the overcrowding at the main branches and creates better financial service delivery	21	58.3%	11	30.6%	0	0.0%	3	8.3%	1	2.8%	4.25	1.153

Source: Primary data

Results from the findings show that the majority (72.2%) strongly agreed that increased commercial bank branch networks increased the number of people who had access to formal financial services**,** (16.6%) agreed while (5.6%) and (2.8%) both disagreed and strongly disagreed. The mean of 4.77 and standard deviation of 0.882 indicated that generally majority of the respondents agreed. This in agreement with Hannig and Jansen, (2010) who noted that commercial banks and other formal institutions are trying to reach larger number of the country's population through increasing their branch networks and automated teller machines in order to ease the access to financial services.

In consideration to the fact that increased commercial bank branch networks enhanced increased outreach, builds skills and fosters transparency among financial service providers, the majority (47.2%) agreed, (44.4%) strongly agreed, (5.6%) were neutral whereas (2.8%) disagreed. The mean of 4.23 implies that most of the respondents agreed that it enhances increased outreach, builds skills and fosters transparency among financial service providers with some average variation of shown by the standard deviation of 0.764. This in line with the findings of the interview where the principal banking officer mentioned that

> "Commercial bank branch networks have the basic financial infrastructure that is used to reduce transactional costs, increase the outreach and it includes auditors, rating agencies, professional networks, credit bureaus, transfer and payment systems, information technology, and technical service providers"

It was revealed that the majority (47.2%) of the respondents strongly agreed that increased commercial bank branch networks created a way of penetrating rural areas and providing financial services that were more convenient, (41.6%) agreed as evidenced by the mean of 4.33

and standard deviation of 1.112, (5.6%) were not sure whether commercial bank branch networks created a way of penetrating rural areas and providing financial services that were more convenient while (2.8%) both disagreed and strongly disagreed. This in agreement with myBank magazine (2012) where banks are encouraged to embrace mobile money as a way of penetrating rural areas and it is convenient since one can have an account in the bank but deposit from wherever he is without necessarily going to the bank or making long lines.

Asked whether increased commercial bank branch networks enhanced business operations, the findings showed that the majority (66.7%) strongly agreed that while the minority (33.3%) agreed with it. The mean of 4.62 and standard deviation of 1.078 presented the (66.7%) of the respondents who strongly agreed. This is in line with Marvotas (2003) who marked that if banking business is properly conducted, savings are collected and invested in growing sectors of the economy, thus increasing returns on investment and employment opportunities

In relation to the fact that increased commercial bank branch networks encouraged the poor who were capable of bringing business considering they had access to markets, the most of the respondents that is (61.1%) agreed, (27.8%) strongly agreed whereas the minority (11.1%) were not sure whether increased commercial bank branch networks encouraged the poor who were capable of bringing business. The mean of 3.43 and standard deviation of 0.599 presented the (50.0%) of the respondents who strongly agreed.

This in line with the findings of the interview where the principal banking officer mentioned that

> "The poor who had hardships in accessing the financial services offered by the commercial banks, currently have been able to obtain financial help thus boosting their businesses"

Findings also indicated that the majority (58.3%) strongly agreed that increased commercial bank branch networks reduced the overcrowding at the main branches and created better financial service delivery, (30.6%) agreed while (8.3%) and (2.8%) disagreed and strongly disagreed respectively. The mean of 4.25 and standard deviation of 1.153 revealed the closeness of the respondents who strongly agreed and those that agreed.

4.4 Increased loans issued by Commercial Banks and Financial Development in Uganda

The third objective of the study was to find out the impact of increased loans issued by commercial banks on financial development in Uganda. The findings were presented, analyzed and interpreted in percentages, frequencies and mean and standard Deviation as indicated below. They are categorized on how the respondents strongly agree, (SA), agree (A), neutral (N), disagree (D) and strongly disagree (SD), Standard Deviation (STD), Frequency (F)

Table 4.5: Increased loans issued by Commercial Banks and Financial Development in Uganda

Increased loans issued by Commercial Banks	**SA**		**A**		**N**		**D**		**SD**		**Mean**	**STD**
	F	**%**	**F**	**%**	**F**	**%**	**F**	**%**	**F**	**%**		
Increased loan issuance can finance production, distribution, investment in businesses	16	44.4%	15	41.7%	3	8.3%	2	5.6%	0	0.0%	3.9	0.696
Increased number of loans issued by the banks enables them to properly allocate and invest much of society's savings	15	41.7%	19	52.7%	1	2.8%	1	2.8%	0	0.0%	4.21	0.769
Increased loan issuance is an indicator of firm growth, industrial expansion and economic development	16	44.4%	16	44.4%	1	2.8%	1	2.8%	2	5.6%	4.2	1.103
Small business are able to get capital to boast their businesses	19	52.8%	11	30.5%	3	8.3%	1	2.8%	2	5.6%	4.11	1.023

Source: Primary Data

Results from the findings show that the majority (44.4%) strongly agreed that increased loan issuance financed production, distribution and investment in businesses, (41.7%) agreed, (8.3%) were not sure while (5.6%) disagreed with it. The mean of 3.9 and standard deviation of 0.696 presented the majority of the respondents who agreed. This was in agreement with Anginer (2003) who mentioned that banks earn their highest return on loans due to their lack of liquidity and higher default risk and added that bank loans and investments may finance production, consumption and the needs of the government.

Asked whether, it has increased number of loans issued by the banks enabled them to properly allocate and invest much of society's savings, it was also indicated that the majority (52.7%) agreed, (41.7%) strongly agreed whereas (2.8%) were not sure and (2.8%) disagreed with the stated impact. The mean of 4.21 and standard deviation of 0.769 presented the most of the respondents who agreed. This was in line with the findings of Huang and Lev (2011) who mentioned that, increased number of loans issued by the banks enabled them to easily mobilize, allocate and invest much of society's savings. This further depicted how significant the loans acquired from commercial banks are.

Findings also revealed that the majority (44.4%) both agreed and strongly agreed that increased loan issuance was an indicator of firm growth, industrial expansion and economic development, (5.6%) strongly disagreed and (2.8%) both were not sure and disagreed that increased loan issuance was an indicator of firm growth, industrial expansion and economic development. The mean of 4.11 and standard deviation of 1.103 presented the responses between those who agreed and those who strongly agreed. This is in agreement with Huang and Lev (2011) who stressed that bank performance has repercussions on investment and also influences the financial sector development as it is regarded to be the top priority to sustain economic growth in developing

countries

In relation to the fact that due increased loans issued by commercial banks, small business were able to get capital to boost their businesses, the majority (52.8%) strongly agreed, (30.5%) of the respondents agreed, (8.3%) were neutral while (2.8%) and (5.6%) of the respondents agreed and strongly disagreed respectively. This was in line with the findings of the interview where the principal banking officer noted that:

> "Individuals have used the loans acquired from commercial banks and other financial institutions to invest in various business projects and have earned out of these investments"

4.5 Financial Development in Uganda

The findings were presented, analyzed and interpreted in percentages, frequencies and mean and standard Deviation as indicated below. They are categorized on how the respondents strongly agree, (SA), agree (A), neutral (N), disagree (D) and strongly disagree (SD), Standard Deviation (STD), Frequency (F)

Table 4.6: Financial Development in Uganda

Financial development	SA		A		N		D		SD		Mean	STD
	F	%	F	%	F	%	F	%	F	%		
There is increased access to financial services over the past 4 years.	21	58.3%	9	25.0%	4	11.1%	2	5.6%	0	0.0%	4.32	1.524
Increased business growth due to access to business capital from loans	19	52.8%	6	16.7%	5	13.9%	3	8.3%	3	8.3%	4.3	0.739
The financial system is now sound and transparent	10	27.8%	21	58.3%	3	8.3%	2	5.6%	0	0.0%	3.53	1.102
Financial services are now available in hard to reach areas	19	52.8%	9	25.0%	2	5.6%	3	8.3%	3	8.3%	4	0.975
Has increased access to financial services promoted economic growth in the country	16	44.4%	20	55.6%	0	0.0%	0	0.0%	0	0.0%	4.22	0.798

Source: primary data

Findings also indicated that the majority (58.3%) strongly agreed that there was increased access

to financial services over the past 4 years, (25.0%) agreed, (11.1%) were not sure whether there was increased access to financial services over the past 4 years as compared to the minority (5.6%) of the respondents who disagreed with it. The mean of 4.32 and standard deviation of 1.524 presented the (58.3%) of the respondents who strongly agreed.

Results of the findings indicated that the majority (52.8%) strongly agreed that there had been increased business growth due to access to business capital from loans, (16.7%) agreed, (13.9%) were not sure while (8.3%) and (8.3%) disagreed and strongly disagreed respectively. The mean of 4.3 and standard deviation of 0.739 presented the closeness of the respondents who strongly agreed and those that agreed. This was in line with the findings of the interview where the principal banking officer mentioned that:

> "The loans granted by commercial banks have been used as capital to start up big investments and generate profits. This has continued to boost development in the country"

The study of the findings also presented that the majority (58.3%) agreed that the financial system was then sound and transparent, (27.8%) agreed, (8.3%) were not sure whereas the minority (5.6%) disagreed. The mean of 3.53 and standard deviation of 1.102 presented the (58.3%) of the respondents who agreed. This was in line with the work of Khan (2011) who, basing on the 2007-2008 global financial crisis demonstrated that stable retail sources of funding, in contrast with reliance on borrowed funds, can greatly enhance the soundness and resilience of financial institutions and reduce volatility of earnings.

It was also in line with the findings of the questionnaire where one of the respondents marked that:

> "The current financial system supported investment, production and other various innovations and also transparency had been enhanced by the recently enacted BOU regulation requiring banks to tell people how much interest they will have paid on the loan by the time of its maturity, also BOU publishes the loan interest rates of all banks in national media thus more transparency"

The findings also revealed that the majority (52.8%) strongly agreed that financial services were available in hard to reach areas, (25.0%) agreed, (5.6%) were not sure while (8.3%) both disagreed and strongly disagreed. The mean of 4.0 and standard deviation of 0.975 presented the (52.8%) who strongly agreed. This was in agreement with the work of (Hannig and Jansen, 2010) who noted that commercial banks and other formal institutions are trying to reach larger number of the country's population through increasing their branch networks and automated teller machines as well as mobile banking services countrywide.

In relation to the fact that increased access to financial services promoted economic growth in the country, the majority (55.6%) agreed whereas the remaining portion (44.4%) strongly agreed. The mean of 4.22 and standard deviation of 0.798 presented the (55.6%) of the respondents who agreed. This reflected the findings of Khan (2011) who asserted that, among the activities of commercial banks are extension of credit services and mobilization of deposits. Development in these areas explains the development of the industry as well as the industry's contribution to economic growth through channeling financial resources from where they are relatively abundant to where they are scarce (Khan, 2011).

This was also in line with the findings of the questionnaire where one of the respondents noted that:

“The poor people have been able to access financial services easily for example they have acquired loans from commercial banks and these loan have been invested in business hence growth and development”

CHAPTER FIVE

SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter presents a summary of findings observed and inferred from the data presented in chapter four. This chapter also provides the conclusions, recommendations and suggested areas for further study. The findings are discussed in terms of the research objectives in relation to literature in chapter two about the effect of increased commercial bank deposits on the financial development of Uganda, impact of increased commercial bank branch networks on financial development in Uganda and the impact of increased loans issued by commercial banks on financial development in Uganda.

5.1 Summary of findings

5.1.1 Increased commercial bank deposits and financial development of Uganda.

Results from the study indicated that the majority of the respondents agreed that the increased deposit generation produced a more diversified and stable funding base and stressed that at the bank level, focusing on retail deposit generation can produce a more diversified and stable funding base that is less sensitive to changes in market interest rates and a bank's financial condition. It was also agreed on that increased commercial bank deposits potentially contributed to the stability of the financial system and it was stressed that at the individual and household level, bank deposits support stability and, given their very large numbers, small savers potentially contribute to stability at the financial system level. From the study, it was also revealed that the majority of the respondents agreed that small businesses were able to acquire starting capital and stressed that due to increased commercial bank deposits, individuals who were not able to solicit a large amount of money at once have been able to acquire starting

capital through bank deposits. It was also agreed on that increased commercial bank deposits enhanced greater access to financial risk-managing tools as commercial banks sought to protect their deposits from risk and financial institutions were able to acquire large capital investments due to increased commercial bank deposits.

5.1.2 Increased commercial bank branch networks and financial development in Uganda.

From the study findings, it was also revealed that the majority agreed and strongly agreed that increased commercial bank branch networks increased the number of people who had access to formal financial services, implying that they had tried to reach larger number of the country's population through increasing their branch networks and automated teller machines in order to ease the access to financial services. It was also agreed on that commercial bank branch networks enhanced increased outreach, built skills and fostered transparency among financial service providers and created a way of penetrating rural areas and providing financial services that were more convenient. Notably majority agreed and strongly agreed that increased commercial bank branch networks enhanced business operations and also stressed that if banking business is properly conducted, savings are collected and invested in growing sectors of the economy, thus increasing returns on investment and employment opportunities. It was also agreed on that increased commercial bank branch networks encouraged the poor who were capable of bringing business considering they had access to markets implying that the poor who had hardships in accessing the financial services offered by the commercial banks, were then able to obtain financial help thus boosting their businesses.

5.1.3 Increased loans issued by commercial banks and financial development in Uganda

From the study, notably majority agreed and strongly agreed that that increased loan issuance financed production, distribution, investment in businesses, banks earn their highest return on loans due to their lack of liquidity and higher default risk and added that bank loans and investments financed production, consumption and the needs of the government. It was also agreed on that increased number of loans issued by the banks enabled them to properly allocate and invest much of society's savings, it was an indicator of firm growth, industrial expansion and economic development and stressed that bank performance had repercussions on investment and also influenced the financial sector development as it is regarded to be the top priority to sustain economic growth in developing countries and small business were able to get capital to boast their businesses.

5.2 Conclusion

It is observed from the study that increased commercial bank deposits produced a more diversified and stable funding base, potentially contributed to the stability of the financial system, enhanced greater access to financial risk-managing tools as commercial banks seek to protect their deposits from risk, more to that small businesses were able to acquire starting capital and also the financial institutions were able to acquire large capital investments.

It was also discovered that increased commercial bank branch networks increased the number of people who have access to formal financial services, enhanced increased outreach, built skills and fostered transparency among financial service providers, created a way of penetrating rural areas and provided financial services that were more convenient, enhanced business operations since it increased the client base, they encouraged the poor who were capable of bringing

business considering they have access to markets and more to that, increased commercial bank branch networks reduced the overcrowding at the that main branches and created better financial service delivery.

From the study, it was also exposed that increased loans issued financed production, distribution and investment in businesses, increased number of loans issued by the banks enabled them to properly allocate and invest much of society's savings, small business were able to get capital to boost their businesses and also increased loan issuance was an indicator of firm growth, industrial expansion and economic development. It was also discovered that there was increased access to financial services over the past 4 years, increased business growth due to access to business capital from loans, increased access to financial services promoted economic growth in the country and the financial was sound, transparent and available in hard to reach areas.

5.3 Recommendations

Based on the results from the study, the following recommendations are provided.

Commercial Banks should build more branches and mostly in rural areas in order to make people benefit from their savings. More branch networks and automated teller machines as well as mobile banking services should be set countrywide to simplify money transfer.

Commercial banks should set low loan interest rates in order to encourage people to acquire more loans and also advise them on profitable ways of investing the loans taken. This will increase investment thus growth and development in the country

The government should set rules and regulations that govern the operations of commercial banks in order to eliminate banks that cannot extend their services worldwide. This will increase the accessibility of financial services by the poor people who stay in villages.

The government should also organize sensitization programs that can educate and advise people on the functions and uses of commercial banks so that they can take use of the available financial services offered by the bank.

5.4 Areas for Further Study

More study and research should be made on the following areas and topics

The effect of increased commercial bank deposits on the development of financial institutions

The impact of increased commercial bank branch networks on accessibility of financial services.

The impact of increased loans issued by commercial banks on investment rates in Uganda.

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Appendix I: Questionnaire

Dear respondent, my name is **Ingabire Bridget**, a student of Uganda Martyrs University. I am carrying out a research study on the topic: "**the relationship between commercial banking in Uganda and the financial development of the Country**"

This questionnaire is therefore intended to seek information on the above subject matter. The information is purely for academic purposes and all the answers will be handled with utmost confidentiality. I therefore request that you kindly spare sometime and fill this questionnaire by ticking appropriate options and filling in the blank spaces where necessary.

Thank you

SECTION A: BACKGROUND CHARACTERISTICS

1. Gender

(a) Male ☐ (b) Female ☐

2. Age Group

(a) 18-30 years ☐ (b) 31 -40 years ☐ (c) 41-50years ☐ (d)Above 50 years ☐

3. Education qualification

(a) Degree ☐ (b) Masters ☐ (c) PhD ☐

(d) others (Please specify)……………………………………………………………..

4. How long have you been in service at this organization?

(a) Less than 2 years ☐ (b) 2 – 5 years ☐ c) 6-9years ☐ more than 9 ☐

<u>SECTION B: How increased commercial bank deposits affect the financial development of Uganda</u>

The following abbreviations are used; **SA** = (Strongly Agree)**, A=** (Agree)**, N=** (Neutral)**, D=** **(**Disagree), **SD=** (Strongly Disagree)

5. To what extent do you agree with the following statements with regard to how increased commercial bank deposits affect the financial development of Uganda?

	Increased commercial bank deposits	**SA**	**A**	**N**	**D**	**SD**
a	Increased Deposit generation can produce a more diversified and stable funding base.					
b	It potentially contributes to the stability of the financial system					
c	More small businesses are able to acquire starting capital					
d	It also enhances greater access to financial risk-managing tools as commercial banks seek to protect their deposits from risk.					
e	The financial institutions are able to acquire (relatively) large capital investments					

SECTION C: Impact of Increased Commercial Bank Branch Networks on Financial Development in Uganda.

The following abbreviations are used; **SA** = (Strongly Agree)**, A**= (Agree)**, N**= (Neutral)**, D**= (Disagree), **SD**= (Strongly Disagree)

6. To what extent do you agree with the following statements with regard to the impact of increased commercial bank branch networks on financial development in Uganda?

	Increased Commercial Bank Branch Networks	**SA**	**A**	**N**	**D**	**SD**
a	It increases the number of people who have access to formal financial services.					
b	It enhances increased outreach, builds skills and fosters transparency among financial service providers.					
c	Creates a way of penetrating rural areas and providing financial services that are more convenient					
d	It enhances business operations since it increases the client base.					
e	It encourages the poor who are capable of bringing business considering they have access to markets					
f	Reduces the overcrowding at the main branches and creates better financial service delivery					

SECTION D: The Impact of Increased Loans issued by Commercial Banks on Financial Development in Uganda

The following abbreviations are used; **SA** = (Strongly Agree)**, A=** (Agree)**, N=** (Neutral)**, D= (**Disagree), **SD=** (Strongly Disagree)

7. To what extent do you agree with the following statements with regard to the impact of increased loans issued by commercial banks on financial development in Uganda?

	Increased Loans issued	**SA**	**A**	**N**	**D**	**SD**
a	Increased loan issuance can finance production, distribution, investment in businesses					
b	Increased number of loans issued by the banks enables them to properly allocate and invest much of society's savings					
c	Increased loan issuance is an indicator of firm growth, industrial expansion and economic development.					
d	Small business are able to get capital to boast their businesses					

Dependent variable

SECTION D: Financial Development

8. To what extent do you agree with the following statements with regard to financial development in Uganda?

	Financial development	**SA**	**A**	**N**	**D**	**SD**
a	There is increased access to financial services over the past 4 years.					
b	Increased business growth due to access to business capital from loans					
c	The financial system is now sound and transparent					
d	Financial services are now available in hard to reach areas					
e	Has increased access to financial services promoted economic growth in the country?					

THANK YOU FOR YOUR TIME AND COOPERATION

Appendix 2: Interview Guide

Dear respondent, my name is Ingabire Bridget, a student of UMU and currently collecting data for compilation for my dissertation. I am here to conduct an interview for a maximum of 15 minutes. The interview I am conducting relates to "**the relationship between commercial banking and financial development in Uganda"** You have been selected to share with us your experience and make this study successful. Information given will be treated with utmost confidentiality.

1. In your view, how have increased commercial bank deposits affected the financial development of Uganda?
2. To what extent have you increased the number of commercial bank branches in Uganda?
3. How has the increased number of commercial bank branches in Uganda improved financial development?
4. In your view, to what extent has increased loans issued by commercial banks to its customers on financial development of Uganda?
5. What recommendations do you have with regards to this topic under investigation?

THANK YOUR FOR YOUR TIME