Declaration:
I, Andrew Timothy Nsamba, declare that this research is my original work and that it has never been presented to any institution or university for the award of Degree or Diploma. In addition, I have referenced correctly all literature and sources used in this work and this work is fully compliant with the Dublin Business School’s academic honesty policy.

Signed: _____________________________

Date: 18th August 2016
Acknowledgement

Special thanks go to my family for their support and understanding, without which completion of this programme and thesis would be extremely hard.

I also wish to express my sincere gratitude to my mentor, Mr. Andrew Quinn, for his unwithering support and counsel from the start of the programme and throughout the compilation of this dissertation.
Abstract

There is a nexus between economic development of a country and development of its financial markets as the latter facilitates efficient allocation of capital. Ugandan companies have very limited access to finance with over 90% having no debt financing at all on their balance sheet. The available finance in form of bank loans is very expensive and short term in nature. As banks cannot match the needs of the business community, the other available option would be bond financing, however, this has not taken off despite having the legal and regulatory framework in place. This study reached out to establish factors impeding Ugandan companies from issuing corporate bonds. The results showed that there were a number of factors that have hindered companies from issuing bonds. These include a shallow financial market with limited investors, low financial literacy in regard to bonds, high issue costs for bonds due to a number of several reasons, the high rates of the benchmark yields on Government securities have also indirectly contributed and the limited size of Ugandan companies. The above factors cannot allow attainment of the full potential of the Ugandan market and as such many companies are still depending on bank loans. This is true even for large multinational banks which could have the capacity to issue investment grade bonds.
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1. Introduction

An economy's financial markets are critical to its overall development (Boubakari and Dehuan, 2010). Strong financial systems provide an efficient way of allocating resources to the most viable investments (Das, 2014) (Hearn and Piesse, 2010). Strong financial systems reduce the information asymmetry between borrowers and lenders and try to allocate resources to investments which maximise returns while minimising risk.

Arguments on whether financial development precedes economic development or the reverse have been going on for a long time. However, “the finance-led growth hypothesis,” which assumes financial development preceding economic development seems to be more favoured (Nyasha & Odhiambo, 2015) (Levine, 1997). This suggests that growth in financial markets is a precursor to economic development. However, the order should not be the main focus; all arguments seem to agree that there is a nexus between economic development and growth of financial systems.

The two major sources of finance are banks and capital markets or can be also viewed as equity or debt (McLaney, 2009). Companies do need capital to improve their productivity and in this regard, debt is a preferred source of capital compared to equity for established companies. This is due to the fact that debt is cheaper than equity and does not require giving up company control to new investors (Contessi, 2013).

The two major sources of debt finance are bank loans and corporate bond markets (Hawkins, 2014). The composition of the debt structure is an issue of contention. Arguments for banks offering more flexibility compared to bonds and the fact that bonds are a cheaper source of finance have been put forward to explain the preference of one to the other in different markets and business cycles (Berg, et al., 2014) (Crouzet, 2015). However, in the post-2007 crisis era, there seems to be a common consensus that though both sources are needed, more dependence should be placed on bond finance (DeFiore & Uhlig, 2015). The Basel committee recommendations on bank supervision are likely to further push for less reliance on bank finance (KPMG, 2011).

Many emerging markets have borrowed massively in the recent past as a result of cheap debt from western countries, cross border capital flows to developing countries increased from $20 billion in 2008 to $600 billion in 2010 (Stiglitz, 2016). The level of corporate debt in emerging markets increased from $4 trillion in 2004 to $ 18 trillion in 2014 (International Monetary Fund, 2015). This trend, however, is not reflected in the Ugandan market.
Co Contessi (2013) also cites maturity mismatch as another disadvantage of bank loans. Due to the fact that term loans are normally short or medium term, they have to be paid back before the investments for which the funds were borrowed have matured to start yielding returns.

In Uganda today commercial loans go at 26% per annum interest rate (Bank of Uganda, 2015) with an interest spread of up to 8% and have an average duration of 3 years. This amplifies the expensive nature and maturity mismatch of bank finance in Uganda.

Worse still, a 2015 survey by the IMF showed that only 9.8% of Uganda’s businesses have debt in their capital structure; confirming the scarcity of debt finance.

This shows that Ugandan companies not only have to contend with maturity mismatch and the high cost of finance but also with the scarcity, which probably explains the high cost.

Despite that, in Uganda today, bank loans are the prevalent source of corporate debt finance with only two non-financial companies sourcing for finance through issuing corporate bonds (Capital markets Authority annual report, 2014).

Ten bond issues have been made on the stock market from 1998 to date and all have been fully subscribed; including the most recent one of $30million (Capital Markets Authority, 2014). However, of the ten, eight of them are to banks, which borrow from the bond market and then lend to companies through more expensive loans, a fact alluded to by the Director of research at the Capital Markets Authority (Muhumuza, 2013).

It can be seen that corporate bonds have numerous advantages and the trend is upwards for both developed and emerging countries. The Ugandan market is still starved of debt finance and the discussion of composition in the debt structure should not be the main focus since many companies do not have debt at all. Large utility and multinational companies which are capable of issuing investment grade bonds are still relying on bank finance; this has the effect of crowding out the small businesses from accessing bank loans and also limiting the amount of cross boarder capital flows enjoyed by other developing countries.

The fact that the corporate debt market has been in existence for 18 years and only two non-financial companies have successfully issued corporate bonds, points to major hindrances for companies. The fact that eight banks have issued bonds probably points positively to the advantages highlighted.

No research has been published to show why Uganda’s companies shun the bond market as a source of finance. This study aims at elucidating factors that impede Ugandan companies from accessing finance from the bond market.

It is hoped that if the factors stifling access to the corporate debt market are identified, plausible solutions will be sought and an increase in the number of companies issuing corporate bonds in
Uganda may be seen. This is expected to attract more flow of cross boarder capital, provide an investment avenue for domestic savings, increase the percentage of companies accessing debt finance from the current 9%, create competition for banks; which is likely to force intermediation costs downwards and ultimately improve country productivity.

The research question to be answered in this study is, “what factors impede companies from issuing corporate bonds in Uganda?” The study aims at finding out in great depth the factors that stop companies from issuing corporate bonds. It is thought that by highlighting these factors, solutions may be found to elicit more activity in the Ugandan bond market. It is also expected that the coexistence of banks and the bond market as sources of finance will lead to a healthy competition that will see loan interest rates come down, an increase in foreign investors and an increase in companies that can access debt finance. Ultimately it is hoped that this will propel economic development.

This dissertation is the write up culminating from the aforementioned study and is organised in six parts: chapter one is the foregoing introduction, chapter two reviews existing literature and theories about the subject, chapter three discusses the methodology used to come up with the data, chapter four highlights the research findings, chapter five discusses the findings and chapter six draws conclusions and recommendations from the study.
2. Literature Review

2.1 Literature Introduction

This study builds on existing literature related to sources of finance and the main factors that determine bank or bond market finance dominance. The literature also discusses the current trend in financial disintermediation and how Uganda fits in. The study also builds on the history and development of capital markets in Uganda with clear growth trends within the different instruments and what the stock exchange has done to try and elicit growth in corporate bond markets. The literature also discusses the relationship between bond issue costs and the bond issuance process. It goes ahead to discuss the effect of the benchmark yield curve on yield spreads. It winds up by discussing the regulatory and taxation environment with specific examples of factors that have hindered the growth of corporate bond markets from different parts of the world.

2.2 Sources of finance

The two main sources of finance are debt and equity. Equity as a source of finance has several downsides for companies in that it is expensive compared to debt, more difficult to raise and leads to dilution of control; making debt finance a preferred source of finance especially for company expansion (International Monetary Fund, 2015) (McLaney, 2009). Indeed, according to the pecking order theory, when companies are sourcing for finance to increase productivity they go for retained profits first, then debt and equity normally comes as last resort. The order is mainly influenced by cost and ease of accessing the funds, with retained earnings being the cheapest and most readily accessible compared to equity which is thought of as the most expensive and most difficult to raise. This has historically been explained by the risk-return relationship in which equity providers are faced with far more risk compared to debt providers.

The two major sources of debt finance are bank loans and bond markets (Berg, et al., 2014) (Contessi, 2013). Banks play an intermediation role by channeling funds from lenders to borrowers; on the other hand, corporate bond markets directly link lenders to borrowers.

A bond is a contract to pay interest and repay principal. This makes it both a financial instrument and a legal obligation enforceable in court. It is clear from the outset that the only difference between a bond and a bank loan is the source of funds. Bond issuers are sourcing for funds directly from both retail and institutional investors within the market.
It has been argued that the main advantage of bank finance is its flexibility (Berg, et al., 2014). Given that banks have a close relationship with their customers, they are always willing to renegotiate bank loans with clients facing financial distress. On the hand, bondholders are dispersed and thus the likelihood of renegotiation is limited. This makes bank finance an attractive source of finance for small companies whose likelihood of getting into financial distress is high; in fact, the majority of Ugandan companies lie in this category.

On the other hand, the mainstay for bonds has been suggested to be the lower cost compared to bank loans (Crouzet, 2015) (DeFiore & Uhlig, 2015). Companies that are mature and have more assured streams of revenue are likely to go for the cheaper bond financing; the benefit of flexibility from bank finance does not apply to them. In Uganda today, the issue of cost should be a big factor, banks have a lot of monopoly and on top of charging high interest costs, they also charge other added costs like acceptance fees, monitoring fees, legal fees, property valuation fees and loan insurance premiums which further increase the annualized percentage rate (APR). This presupposes that going by cost many companies would be issuing bonds. It is, however, probable that there are other factors which push the cost of bond finance higher, the study aims at providing these answers.

A 2015 report of the IMF shows that 90% of businesses in Uganda do not have debt in their capital structure and the 10% still go for bank finance only, probably suggesting the preference for flexibility rather than lower cost.

Large stable companies like utility and multinational companies are also still relying on bank finance despite having a remote likelihood of financial distress. This has the effect of crowding out the small and medium companies whose only likely source would be bank finance given the likelihood of financial distress. This suggests that other factors rather than flexibility may explain this mismatch.

The process of intermediation through banks or disintermediation through bond markets has had much discussion. The dominance of bank or bond finance has been found to vary between countries and business cycles (Berg, et al., 2014) (Crouzet, 2015). In Europe for example, bank finance has been the main channel compared to the USA where bond finance is more prevalent (Berg, et al., 2014) (DeFiore & Uhlig, 2015).

Many reports have linked the 2007 financial crisis and the 1997 Asian financial crisis to over-dominance by banks (Das, 2014) (DeFiore & Uhlig, 2015). Post-2007, bank financing has been on the decline in Europe (Schaeffer and Cimilluca, 2012). In the UK, USA, and the EU there is now a deliberate policy to support bond financing with central banks directly buying corporate bonds from the market (DeFiore & Uhlig, 2015). Over-reliance on the banks was seen to have a domino effect in case a few banks got stressed out. This is due to the fact that there are a lot of
interbank transactions which makes the systemic risk very high. In addition, if a few banks get affected, the others stop issuing credit for fear of getting into the same loop leading to a financial freeze. As a result of the aforementioned, it is argued that dependence on the financial markets rather than banks reduces the systemic risk and the extent of the financial contagion in case of corporate stress. So there is a deliberate trend to rely more on bond financing and less on bank loans.

Indeed this trend is also seen in emerging markets. A 2015 report by the IOSCO shows that corporate bonds as a source of finance have increased by 263% between 2005 and 2014 in emerging markets of Asia, South America, India and Africa. Many emerging markets have borrowed massively in the recent past as a result of cheap debt from western countries, cross border capital flows to developing countries increased from $20 billion in 2008 to $600 billion in 2010 (Stiglitz, 2016). The level of corporate debt in emerging markets increased from $4 trillion in 2004 to $18 trillion in 2014 (International Monetary Fund, 2015). This was mainly fueled by the low-interest costs in the western markets coupled with massive quantitative easing. However, within that number, Uganda only has $30million, a bond issued by one company in 2014.

Overall, it appears that internationally, corporate bonds are gaining a lot of preference over bank finance; however, this trend is not reflected in the Ugandan market. This study aims at providing answers to this mismatch.

The current trend is likely to be amplified by the new Basel committee requirements on bank supervision, which are likely to reduce the capability of bank lending while increasing its cost (KPMG, 2011). In Europe, the Middle East, and Africa, annual bank loans decreased from $1.4 trillion in 2007 to $400 billion in 2012 as a result of more stringent capital requirements for banks arising out of the Basel committee recommendations (Polić, et al., 2015). The Basel committee recommendations appear to reduce the risk taking nature of banks by requiring more strict risk assessment methods and much higher capital being set aside for the risk taken. This will definitely lead to reduced lending by banks; however, it will also reduce the liquidity with the capital markets as banks are major players in these markets.

Russ and Valderrama (2012) argued that introduction of bond financing is most beneficial where bank loans have very high transaction costs. This makes a perfect fit for Uganda, given that on top of the 26% interest rates, there are additional one-off costs in the form of acceptance fees, monitoring fees, insurance fees, valuation of property costs and legal costs. These push the annualised percentage rate for finance cost to 30% and beyond for short-term bank loans.

A case seems to have been made for trending towards the development of bond finance both in the developed and emerging world; however, Uganda has not taken off despite having a
regulatory and legal framework in place. This study will try to elucidate the reasons why Uganda has not taken off from the companies’ perspective despite the strategic fit highlighted by many arguments.

2.3 Growth and development of Uganda’s capital markets.

In 1994 Bank of Uganda chaired the Capital Markets Development Committee (CMDC), which oversaw the introduction of the Capital Markets Statute of 1996. This created the Capital Markets Authority (CMA) and made provision for the licensing of Securities Exchanges (Capital Markets Authority, 2013), the first of which was the Uganda Securities Exchange and recently the ALT Xchange Ltd which starts operations in 2016 (Khanyile, 2015). The Ugandan Securities exchange started operations in 1997 and acts as an avenue for raising finance through issuing debt and equity instruments. Eighteen years later, ten corporate bonds have been issued, eight of which were issued by banks and two by non-financial companies. The most recent issue was for $30m by Kakira Sugar Works Ltd. in February 2014 (Uganda Securities Annual report, 2015).

Trading in equity instruments has grown by 500% in annual turnover from 2010 to 2014 and Government securities instruments have seen a 400% increase over the same period (Uganda Securities Exchange, 2014); however, growth in corporate debt instruments for non-financial companies is almost nil over the same period.

Table 1: Median financial indicators for selected groups and outlier countries among major ACCA markets

<table>
<thead>
<tr>
<th>Groupings</th>
<th>SME loans % of GDP</th>
<th>Stock market cap to GDP</th>
<th>Informal equity to GDP</th>
<th>Private bond market cap to GDP</th>
<th>Public bond market Cap to GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed markets</td>
<td>13%</td>
<td>152%</td>
<td>0.9%</td>
<td>26%</td>
<td>34%</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>28%</td>
<td>44%</td>
<td>2.8%</td>
<td>18%</td>
<td>36%</td>
</tr>
<tr>
<td>Frontier markets</td>
<td>10%</td>
<td>24%</td>
<td>1.4%</td>
<td>N/A</td>
<td>27%</td>
</tr>
<tr>
<td>Total sample</td>
<td>11%</td>
<td>48%</td>
<td>1.0%</td>
<td>20%</td>
<td>34%</td>
</tr>
</tbody>
</table>

The above table shows results of a survey undertaken by ACCA (2012). In this study, Uganda was included among the frontier countries. It is clear that whereas the frontier countries are trailing in almost all indicators, the one for the private bond market has not even
taken off. This study aims to find out why the equity and public debt markets are growing but the corporate debt market is stagnant.

To stimulate the growth of the bond market in Uganda, The Uganda stock exchange has put in place three segments for the issue of debt securities; the Fixed Income Securities Market (FISM), the Alternative Investment Market Segment (AIMS) and the Growth Enterprise Market segment (GEMS). They cater for different categories of companies and investors. The GEMS has the least stringent rules which allow a company with zero net assets and no prior trading to issue securities (Uganda Securities Exchange, 2014). This provides a lot of flexibility for companies and investors and helps reduce listing costs; however, there seems to be a missing link because this has not elicited the expected response.

In its prospectus, Kakira sugar works revealed that the finance raised was to be used for expansion into producing ethanol and electricity from sugar cane molasses. The ethanol is expected to be mixed with diesel to reduce the cost of running diesel combustion engines. The project is expected to provide more jobs, reduce the aggregate imports for diesel and ultimately improve the country’s Gross domestic Product through increasing productivity and reducing on importation costs. It is clear that investments like these do provide enormous benefits and have a multiplier effect on the economy. Similar opportunities for large investments should still exist given the nascent stage of economic development. These should be able to provide high returns with minimal risk making bond financing a suitable source of finance. However, such project expansions seem to be non-existent, the study aims at finding out why companies are not using the bond market to undertake such huge projects.

From the foregoing, it can be seen that the capital markets have been in existence for at least 18 years, which is not exactly a very short period; there seems to be a good development in both the equity and government bond markets but almost none in the corporate bond market. The latest corporate bond issue seems to provide a lot of expectation and having a few similar ones may be the missing link to higher sustained economic development.

2.4 The Bond Issuance process

The process of issuing bonds is highly technical, rigorous and complicated. When corporations want to raise funds by way of a bond issue a lot of special intermediaries are involved before successfully reaching out to the market.
The parties include transaction arrangers, placing agents, legal advisers, auditors, fiscal agents, guarantors and stock brokers.

The process starts with pre-issuance analysis, market analysis, transaction structuring, preparation of documentation, marketing and placing and finally securities issuance as highlighted in figure 1 below.

**Figure 1: The stages of a bond issue**

![Diagram of bond issuance stages]

Source: USAID bond issuance guidelines to emerging markets

In the next section, a detailed account of what each stage involves is discussed as adopted from the 2012 USAID bond issuance guidelines to emerging markets. This discussion is intended to throw more light on the complexity of the process and its likely effects on transaction costs.

**Transaction structuring**

If the internal needs analysis and the external market analysis conclude that there is need and capacity to raise a corporate bond, the transaction is then structured.
This is undertaken by transaction arrangers who basically come up with the bond design and the choice of the market that is likely to provide the most attractive terms depending on the company’s needs and the prevailing market conditions.

The bond design will encompass issues to do with the bond size, the bond tenor, the par value, and the coupon rate, the currency of issue, the redemption provisions, security backing, the bond covenants and events of default. Each of these has numerous ramifications to consider and will require a great deal of input. This service is mainly offered by investment bankers or financial advisers and they charge a transaction arrangement fee which is usually a percentage of the issued amount.

Investment bankers generally have an excellent understanding of capital markets, relevant government regulations, and other factors affecting a bond issue. They are expected to be innovative and should come up with new securities which improve and broaden the range of options available to investors and issuers; generally with a view to reducing an issuer’s funding costs and increasing investors’ choices of investment products. It should be remembered that this innovation led to the complex products of securitization that are thought to be the main precursor for the 2007 financial crisis.

**Bond placement and marketing**

Upon agreeing on the transaction structure, the bonds have to be placed and marketed to potential investors a function undertaken by placing agents.

Placement agents are charged with the duty of finding potential investors for the bonds issued. Investment banks have traditionally also offered this service. They usually have well-developed networks and may identify the brokers and sales forces most able to market a particular bond offering. Investment bankers also have established networks with investors who may be interested in the issue. This raises the much talked about conflict of interest in which investment bankers are designing products which should be in the best interest of the bond issuers but also meet the interests of the investors who are normally their clients as well; not to mention that the banks also need a profit from all these arrangements.

For purposes of marketing, Investment banks may also arrange road shows in which management of the issuing company are invited to present facts about their issue and the company at large to potential investors.

In some instances, bonds have to be underwritten, a service provided by banks and insurance firms. When bonds are underwritten, the risk of buying the newly issued bonds from the issuer is taken over by the underwriter. The underwriter buys all the bonds from the issuer at a discount and then resells the bonds to the public or to dealers who sell them to the public. The underwriter earns a profit, based on the difference between its purchase price and the selling price; this
difference is sometimes called the underwriting spread. Underwriting guarantees the proceeds of an issue; however, this comes at a cost.

Sometimes the investment banker markets a new issue but does not underwrite it. The investment banker simply acts as a sales agent under a best efforts agreement, promising to do its utmost to market the bonds.

Investment bankers also may sell newly issued bonds through private placements to large, institutional investors like insurance companies and pension funds.

**Legal and financial documentation**

Audited financial statements are typically required, both for registering an issue with the regulatory authority and listing the securities on the appropriate exchange. The same financials also make part of the prospectus that is used for listing and marketing purposes. Rating agencies also make use of financial statements in the credit rating assessment process. The assurance that the financial statements reflect a true and fair position of the financial health of a company is provided by external auditors; and they generally charge hourly rates for consulting arrangements.

Lawyers act as counsel to the issuer to advise on compliance with relevant laws, prepare legal documentation for the issue, assist with the preparation of disclosure materials and in the registration process, and also advise on structuring issues. They have a big input in coming up with the debenture deed and the prospectus.

**Third Party Enhancement**

In certain instances, credit enhancement may be required. In the Ugandan case, this is so if the issuer does not have a credit rating or does not meet the required minimum capital. Third party credit enhancement lowers the yield on a bond by enhancing the security of the issue and therefore decreasing the risk to investors. Although the yield of the bond is reduced, the actual cost to the company is normally higher due to the cost of the credit enhancement. Credit enhancement may come in the form of a guarantee by a bank or an insurance company or by providing asset backing. A guarantee may be provided on all or a portion of the principal amount of a bond and a guarantee fee is paid for such a service.

**Fiscal agent and registrar**

A fiscal agent acts as an agent of the issuer to make principal and interest payments to the bondholders and to publish notices but does not assume a fiduciary obligation to the bondholders. A fiduciary obligation to bondholders is held by a trustee in case appointed. Fiscal agents are normally investment banks.

A registrar is required in the case of a public issue to maintain the register of bondholders; the bond registrar tracks the investors who own the bond and which investors should receive interest
payments. When the bond matures, the registrar’s records determine which investors should be repaid the principal amount on the bond issue. This role can still be played by an investment bank or another trust company.

In his paper titled financing innovations and capital structure choices, Damodaran argued that as bonds become more complex, investment banks become more indispensable and thus charge higher fees (Damodaran, 1999).

In another study undertaken in the USA, it was concluded that modernization and easing of the bond issuance process mainly benefit issuers and investors and not intermediaries (Musto & Popadak, 2016). The study was following up on the effects of a Securities Exchange Commission (SEC) decision in which investors on average were given 36 minutes to evaluate a prospectus and bond issue terms; all documentation was online. However, this is still very unlikely in an emerging market like Uganda, where the number of intermediaries who can offer the services are still limited.

From the foregoing, it can be appreciated that the process of issuing a bond is quite rigorous and technical. Several intermediaries have to be involved to make a bond issue successful. The different agents all provide a service at a fee which may be flat or a percentage of the issued amount. The size of the bond does not cut the process short as most or all the documents and intermediaries will have to be involved. This implies that the relative cost of the bond will be much less if the issue size is huge. It can also be seen that repeat issues can come at much lower costs than new issues because a number of documents will need updating rather than develop from scratch. In economies where professionals who can provide these services are limited the cost is definitely going to be much higher.

It should also be appreciated that complexity of the process may be a big factor in determining the level of financial literacy in regard to bonds.

Many financial executives in the emerging markets may know about bonds but may not be in a position to discuss the nuances regarding a bond issue. This may hinder their capability to obtain board approval given that many boards may not have any knowledge and thus develop phobias.

The same reasoning can be advanced for the general public whose lack of knowledge on how bonds are issued will affect the number of retail investors and thus hamper the financial deepening of the bond market. These may be plausible reasons as to why the Ugandan bond market is not developed; however, a study to bring up such factors as the reasons hampering companies from issuing bonds has not been done. This study is aimed at carrying out an in-depth survey of the Ugandan market to confirm the factors that are at play in this market.
2.5 Regulation and taxation framework

Corporate bond markets are characterised by three major pillars: regulatory and legislative framework, market participants, and the instruments themselves. The regulatory and legislative framework has been shown to have a huge impact on the market participants and the instruments. A study done in Kenya reached a conclusion that a stringent regulatory framework, which required a lot of disclosures and minimum track history discouraged potential issuers of bonds (Bitok, et al., 2014). In a study done in Bosnia-Herzegovina (BiH), the length of the issue process was found to be one of the main hindrances to corporate bond issue (Polić, et al., 2015). In a 2012 survey undertaken by the ACCA, it was found that weak financial information disclosure due to lack of capacity was a major deterrent to the growth of the bond markets in developing countries. The capital markets Authority in Uganda adopted a merit system for approval of new bond issues. In the merit system, potential issuers are required to put together a document which is reviewed against set standards to assess compliance with minimum standards.

The regulatory framework is aimed at protecting investors by reducing the information asymmetry between companies and potential investors and to promote transparency. However, in markets with a low capacity for proper disclosure of information, such requirements may be a deterrent for companies to issue bonds. The same argument can be advanced on the side of investors who may not be willing to invest in markets with low information disclosure capacity. In addition, some companies view this public disclosure as a loss of privacy and thus lost competitive advantage (Bitok, et al., 2014). Such markets may favour bank finance over the bond market given the level of confidentiality accorded by banks.

Having said that, the stock exchange in Uganda has a number of companies which are already listed for equities and routinely disclose all required information; at least these would have found disclosure of information non-restrictive to issue bonds as well, but this does not seem to be the case.

In addition, the Stock exchange has three different segments with varying requirements for disclosure and also allows private placing in which information is only shared with specific investors. Despite this flexibility, companies have still found it hard to issue bonds. The study will try to bring to light whether disclosure is a hindrance.

Centralised Security Depository

According to the financial Times, the centralised securities depository is an institution or facility for holding securities and enabling securities transactions to be processed by means of book entry. The CSD manages the settlement of securities. In Uganda, the Securities certificates
depository act was passed in 2009. Currently Uganda has two Central Securities Depositories, one run by the securities exchange and one run by the central bank. According to the guidelines issued by the Capital markets Authority, all investors who wish to trade in Ugandan securities must open accounts on one of these depositories. Both CSDs are automated and this makes transactions faster and cheaper and also encourages investments from foreign participants (Nsiko, 2015).

Transaction costs have been identified to greatly deter issuance of corporate bonds. In a study done in the USA, it was seen that reduction in disclosure requirements greatly brought down the issue costs and led to a 65% increase in bond issue within that market segment (Chaplinsky & Ramchand, 2004). Transaction costs are greatly coming down on the secondary market but are still high within the primary market (IOSCO, 2011). The costs tend to be higher in markets where professionals are few and hence more expensive due to demand supply pressures (ACCA, 2012). High transaction costs are likely to make small short-term issues very expensive and favour long-term issues with a large amount. In an economy where not so many companies can issue huge long-term bonds, this may be a major deterrent.

**Credit rating**

A proper credit rating system has been suggested as an essential component for the proper functioning of a corporate bond market (International Monetary Fund, 2015). The credit rating system provides risk indicators for particular bond issues and encourages the most efficient allocation of capital by differentiating interest rates on the basis of risk. It also provides incentives for bond issuers to improve their financial outlook as well as the quality and quantity of disclosure (Tendulkar, 2015). They measure a given debt issuer’s ability and perceived willingness to make full and timely payments of principal and interest over the lifetime of the rated financial instruments. Thus, a credit rating system facilitates the “transferability” of corporate bonds (IOSCO, 2011).

To avoid monopoly, a market needs more than one credit rating agency (Tendulkar, 2015)(International Monetary Fund, 2015); however, this is very difficult in Uganda’s situation where even one agency cannot be sustained due to lack of business. Though the Capital markets Authority in Uganda has provisions for making issues without the backing of a credit agency rating, this may not be so appealing to foreign investors. This leaves external credit rating agencies as the only alternatives, further pushing up the issue costs. Engaging foreign experts would lead to higher costs due to additional travel, correspondence and learning curve costs. This may partly explain the shunning of Ugandan bond markets.
**Taxation**

The capital structure theory of Miller and Modigliani concluded that taxation has a huge effect on the capital structure of a company; in their theory, with tax, they concluded that a company should be as highly geared as possible to fully enjoy the benefits of the tax shield (BINSBERGEN, et al., 2010). Other scholars challenged this later when they argued that their theory ignored many factors which would limit the benefits of the tax shield to a certain level (BINSBERGEN, et al., 2010). However, it is widely agreed that debt confers tax benefits in markets where interest costs are tax deductible (McLaney, 2009).

In a study done in the USA, it was shown that quality of future earnings affected the size and the time horizon of bonds issued by companies (Mackie-Mason, 1990). Companies with good future earnings issued longer term and larger size bonds because of the expected tax benefit compared to companies which were not sure of utilizing the tax shield. A study done in Kenya showed that introduction of tax incentives in the form of lower corporation tax and tax allowable expenses marginally increased the number of companies listing on the stock exchange (Bitok, et al., 2014).

The Ugandan income tax statute of 2012 allows finance costs in the form of interest expenses and issue costs as deductible expenses for tax purposes; this would be expected to motivate companies to issue more bonds. While in other jurisdictions tax incentives have elicited a positive effect in bond activity, the same is not true in Uganda. It has, however, been argued the effects of taxation are better seen in developed markets (Bitok, et al., 2014). It is possible that the concessions offered by the tax framework are not attractive enough for Ugandan companies or there is a general lack of awareness. This study aims to find out why companies still shun the bond market even where such incentives exist.

**2.6 The benchmark yield curve**

Yield is the rate of return on a bond. A bond’s stated interest or coupon rate may be fixed or float with reference to an index. Yield is the reflection of the underlying price of a bond after factoring in the fluctuations in market interest rates and other factors, like deteriorating or improving credit quality, that affect the value of the bond.

Current yield is the annual return on the amount paid for a bond, regardless of maturity. If the bond is purchased at par (100% of face value) and the stated interest rate is 12%, the current yield is 12%. If the bond is trading at a discount or premium, current yield will reflect the discount or premium. For example, if the price of a 10% bond with a $1,000 face value is 1050, its current yield is 9.52% (1,000 x 0.1/1,050). Yield to maturity is more meaningful because it takes into account the return on the bond if held to maturity (McLaney, 2009).
The financial times defines a yield curve as “a graphical representation of the relationship between the yields and maturities of different bonds of similar quality, currency denomination and risk (2016).”

Government yield curves are widely used as references for pricing corporate bonds for a number of reasons (Wooldridge, 2001). He cited the fact that Central governments in most countries are viewed as the most creditworthy borrowers which issue securities essentially free of default risk, which makes the government yield curve the best proxy for the nominal risk-free rate. In addition, Governments have both large borrowing needs and a long life, so are able to offer a wider range of maturities which can cater for an entire range of possible corporate bond issues. However, he argued that whereas the Government yield curve is supposed to only cater for future interest rate movement expectations, a number of idiosyncratic factors were being included in the pricing of Government securities. This has the effect of limiting their use as benchmark yield curves.

In a study undertaken in Japan, Masazumi et al concluded that the main factors that drive the credit spread between Government bonds and corporate bonds are four: default risk, general economic conditions, the value and volume of Government bonds outstanding and the monetary base. (2003) Their study concluded that the high default risk as depicted by the number of bankruptcies reported is likely to increase the credit spread for corporate bonds; this is due to the increased risk to the investor of not receiving all the expected cash inflows.

The general economic conditions coupled with the amount of money in circulation were both inversely proportional to the credit spread of corporate bonds. If economic conditions are bad, there is a tendency for the public to rush for safer investments like Government bonds; this increases the demand for Government bonds while reducing the demand for corporate bonds. This has the effect of reducing the yield on Government bonds while increasing the yield for corporate bonds hence widening the credit spread. This was seen at the peak of the 2007 financial crisis or most recently after the release of the Brexit results.

However, they concluded that the effect of the volume and value of Government bonds was minimal in increasing the credit spread for corporate bonds. This is in contrast to the crowding out effect which has been put forward by many scholars.

In contrast, a 2014 study in the USA concluded that volume of Government debt was strongly negatively correlated with corporate debt and investment. These relations were found to be more pronounced in larger, less risky firms whose debt is a closer substitute for Government securities (Graham, et al., 2014). In essence, it implies that when Government borrowing increases, there is a tendency for investors to put more funds into Government securities and less in corporate
securities. This is more likely to be true for investment grade bonds which target the same group of investors as Government bonds.

In a comparison between Treasury yields and corporate bond yield spreads, it was concluded that there was a strong inverse relationship between Treasury bond yields and corporate bond yield spreads (Duffee, 1998). An increase in Treasury bond yields as a result of a drop in Treasury bond prices, most likely results from lower demand. The relationship suggests that such an increase in the yield will correspond with a fall in yield spread for corporate bonds. This means that while the Treasury bonds’ yield is increasing the corporate bond yield is reducing hence a reduction in yield spread.

This confirms that demand for Treasury bonds affects the demand for the corporate bonds especially the investment grade bracket, further confirming the crowd out effect. The crowd out effect is further amplified in markets which have limited investors.

The foregoing discussion suggests that the rate at which Government is borrowing has a big effect on the cost of corporate bonds given that it is used as a reference point for setting the yield for corporate bonds. In addition, the spread between Government securities and corporate bonds is affected by many factors including the volume and value of Government borrowing.

If there is no clear price discovery within the Government securities market, the inefficiency is likely to be transferred into the corporate bond market. If Government fiscal deficit is quite large, you are likely to get more issue of Government securities and thus crowd out the corporate sector leading to both a higher benchmark rate and higher credit spread.

The Ugandan Debt management office is using the primary dealership system in which six banks have been entrusted with the role of being primary dealers (Bank of Uganda, 2015).

In a 2010 paper written for the World Bank, Primary Dealers are defined as “financial intermediaries appointed by a Debt Management Office to perform certain specialized functions in the Government securities market.”

The Primary dealers and the Debt Management Office are supposed to pursue a common strategy to support funding of the government and development of the market. The two parties get into an institutional arrangement by way of a legal contract or Memorandum of Understanding.

The paper puts forward two major benefits of a primary dealership system: “(i) to build a stable and dependable demand for Government securities by submitting bids at auctions and by broadening the investor base, thereby decreasing market and refinancing risks; (ii) to lower the cost of Government funding by enhancing price discovery through promoting a secondary market.” (Gemloc Advisory services, 2010)

The paper alludes to the fact that the principal risk is the limitation to competition and the corresponding potential incentive to collusive behaviour. However, it suggests overcoming this
by doing two things: having a sufficiently large number of primary dealers to ensure competition and to put in place an incentive system to reward good performance. If the number of primary dealers is not sufficient to promote competition, they may talk to each other and end up determining the price at which bonds are sold through collusion. Definitely, the rate is expected to be much higher and will not match the actual and perceived risk of Government borrowing.

Whether or not six is a sufficiently large number in the case of the Ugandan market is an issue for further research and debate. In addition, the level of activity by the six banks will greatly determine the likelihood of limited competition. If out of the six, depending on the level of liquidity only a few are active; then the price discovery function is lost. If the price discovery function is not efficient enough and there is limited competition within the primary dealers, the Government securities are likely to have an inflated yield which is likely to be transferred to the corporate bond market. This would have an effect of making the cost of borrowing prohibitive within the bond market.

The study aims at finding out whether Ugandan companies feel that they are being crowded out by Government borrowing.

2.7 Literature Conclusion

Having some debt in the capital structure has been shown to have several benefits to the company; bond finance as a source of debt has been favoured for corporate expansion and growth. The Ugandan securities exchange has provided a flexible avenue for the issue of debt instruments. All indicators show that the corporate bond market in both developed and emerging economies is on the increase and the Ugandan debt market is starved; the big question that remains unanswered is why Uganda’s companies still shun the bond market as a source of finance. Probably the answer lies in the complexity of the bond issuance process, the cost of issue, the bond yield and the required infrastructure. Similar studies have been done in Kenya on The Nairobi stock exchange and in Bosnia-Herzegovina (BiH) which are both developing markets. The study in Nairobi looked at capital markets development in general, comprising of both equity and debt instruments. The study in BiH was a deductive study which focused on all the three pillars of the bond market. Both instances showed diverse findings that could not be generalised to fully account for impediments from Ugandan companies’ point of view. Given the emerging popularity of behavioural finance, it is appreciated better that markets can react differently towards the same issue. It is hoped that this study will bring out factors that hinder corporate debt issue peculiar to the Ugandan companies.
3. Methodology

3.1 Methodology Introduction

Creswell defines a research design as “the plans and the procedures for research that span the decisions from broad assumptions to detailed methods of data collection and analysis (2008).” While designing a research it is imperative that the methods and assumptions adopted meet the overall objective of the research. On top of the suitability, care must be exercised to ensure that the methods chosen are feasible and acceptable to intended recipients of the outcome (Denscombe, 2014). One of the principle recipients of this study are the lecturers at Dublin Business School.

The main objective of this study is to come up with factors that impede Ugandan companies from issuing corporate bonds. From the onset, it can be appreciated that the main focus of the study is to understand the phenomena from the companies’ perspective that hinder financial executives from opting for bonds as a source of finance.

To achieve the stated objectives of this study, an “Interpretivism” philosophy with an “inductive” approach was taken in which no major conclusions were made at the onset regarding the factors but rather was respondent driven by getting views from the research population. A survey with a qualitative approach was undertaken in order to get in-depth information from the research population. Primary data was collected through face to face interviews so that more depth could be reached by interacting with a few people.

3.2 Research Design

The research onion as shown in figure 2, was used to outline and define a path for development of the research methodology for this study. The methodology spans from broad assumptions entailed in suitable research philosophies, approach, and relevant strategies and will cascade down to detailed techniques involved in the collection and analysis of the data.
3.2.1 Research Philosophy

Epistemology is concerned with the study of knowledge and what is acceptable within a given field of study (Saunders, et al., 2007) (Collis and Hussey, 2003). An Epistemological issue concerns the question of what is (or should be) regarded as acceptable knowledge in a discipline. The major contest here is whether the social and business world should be studied in the same way as the natural sciences. The philosophy adopted by a researcher is mainly influenced by his view of how knowledge develops; whether theory guides research or theory is an outcome of research (Bryman & Bell, 2011). A research philosophy contains important assumptions that will shape the researcher’s strategy and data collection methods (Saunders, et al., 2007). According to Saunders et al, 2007 there are three epistemological approaches to research philosophy: Positivism, Realism, and Interpretivism.

It is imperative that a researcher critically thinks about which philosophy to adopt, this will not only shape the detailed research design but will also determine whether the researcher’s findings are acceptable.
Positivism
The positivism is a philosophy position that can be identified with a group of researchers. It looks at research as being the means in which data is collected about existing theories to enable development of laws (Bryman & Bell, 2011).

The positivism approach is normally adopted by a researcher who prefers to work with an observable social reality in order to come up with law-like generalizations similar to those produced by the physical and natural scientists. In this tradition, the researcher becomes an objective analyst, clearly making detached interpretations about the data that is collected in an apparently value-free manner (Saunders, et al., 2007). Saunders et al further state, that the emphasis is on a highly structured methodology to facilitate replication and on quantifiable observations that lend themselves to statistical analysis. The assumption is that the researcher is independent of and neither affects nor is affected by the subject of the research; which may not be very pragmatic as the researcher makes quite a number of subjective decisions throughout the data collection process.

Realism
Realism states that real objects exist independent of human consciousness, but that knowledge is socially created (Saunders et al, 2007).

The essence of realism is that what the senses show us as reality is the truth: that objects have an existence independent of the human mind. Realism is similar to positivism in that it assumes a scientific approach in development of knowledge.

Critical realists argue that the social world is constantly changing, and therefore it is imperative to understand the underlying views. This lends to the principles of business and management in which phenomena have to be understood before change can be instituted.

From an organisational perspective, Hatch and Cunliffe (2006) describe the realist researcher as one who enquires into the mechanisms and structures that underlie institutional forms and practices, how these emerge over time, how they might empower and constrain social actors, and how such forms may be critiqued and changed.

Interpretivism
This has also been referred to as social constructivism (Creswell, 2013). There have been many criticisms on applying the positivism view which defines “laws” in the same way as physical sciences in the complex social world of business and management. This led many researchers to argue for an interpretivist approach. Interpretivism holds the assumption that people always try to understand their surrounding and continuously develop an individual interpretation of what
they go through (Creswell, 2013). The interpretations are varied and quite multiple and this calls for open-ended questions and observations to bring out these views during data collection. The researchers aim is to interpret the meaning individuals have about their world hence the term interpretivism (Bryman & Bell, 2011). Interpretivist approach focuses on diverse cultures, socioeconomic conditions, and the experiences and perceptions of the actors involved (Saunders, et al., 2007), which emphasises conducting research among people rather than objects.

From the foregoing, an interpretivism approach which heavily relies on the views of the participants and emphasises the role of people as social actors was adopted in this study. Although research has been done in this area, it pertains to other geographical areas; no research had been done in Uganda. It must be appreciated that businesses are unique, exist within different circumstances and are run by different individuals. Due to the aforementioned fact, factors that have been raised elsewhere cannot be generalised to the Ugandan market, hence the need to heavily rely on the views of Ugandan participants. This approach enabled the researcher to gain deep insights into the factors that are impeding companies from issuing bonds on the Ugandan Market without limiting him to only rational factors.

The individual nature of responses helped highlight the divergences and the resemblances both of which are necessary for understanding why companies are shunning the bond market.

Behavioural finance emphasises explaining financial decisions based on psychological, social, cognitive, and emotional factors (Steverman, 2014). Given that behavioural finance is gaining more prominence, knowledge collected using this approach is likely to be acceptable in this field.

3.2.2 Research Approach

There are two types of research approaches namely inductive and deductive research.

**Inductive approach**

Saunders et al. (2007) state that inductive approach involves the development of a theory resulting from observations of empirical data. The qualitative research strategy is regarded as inductive. Given that the qualitative research strategy involves gathering data in form of words using open ended questions, it mainly lends to the inductive approach. The goal of understanding a particular phenomenon of interest within its social context will involve interpreting data from social actors and then drawing conclusions about it.

**Deductive approach**

A deductive approach is an approach in which there is an assumed assertion in the form of a hypothesis and research is needed to either prove or disprove the assertion (Bryman & Bell, 2011).
The quantitative research strategy is regarded as deductive. The theory used in the research becomes a framework for the whole study, research questions or hypotheses and procedure for data collection are built around this theory (Creswell, 2013).

Deductive approach is suitable when the researcher has ample knowledge about the research to develop a hypothesis. The observation must be quantifiable hence lending itself to quantitative approach rather than qualitative. The researcher must be independent of what is being observed. Though this attribute is also desirable for the inductive approach; however, many times the researcher is part of the research especially when it comes to interpretation.

The inductive approach focuses on understanding the meanings and interpretations of ‘social actors’ and to understand their world from their point of view, it is highly contextual and hence is not widely generalisable (Saunders, et al., 2007).

In this study, little knowledge existed about the factors that impede Ugandan companies from issuing bonds as no research had been published. Due to that fact, it was difficult to start with a hypothesis. An Inductive approach was adopted as factors which are impeding companies from issuing bonds were picked up from the data collected from research participants who in this case were key players in the corporate bond market. The focus was on getting to understand from the key players’ point of view, which factors impeded companies from issuing bonds. Similar studies have been done elsewhere; however, the researcher could not be sure if the same factors could be transposed onto the Ugandan market. For this reason, no prior deductions were made and this enabled the researcher to collect the data with an open mindset. Different views of the phenomena were expected to be gathered from the research population and these generated a rich set of factors from which further work can be done. There was a conscious effort to try and limit the researcher’s bias during collection and interpretation of data.

The adoption of a particular research choice enables you to come up with guided research design and strategies as well as being able to adjust your research design in case of constraints.

### 3.2.3 Research Strategy

Sauders et al, (2007) describe the research strategy as a generic plan guiding the way for the researcher to answer the research questions set forth. Each type of research strategy could be used for all three purposes: exploratory, descriptive and explanatory. According to Collis and Hussey (2003), the types of research strategies available include cross-sectional studies, experimental studies, longitudinal studies, surveys, action research, case studies, ethnography, grounded theory, hermeneutics, and participative enquiry. The claim that one research strategy is better than the other research strategy is a myth (Saunders et al, 2007).
Having adopted the Interpretivism epistemology with an inductive approach, experimental studies could not be used. Given that the study was bound within a limited time, case studies and ethnographies were not feasible as they require prolonged follow up of a given group. The best choice was a survey in which only qualitative data was collected. The survey enabled the researcher to get in-depth information from the research population.

The study was exploratory in nature and the grounded theory strategy was used as well. Grounded theory is a strategy in which the researcher forms a general theory of what is being observed anchored on the views of the participants (Creswell, 2013). This study lent itself a lot to this strategy as the final themes arose from what the participants’ views were. The choice of the latter key respondents depended on the emerging themes from earlier interviews.

“Phenomenological research is a strategy of inquiry in which the researcher identifies the essence of human experiences about a phenomenon as described by participants (Creswell, 2013).” Phenomenology involves studying a small number of participants through an extended engagement.

Phenomenology as a strategy was used in which the researcher through inquiry identified the factors that impeded Ugandan companies from accessing the bond markets from the experiences of key respondents.

Due to time constraint, only qualitative data was collected from the research participants. It is hoped that this generated factors that impede Ugandan companies from issuing bonds in the corporate bond market. Follow on studies can then build on these factors as initial theoretical frameworks to undertake quantitative studies.

3.24 Sampling - Selecting Respondents

Sampling and selection are principles and procedures used to identify, choose, and gain access to relevant data sources (Mason, 2002). A sample is “a smaller (but hopefully representative) collection of units from a population used to determine truths about that population” (Field, 2005). There are two types of sampling techniques: probability or representative sampling and non-probability or judgmental sampling (Saunders et al, 2007).

For this particular study, the research population would include key decision makers in Ugandan companies who determine first the capital structure and then the debt structure. These are very varied, difficult to pinpoint and quite a large population. For this reason, non-probability sampling was used. The sample was small, non-representative and no statistical inference was drawn from results.
The sample chosen was purposive with a focus on in-depth knowledge of Ugandan corporate bond market. Based on this, a homogenous sample based on the level of expertise in the industry was selected and in this regard, people with relatively good exposure to the Ugandan corporate bond market were selected.

Four key players were chosen as the respondents based on their expertise and experience. The line-up included senior staff from the Capital markets authority, Central bank staff, an Investment adviser and a Finance director from a large utility company.

3.2.5 Time Horizon

There are two types of time horizons, cross-sectional studies, and longitudinal studies. Longitudinal research involves study over longer periods of time and is typically involved in measuring change during this time period which is not suited to projects with short-term time restrictions whereas cross-sectional studies are noted as snapshots of a particular phenomenon at a particular time (Saunders, et al., 2007).

Due to time restrictions for this research, the study is cross-sectional. A cross-sectional study engages the collection of data on more than one case at one specific time in order to collect quantitative or quantifiable data when more than one variable is considered (Bryman & Bell, 2011). Therefore the study will bring the factors that exist at a given point in time rather than a follow-up of factors over the years.

3.3 Data Collection Instruments

Primary data was collected using face to face in-depth individual Interviews, which were on average lasting one hour. In-depth interviewing is a technique designed to elicit a vivid picture of the participant’s perspective on the research topic. During in-depth interviews, the person being interviewed is considered the expert and the interviewer is considered the student. The researcher’s interviewing techniques are motivated by the desire to learn everything the participant can share about the research topic (Flick, 2014).

Interviews were semi-structured in which general questions were prepared for use during the interviews. The semi-structured interviews helped create a logical flow of the interview process while trying to elicit as much information as possible. It also helped allow the researcher some latitude to ask follow-on questions to improve clarity and relevance of the responses given. Questions were posed in a neutral manner, and the researcher listened attentively to the respondents’ views, and follow-up questions and probes were based on these responses.
The researcher actively avoided providing leads based on any preconceived notions and did not encourage participants to provide particular answers by expressing approval or disapproval of what they said.
All interviews were electronically recorded and this formed the primary record of data collected. Interview notes were kept by the interviewer to highlight exceptional occurrences during the interviews and to help link non-verbal expressions to the interview responses.

3.4 Data Analysis Procedures

Qualitative data analysis has been defined as the interpretation and classification of collected data with a view of extracting implicit or explicit meaning expressed as general statements (Flick, 2014). It involves several levels of analysis to bring out the meaning from what was said or not said.
Recorded interviews were transcribed into text and because of the time constraints, two secretarial assistants were used to transcribe the recordings into text. The assistants were first trained in transcribing. This enabled the timely start of the data analysis.
For purposes of quality control, the text was compared with recorded data by listening while reading, to ensure that what was transcribed is the exact match of what was recorded.
Data was categorised based on concepts and indicators generated from the literature review and from the data collected. Emphasis was placed on how each data set fits within a particular category. This was an iterative process which was repeated several times to further reduce the categorisation and identify any new ones not previously captured.
Categories were studied further and themes, patterns, and relationships existing within the different categories were identified.
Core categories were generated; a core category is a central issue or focus around which a number of other categories integrate. These became the story lines upon which the findings were based. N-vivo coding software was used to undertake the analysis.

3.5 Research Ethics

“In the context of research, ethics refers to the appropriateness of your behaviour in relation to the rights of those who become the subject of your work, or are affected by it.” (Saunders, et al., 2007).
The researcher expected to encounter three main ethical challenges: maintaining the anonymity of respondents, confidentiality of data collected and getting an informed consent from research
participants. A number of steps were undertaken to try and avert any situation where any of these would materialise.

First, the researcher clearly informed participants about the study, its purpose and processes and obtained explicit consent from interviewees by way of a signed consent form. All participants were assured of the confidentiality of information gathered by the research team. However, given the expected benefits from the study, it was made clear that findings may be used for follow-on studies. Throughout the analysis and write ups, codes instead of names were used to identify respondents. Where there was a need to quote a particular respondent, express permission in writing from such a respondent was sought after clearly explaining the final recipients of the data.

To avoid misrepresentation of facts, the researcher ensured that what was transcribed was exactly the same as what was recorded and this was done through concurrent listening and reading. A copy of individual transcripts was shared with each respondent to confirm whether it accurately reflects their views; however, given their busy schedules, they may not have had time to read through, so less reliance was placed on this approach as no respond provided a feedback.

3.6 Limitations of the Methodology

By anticipating and trying to identify research limitations in advance, the researcher planned around these issues to minimise the effect of these limitations.

The most likely limitation a short term or snapshot research study like this faces is findings being overtaken by events of time. The research was conducted over a short term period. Due to the dynamic nature of the financial industry, and the fact that this was a cross-sectional study, many of the factors may become irrelevant with time and some new factors may emerge. However, the researcher believes that the factors generated by the study were the most pertinent at this point in time.

In terms of research validity, qualitative analysis with subjective opinions can be prone to the bias of the researcher. According to Mason 2002, qualitative research often depends on the individual judgment of the researcher and is heavily dependent on the researcher's interpretation in the analysis of interview data or case study information. To minimize the subjectivity, vigilance to avoid personal bias was maintained throughout the study.

Reliability of data/information is another potential limitation of the research.

The sincerity of responses from interviews can be tainted due to corporate policies of the organisation and confidentiality constraints. The researcher assured confidentiality for the collected data and tried his best to make respondents feel at ease during the interview process.
The factors presented by the chosen sample may not be representative of the whole market. However, given the diversity and experience of the key informants, it can be assumed that the depth of the responses was rich enough and should be able to cover most companies in the market. In addition, the interviews were semi-structured and this helped to bring out a detailed account of the factors encountered by most companies as well as provide the researcher with a leeway to seek clarifications. However, that said, this study cannot bring out the prevalence and extent to which the factors, which were raised, affect particular companies. This can only be done in subsequent projects, using quantitative methods.
4. Research Findings

The respondents included a director from the capital markets authority, an executive director of the central bank, head of investment banking from a commercial bank and a head of finance in a utility company. The interviews with respondents were transcribed and are attached as appendices. For purposes of clarity: WP FOUR refers to Executive Director central bank, LT ONE refers to Director Capital Markets Authority, ALO THREE refers to the Head of finance of a public utility company and PR TWO refers to head of investment banking of a commercial bank.

This chapter highlights the findings that arose from the in-depth analysis of the transcribed interviews and repeated listening to the recorded interviews. The interviews were semi-structured and therefore the findings will be laid out in the same order as the interview questionnaire although, from the analysis, themes and relationships arose across the interview questions.

Capital structure and cost of debt

All the respondents seemed to agree that whereas an optimum capital structure calls for a balance between debt and equity, the status quo in the Ugandan economy promotes having more equity rather than debt. This they attributed to the high cost of debt in the country which makes debt servicing almost impossible. The respondent from the central bank stated that the nominal cost of debt was estimated to be 30% inclusive of arrangement and monitoring fees. This puts the real cost of debt at 23% given that the average inflation rate stands at 7%. He added that this has fueled the number of non-performing loans to move from 4%, a year ago to the current 7.4%.

In addition, it also emerged that most Ugandan companies are family businesses in which expansion is limited and therefore prefer to maintain the family equity and only borrow minimally. However, one respondent differed and highlighted a new phenomenon in which established companies have started to use existing assets to acquire a lot of debt and these have become highly geared though he emphasised that this is a very small percentage.

Factors that impede Ugandan Companies from issuing corporate bonds

A multitude of factors came up and the analysis showed that the respondents did not differ much, with most of them highlighting similar factors.

In what appeared surprising, all respondents had a lack of knowledge in regard to corporate bonds as the biggest factor hindering issue of corporate bonds. The lack of knowledge was at two levels: the first one being at the level of the finance executives, where the majority have limited knowledge regarding bonds and cannot elucidate how a bond issue works. The second is the
general population in which despite having some financial literacy, the knowledge regarding bonds and how they work is almost non-existent even within the middle class.

This, the respondents asserted has hindered the growth of the retail investors market. This has created an oligopoly tending towards a monopoly for institutional investors spearheaded by the state-run pension fund. Having one major player has locked out the effect of market forces and this means that prior to any issue an issuer has to approach the pension fund to assess the level of interest. In the event that the pension fund is not interested then the issuer cannot proceed with the issue. It also emerged that other less rigorous but equally profitable avenues exist for the pension fund to invest its funds.

The disclosure and governance requirements that come with a listing of bonds were highlighted as a huge hindrance to many companies by two of the respondents. This they argued does not mean that the requirements are excessive; however, the current practices by companies are very rudimentary making it very hard to attain the basic requirements that come with issuing of bonds. There is no regulatory framework that requires companies to give detailed disclosure of annual financial performance and health of a company. The closest companies come to giving this type of disclosure is to the revenue body while making tax returns. However, it emerged that the revenue body is more interested in revenue and costs without following any particular reporting framework. This makes the requirements of approval for listing prohibitive as it becomes very costly to work backwards to come up with audited financial statements which adhere to international Financial Reporting Standards. Worse still, respondents submitted that the continued disclosure and the attendant governance requirements after listing create discomfort with many companies as they feel that their privacy and flexibility is being eroded.

Two of the respondents stated that sectors which are currently regulated and have to make periodic reports to the regulators find it much easier to attain the required disclosure standards for listing. This is true for the telecom and banking sectors. As a result, most of the listed bonds were from banks; actually 80% of the listed bonds.

It came out clearly from two of the respondents that the scale of operation for most Ugandan companies cannot match the level expected in the corporate bond market. One of the respondents alluded to the fact that the investors are institutional, and the expected level of investment is high with an estimated threshold of 10 billion Uganda Shillings equivalent to USD 3,000,000. Given the limited scale of operation, very few Ugandan companies can absorb this kind of money.
In addition, even if the investing threshold was lower the relative cost of issuing would be prohibitive. The respondent from Capital Markets Authority estimates that to make economic sense, a minimum USD 3,000,000 should be raised in order to keep the relative issue costs below 2% of the issued amount.

Three of the respondents alluded to the fact that there appears to be no incentive arising from cost saving or the regulatory framework to encourage issuing of bonds. This was attributed to the fact that though the coupon rate for bond finance is marginally lower than bank loans, this benefit is eroded by the complex issue process and issue costs.

Three of the respondents alluded to the fact although most blue chip and multinational companies don’t seem to have a problem with most of the factors highlighted above; they still do not issue bonds on the Ugandan stock exchange because there is no incentive.

One respondent referred to a study done within one of the leading investment banks which revealed that overall it was cheaper for a well-established company in Uganda to raise finance by way of bank loans rather than issue bonds. Whereas the interest rate for bonds may be lower, the arrangement costs make it more expensive in the long run.

The respondents argued that arrangement costs tend to be high due to the fact that the players are limited creating a scarcity of the resource and sometimes have to be outsourced from other countries like Kenya and South Africa.

Two of the respondents argued that because of the above issue multinational companies are finding it much cheaper to borrow from foreign markets especially given the current wave of cheap finance within the western world.

The respondent from the central bank highlighted that there is no incentive within the regulatory and tax framework. Whereas the tax framework provides for interest payments and issue costs as tax-deductible expenses, this benefit is conferred to all types of debt financing. Therefore companies do not find it beneficial to issue bonds rather borrow from the bank.

All respondents agreed that the Government borrowing rate is very high. Currently, a 10year Government bond goes at a nominal yield of 18%. With inflation standing at 7% the real rate is estimated at 11%.

Two of the respondents stated that because most bonds issued earlier have used the Government yield curve as the benchmark if the Government rate is high then bond financing will also be quite expensive. These two attributed the high rate for Government borrowing to the primary dealership system used by Government to raise funds and the continued raising of funds from the market for consumption rather than investment.
This high borrowing cost has fueled companies which have access to external sources of funds to actually borrow from foreign markets. This they argued is supported by the recent increase in the amount of foreign currency denominated loans to around 40% of the loan book.

One respondent, however, argued that the high Government borrowing rate is a reflection of the investors’ perceived risk.

In conclusion, they asserted that currently, equity appears to be cheaper and more favourable for some companies; one of the respondents sighted recent examples in which listed companies have opted for rights issues instead of the debt issue. Three listed companies of Uganda Clays, New vision, and National Insurance Corporation all opted for rights issues.

**The future of the Ugandan bond market**

All respondents agreed that whereas it is highly desirous to have a booming bond market, this may not happen in the near future. They argued that many factors had to change before the bond market could thrive.

They all upheld the fact that a booming bond market is likely to bring down the cost of borrowing and increase the capital available to companies; this they hoped would encourage more productivity and lead to faster economic development.

One respondent alluded to the fact that all this could be achieved in the short run in case Uganda starts exporting the recently discovered oil and have the funds properly invested. This he argued would reduce the fiscal deficit of Government, hence less Government borrowing and would increase Uganda’s foreign exchange earnings thereby reducing the pressure on the exchange rate. A stronger Uganda shilling may see a rise in the issue of Euro bonds at competitive rates.
5. Discussion

The main objective of this study was to come up with factors which impede Ugandan companies from issuing corporate bonds. A number of factors were raised and in this section each of the factors will be discussed in detail and where available existing literature will be used to support the findings.

Low financial literacy

The World Bank has defined financial literacy as “the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being.” All respondents agreed that the level of financial literacy is very low within the Ugandan population and in particular knowledge about corporate bonds is almost missing.

In a 2010 study carried out by the World Bank, a positive correlation was found between financial literacy and use of financial services (World Bank, 2011). According to the 2014 National population and housing census, Uganda has a population of 38 million people of which 60% are below the legal employment age of 18 years. This leaves 12 million people eligible for employment, though it can be argued that not all 12 million are capable or are willing to be in employment. However, statistics from the central bank show that currently, Ugandans have 5 million bank accounts and if ownership of a bank account can be a good yardstick to measure financial literacy; this is quite low compared to other countries where this percentage is close to 100%. Of the five million people with bank accounts, only two million have accessed bank finance, further reducing the number of people who may be assumed to have some knowledge about debt financing.

Although the estimates have not been made, going by the level of bank account and bank loan access it is clear that the level of financial literacy in regard to corporate bonds would indeed be low. This is in support of the views raised by the respondents. This implies that knowledge about corporate bonds is extremely limited, and this has had the effect of locking the population out of the retail investment segment of the corporate bond market and leaving only institutional investors.
On the side of financial executives, all respondents agreed that the technical knowledge regarding corporate bonds’ issue process is lacking. Whereas, many financial executives know about the corporate bonds, they cannot ably go through the issuing process of a bond. Currently Uganda has 4000 certified public accountants, who actually know about the valuation and theory behind corporate bonds; however, due to lack of an active market, they appear not to have the practical knowledge of how to go about an issue of a corporate bond.

This is compounded by the fact that this knowledge is non-existent within the membership of most boards. So if the finance directors cannot convincingly explain the nuances of a corporate bond issue to the board, then chances that the board will give approval would be minimal.

Low financial literacy in regard to corporate bonds is a major reason as to why many companies cannot issue bonds. The limited knowledge at executive level negates the push effect while the limited knowledge within investors hinders the pull effect.

**Shallow Financial market**

The Ugandan banking sector is characterized by a few large mainly multinational banks dominating the bank loans sector. These are liquid and extremely risk averse. Such an oligopolistic banking sector has negative consequences, among which are high-interest rate spreads which crowd out credit to the private sector by making loans too costly. In this context, banks favour government assets, thus resulting in low intermedidation rates and a smaller share of credit allocated to the private sector. The competitor would have been the corporate bond market; however, the outlook is not very different. With very low levels of financial literacy in relation to corporate bonds, the retail market segment is non-existent. This leaves the market to only institutional players. Worse still, the pension sector has not been liberalised, it is still run by one state enterprise, the National Social Security Fund (NSSF). The Insurance sector is still not very developed and there aren’t any mutual or trust funds. Basically, this leaves one huge player the NSSF with close to 3billion dollars to invest. However, the retirement benefits regulations restrict the percentage of money that can be invested by public pension funds in bonds to 10%.

This makes the corporate bond market very shallow with limited competition and funds. Prior to issuing bonds, companies have to engage the NSSF since it is the major player in this market; if it is not interested in a particular bond, then there is no point going ahead to list. It also implies that the investor has very high bargaining power when it comes to fixing the terms of the bond and the monopoly exacerbates the risk averseness.

This leaves the Ugandan business community with no option save for the slow organic growth using equity and retained earnings and where possible bank loans.
The limited investor base greatly limits the financial depth of the Ugandan corporate bond market and greatly discourages companies from issuing bonds. The monopoly enjoyed by the pension fund makes the terms of bond issuances very unattractive and unlikely to push companies into issuing bonds.

**Disclosure requirements**

In bank financing, there is a close relationship between the bank and the customer. The bank invests a lot of resources to get information about the client and continuously monitors the client projects and progress. This comes at a cost and some scholars have argued that this is what makes bank financing more expensive compared to bond financing.

On the other hand, the corporate bond market will have investors who are distant from the operations of the business and entirely depend on publicly available information. To protect such investors, capital market regulators put in place disclosure requirements to reduce the information asymmetry between companies and potential investors so as to promote transparency.

Uganda is no exception; the Capital Markets Authority of Uganda adopted a merit system for approval for new bond issues. In the merit system, potential issuers are required to put together a document which is reviewed against set standards to assess compliance with minimum standards. All respondents were of the view that companies struggle to meet the bare minimum of these standards.

The simplest of them is a presentation of 3-year financial statements which are compliant with International Financial Reporting Standards. This alone is an uphill task for a number of companies.

Most respondents attributed this to the fact that there is currently no regulatory framework that requires companies to give detailed disclosure of annual financial performance and health of a company. The closest companies come to giving this type of disclosure is to the revenue body while making tax returns. However, it emerged that the revenue body is more interested in revenue and costs without following any particular reporting framework. In fact, the Uganda tax body has introduced a web portal where one inputs one's total revenue and total expenditure and the application calculates the tax liability. Requiring such companies to upgrade to full compliance with the International Financial reporting Standards will imply heavy costs on them in terms of time and hiring the scarce certified accountants.
In addition, most respondents alluded to the fact that most companies are not ready to have their information continuously shared in the public domain. The fact that most businesses are family owned or started to meet one's income requirements creates a proper governance shortfall. Most of these companies are not professionally run and requiring them to disclose information on a regular basis would be interpreted as interfering with their privacy.

On the other hand, although banks do require similar or even more information, they are not very strict in regard to compliance with a given framework that would warrant the employment of professionals who are scarce and expensive. Respondents argued that banks pick out the most important indicators which they dig out by themselves and continuously monitor the same. This makes it easy for such companies to comply with bank requirements.

This implies, that even for large companies, the cost of listing would be further amplified by the requirement to adhere to basic minimum disclosure requirements.

This probably partly explains why it has been so easy for banks to issue bonds in the market. 8 of the 10 earlier issues were by banks. Banks are regulated and are required to make periodic reports to the regulators on a continuous basis, therefore the disclosure requirements for listing bonds are not an additional burden to them.

As a result of the foregoing, companies which would be candidates for issuing bonds are more comfortable getting loans from banks.

**Limited scale of operation**

From the bond issuance process, it can be appreciated that the size of bond issue relies on an internal and external market analysis. The internal analysis will consider issues like the probable project to undertake, expected cash flows from the company, the debt coverage ratio and the capital structure of the company. The external analysis will focus on the available finance and the associated costs.

As already highlighted, there are only institutional investors in the Ugandan bond market whose scale of operation is at the high end by Ugandan standards. NSSF has earlier hinted on an investment threshold of $3,000,000. Definitely, this makes sense in the eyes of the investor as it will minimize the costs both for investment and subsequent follow-up. This threshold would probably be much higher for foreign investors.

This amount is way too high for many Ugandan businesses; they simply cannot absorb such amounts given their scale of operation and likely investment projects. One respondent stated that Ugandan businesses operate on a rather small scale with no vision for huge expansion.
Most of the respondents attributed this to a cultural orientation; most of the businesses are family owned and are started as a means of getting a livelihood with no scalability in mind. Once a stable reasonable income is reached, then most of them find no reason to expand further.

In addition, the ecosystem surrounding these businesses does not allow them to expand: the business advisers are either non-existent or focusing on minimising costs rather than scalability, the market focus is internal and not ready to compete with foreign imported goods, Government has not provided infrastructure in the form of market research and technical advice to promote expansion into foreign markets.

Good examples are the legal advisers who emphasise minimising the amount of equity capital declared at the time of business registration so as to minimise the stamp duty. Stamp duty is a form of tax paid as a percentage of the equity value of newly registered companies.

Given the limited scale of operation, such small companies cannot absorb the minimum threshold for institutional investors; however even if the thresholds were lower, the relative costs of the issue would become prohibitive as discussed in the subsequent paragraph.

It turns out that this would become a huge hindrance to companies and they opt for bank finance which can be tailored to the needs of the business.

**High Issue costs**

Issue costs arise from the transaction arrangement and compliance with the issuance and listing requirements set by regulators as shown in table 2.

Activities for issuing a bond include structuring, placement and marketing, underwriting and listing of the securities. These would entail appointment of a transaction arranger, a placement agent, an underwriter and sponsoring stockbroker. However, in Uganda it is not a requirement to have bond securities underwritten and listed; because of that fact, many transactions end up with an investment bank acting as a transaction arranger and placement agent.

Other fees due to professional agents include those for legal counsel, reporting accountants, paying agent and registrars, printing and/or marketing. Guarantee fees will be added in case the issue is guaranteed. On top of these fees, there are also fees due to regulators; in this case, the Capital markets Authority and the Uganda Securities exchange which have fixed their fees at 0.1% of the issued amount.

From the table below it can be seen that the requirements set by the Ugandan regulators are not very different from those set by Kenyan regulators. This corroborates with what two of the respondents referred to; that though the requirements are not very stringent the issue costs are seen to be high because most companies are starting from below par.
Table 2: Summary of Issuance and Listing Requirements for Fixed Income Securities; comparison between Kenya and Uganda

<table>
<thead>
<tr>
<th></th>
<th>Kenya</th>
<th>Uganda</th>
</tr>
</thead>
</table>


Table 3: New Issue Costs in Selected East African Currencies by the same issuer (East African Development Bank). All figures are a percentage of amounts issued.

<table>
<thead>
<tr>
<th>Issuer/Share Capital</th>
<th>Kenya</th>
<th>Tanzania</th>
<th>Uganda</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>body corporate with minimum issued and paid up share capital of Ksh 50mn (Equivalent to USD 0.5 million) and net assets of Ksh 100mn before the public offering;</td>
<td>company or corporate body with paid-up share capital and reserves not less than Ushs 1bn; (equivalent to USD 300,000)</td>
<td></td>
</tr>
<tr>
<td>Financial statements</td>
<td>must have audited financial statements complying with IFRS for the last three financial years</td>
<td>• must have audited financial statements complying with IFRS for the last three financial years preceding the issue.</td>
<td></td>
</tr>
<tr>
<td>Cash flow projections</td>
<td>• the accountant’s report shall disclose a proforma balance sheet, profit and loss account and cash flow projection for the next 12-months following the issue;</td>
<td>the Issuer shall prepare for submission to the CMA a cash flow projection for the next 12 months;</td>
<td></td>
</tr>
<tr>
<td>Profitability</td>
<td>the Issuer must have declared profits after tax attributable to shareholders in at least two of the last three financial periods preceding the application for the issue;</td>
<td>the Issuer shall have made profits in at least two of the last three financial years preceding the issue;</td>
<td></td>
</tr>
<tr>
<td>Guarantee requirements</td>
<td>• where the Issuer does not satisfy the requirements it may seek a credit enhancement to have the securities guaranteed;</td>
<td>in the event that an Issuer does not have a minimum paid-up capital and reserves of Ushs 1bn the Issuer must obtain from a bank or any other institution recognised by the CMA, a financial guarantee to support the issue;</td>
<td></td>
</tr>
<tr>
<td>Issue size</td>
<td>The minimum size of the issue shall be Ksh 50m; (Equivalent to USD 500,000)</td>
<td>the minimum size of the issue shall be Ushs 500m; (Equivalent to USD 150,000)</td>
<td></td>
</tr>
<tr>
<td>Listing</td>
<td>government bonds must be listed; all corporate fixed income securities offered to the public...shall be listed&quot;</td>
<td>government bonds must be listed; there is no requirement for corporate bonds to be listed;</td>
<td></td>
</tr>
<tr>
<td>Other parties</td>
<td>The Issuer shall appoint a paying agent and registrar for the issue.</td>
<td>the Issuer shall appoint one receiving bank, payment and settlement agents and an approved registrar and Trustee</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Fixed</td>
<td>Fixed</td>
<td>Floating</td>
</tr>
<tr>
<td>----------------</td>
<td>-------</td>
<td>-------</td>
<td>----------</td>
</tr>
<tr>
<td><strong>Issue costs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transaction arranger</td>
<td>0.250</td>
<td>0.290</td>
<td>0.600</td>
</tr>
<tr>
<td>Placing agent</td>
<td></td>
<td></td>
<td>0.100</td>
</tr>
<tr>
<td>Sponsoring broker</td>
<td>0.250</td>
<td>0.058</td>
<td>0.200</td>
</tr>
<tr>
<td>Legal fees</td>
<td>0.100</td>
<td>0.077</td>
<td>0.112</td>
</tr>
<tr>
<td>Reporting Accountants</td>
<td>0.143</td>
<td>0.770</td>
<td>0.093</td>
</tr>
<tr>
<td>Fiscal agent/registrar</td>
<td>0.430</td>
<td>0.290</td>
<td>0.186</td>
</tr>
<tr>
<td>Printing /Marketing</td>
<td>0.005</td>
<td>0.034</td>
<td>0.037</td>
</tr>
<tr>
<td><strong>Regulatory Fees</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CMA approval</td>
<td>0.188</td>
<td>0.117</td>
<td>0.100</td>
</tr>
<tr>
<td>Stock exchange fees</td>
<td>0.023</td>
<td>0.038</td>
<td>0.100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1.39%</td>
<td>0.99%</td>
<td>1.53%</td>
</tr>
</tbody>
</table>

As seen from table 3, in relative terms the percentages appear small due to the fact that the amounts issued were large; however, if the amounts issued were small coupled with the fact that most fees have a floor, the cost would become prohibitive. One respondent argued that to make economic sense the minimum issue amount should be USD 3,000,000 which is way out of reach for most Ugandan companies. In comparison, the cost of making a new corporate issue in Malaysia is on average 0.685% (International Securities Consultancy Limited, 2008). As seen in the table above, Uganda seems to be the most expensive compared to other East African Countries. This confirms what the respondents in the study alluded to; the fact that there is very limited expertise in this area among the professionals and the investment banks creating oligopolies. This is likely to give the professionals an upper hand while negotiating fees resulting into the high rates. From the above table, it can be seen that the investment bank in Uganda charged 300% more for transaction arrangement compared to the other two countries. The scarcity of professionals coupled with the lack of basic disclosure standards, small issue sizes and the fact that the issues would be new, would indeed make the bond issue costs prohibitive for Ugandan companies.

**High benchmark yield rate**

The Government yield curve is used as a benchmark for setting the yield for corporate bonds. The Government rate is taken as the nominal risk-free rate and premium is added on top of this to cater for other market risks like default and interest rate risks.
Many respondents were of the view that Government is currently borrowing at an inflated rate. Currently, the 10yr Government bonds go for a nominal rate of 18% compared to 12% in neighbouring Kenya. Given that, the average rate of inflation is 7%, it implies that Government is borrowing at a real rate of 11%.

Currently, Government is using the primary dealership system in which six banks were appointed as the major counterparties for bidding during a Government securities auction. The major risk such a system poses is the limited competition and likelihood of collusion resulting in yields set above what the actual and perceived market risk would dictate. Whether this is true or there are other factors to explain the high perceived risk is an issue open for debate. The high rate could also be explained by the ever increasing fiscal deficit coupled with increased Government borrowing. Currently, Government borrowing stands at 37% of the GDP and is estimated to rise by 2% per year, which may not be very high compared to many countries which are averaging 100%.

The Governor Bank of Uganda asserted that “large domestic borrowing by Government has partly resulted in high Government securities interest rates, thereby crowding out the private sector from the credit market.” (Mugerwa, 2016).

The Governor's remarks seem to suggest that though Government borrowing to GDP is quite low compared to other countries, it appears that the bigger percentage is from the domestic market which is too shallow to accommodate the borrowing. This implies that continued borrowing from the domestic market will crowd out the private sector and the concentration of debt within a few institutional investors increases the perceived risk and hence charging a higher rate.

With Government borrowing at such a high rate, there would be no incentive to lend to the private sector.

The high Government securities yield rate would translate into a high yield rate for corporate bonds, given that it is used as the benchmark rate. This implies that for investors to lend more risky companies through corporate bonds, a risk premium has to be paid. The high rate of borrowing makes it economically unviable to borrow such funds for economic expansion.

On average, the real estate sector has a rate of return on investment standing at 10%, with other sectors closely following. This implies that such business can only borrow to meet unexpected eventualities but not for planned expansion. Such borrowing is definitely not viable within the bond market, which explains why bank loans are prevalent.

Lack of incentive for companies
Having highlighted so many hindrances to access of the Ugandan corporate bond market, surely there would be some blue chip or multinational and utility companies which would have a way around all the factors raised above. However, it emerged that such companies have no incentive to issue bonds. This was mainly attributed to the high cost of bond financing in Uganda created by the many factors already discussed. As a result of this many of these blue chip companies have opted for bank loans where they can negotiate very favourable terms. In fact, it was not uncommon to see syndicated bank loans issued to large corporations. Multinationals and local companies that have strong diversified foreign currency earnings or support from a foreign parent have opted for foreign denominated loans from foreign markets as was seen by UMEME, an electricity distribution company, which raised $400million.

For other companies whose earnings are in Ugandan shillings, they cannot issue Euro bonds given the additional risk of foreign exchange fluctuations and the high country risk attached to Uganda as a country.

It also emerged that there are no incentives arising out of the regulatory and legal framework. The income tax law provides for acceptance of interest and debt issue costs as deductible expenditures while calculating corporation tax. However, this benefit is conferred to all forms of debt finance. This concludes that there is nothing special that can push a Ugandan company to opt for bond financing at the moment. This is further compounded by the risk of under subscription given the shallowness of the investor base.

6. Conclusions / Recommendations

In conclusion, the results of this study provide fascinating insights into the factors that impede Ugandan companies from issuing corporate bonds.
Limited financial literacy in regard to corporate bonds at the levels of finance executives, corporate boards and the investing population has curtailed both the push and pull effect on the bond market.

The limited scale of operation for most Ugandan companies hinders their ability to absorb funds and yet small bond issues are not economically viable due to high issue costs. This is compounded by the fact that scarcity of professional service providers within the Ugandan market has led to higher than normal issue costs.

The disclosure requirements set by the Capital Markets Authority to help reduce information asymmetry between issuers and investors are a hindrance to corporate bond issue. This is mainly due to the fact that many companies are still far below the required basic minimum, making it so expensive for them to attain the required level.

The benchmark yield on Government bonds is high, and this makes corporate bonds equally expensive. This has had the effect of eroding away any incentive arising from cost saving for a bond issue with companies opting for other sources of finance which can be accessed at the same or even lower yields yet they are easier to access.

The limited investor base has led to an oligopoly tending towards a monopoly and this has given the investors an upper hand when agreeing on bond terms much to the detriment of bond issuers. With these factors in place, the Ugandan corporate bond market is still far from realizing its full potential.

Though this study has highlighted the factors that impede Ugandan companies from issuing bonds, it cannot assess the extent of impact on the different companies and sectors. I recommend a follow on quantitative study, to come up with the extent to which the factors identified in this study impact on Ugandan companies in the different categories.

What can be done to help alleviate the situation?

In the short to medium term, Government borrowing rates should be brought down; this can be done mainly through reducing the fiscal deficit and thus the volume and value of Government borrowing.

In addition, more efficient price discovery practices should be implemented to get a better match for the risk that Government has to pay for. Opportunities like widening the investor base for Government securities should be explored.

It is hoped that lower Borrowing rates will translate into cheaper bond finance and this may provide the much-needed incentive for borrowing.
Regulatory ant tax incentives should be provided to encourage mergers and acquisitions and injection of private equity from well-organised investors into existing Ugandan companies. This will transform small companies into sizeable well-organized firms which can absorb the funds issued by bond markets and will also enable them to negotiate better terms.

The pension sector should be fully liberalized to allow for more players in the capital markets. This will provide better price discovery for both the Government and corporate bonds. The liberalization is already under way, and the effects should be seen sooner than later, in case it is fully implemented.

Given that most companies in Uganda are still small and cannot access corporate bond funds, in the interim, special intermediaries which can borrow sizeable amounts from the markets can be set up. These will then pass on these funds to the small companies at competitive rates.

In the long run, a deliberate effort should be put in place to improve financial literacy in regard to corporate bonds at all levels. This may involve inclusion within the school syllabus and promote professional and short courses which are geared towards improving knowledge about corporate bonds at different levels and in different depths.

Having one large well-advertised bond issue targeting the retail investors may help bridge the gap much faster as the public, as well as finance executives, will pick interest in finding out how this works. The issue costs for this planned issue can be subsidized by Government to reduce the burden on the issuing company.

Improving financial literacy is likely to help create interest from the retail investors and this may push for better price discovery both in the public and corporate bond sectors. Having more professionals who can provide intermediary services for the bond issuance process is likely to bring down issue costs in the long run.

Disclosure and governance requirements should be introduced for all companies starting with the very basic forms and slowly upgrade to more detailed forms. This will not only help companies to meet the disclosure requirements for a bond issue but will also lead to better run companies.

This research and other research to follow will contribute to the knowledge of the factors that impede Uganda companies from issuing corporate bonds. The results of this study suggest that there quite a number of challenges faced by Ugandan companies in regard to their capability to issue bonds. The study concludes that Ugandan bond market is still far from achieving its full potential and this may take some time.

It is hoped that the findings and recommendations contribute empirical results relevant to both academic research and policymakers.
7. Reflection

After 12 months of interfacing with a new academic and non-academic environment, I must say that a lot has changed in my skills set and my approach to life. Going through the masters’ programme has taught me so much more than the basic academic knowledge. As a masters student, a lot of learning resources were available to me including lecture time, access to online resources, access to several hard copy books and magazines and links to a multitude of articles, educational videos, and current news. With the benefit of hindsight, I must say that I utilised a number of these learning resources to help me achieve the intended objectives of gaining an in-depth understanding of the subjects. From the academic perspective, I must appreciate the exposure to contemporary issues and broadening of my thinking mainly in the fields of capital markets and political economics.

The main objective for enrolling for a Master’s programme was to further advance my career in Accounting and Finance. In the short term, I hoped that this would translate into a well-paying job at a senior level and in the medium to long term enable me to start my own businesses.

The job I am targeting requires specialist knowledge in Finance and Accounting, given that at a senior level one is often required to give expert opinions. My knowledge in Finance and Accounting has been further enhanced to a level that I am now comfortable to give an expert opinion on a number of issues. The course has exposed me to contemporary issues and also equipped me with skills on how to keep abreast of contemporary issues; this is very pertinent to my future operations given that some of the areas are very dynamic.

Mastery over the subject area coupled with exposure to contemporary issues has given me the much-needed confidence to start presenting papers at high-level conferences, which I intend to embark on soon after the course.

Public speaking has always been one of my strengths, but it was a huge challenge for me to make presentations to audiences with a myriad of cultures and backgrounds. The course has further enhanced my presentation skills and English proficiency and interaction with a diversity of people has given me the confidence to express my views to any audience.

Listening to very fluent English from all the lecturers I interacted with, has greatly helped me to improve my English Language. I deliberately had my main focus on adding to my vocabulary, perfecting pronunciation of certain words and improving the use of intonation to relay messages, especially during public speaking. I have also greatly improved my writing skills.
At senior manager level, I expect to have repeated presentations to very high profile audiences. And the improved English proficiency coupled with better presentation skills will boost my confidence to speak in public and be comfortable to address people from a myriad of cultures.

The job I am aiming at should be senior and requires a lot of soft skills; therefore, it was imperative that during my time at Dublin Business School (DBS), I develop more people skills to enable me to undertake my next task. The taught modules equipped me with more people skills especially in the area of emotional management, managing difficult employees and dealing with ethical dilemmas. However, I must say that the taught modules were not so deep on this aspect.

I should, however, highlight that the personal interactions I have had with the widely diverse student’s body have added a great deal to my people skills. DBS has students from all over the world with diversity in cultures and approach to life. I had to interact with many of them on and off the campus; this enabled me to learn other approaches to dealing with people, be more tolerant and at times be more assertive.

I now want to change my focus to the dissertation.

Prior to starting my course at DBS, I sought for a loan from a bank worth $100,000. Though my credit rating is very good with no taint at all, it took me 3 months to get the money during which time there were numerous endless interactions and new demands, despite having a clean credit history spanning almost 10 years. On accessing the loan, the interest rate was 25% and on top of that, I had to pay for other costs which brought the annual percentage rate to 30%. This was a clear message that there is something wrong within the finance sector. There was no efficiency in allocating funds and the costs were way too high.

Upon starting my course, a lot was discussed in the area of capital markets and further reading revealed that market forces would be the answer to many problems within Finance. I realised that the Ugandan economy was starved of finance and was accessing the available finance painfully and at a very high cost. This prompted me to ponder over why Ugandan companies are not sourcing for finance from the bond markets which are more market-centered. This became the origin of my research topic.

The emphasis on using primary data for the research created a challenge for coming up with good research topics in the finance and accounting area. In my view, I think a lot of research can be done in this area by analysing existing data to come up with well-grounded theories. Throughout the subsequent classes, I developed an immense interest in the area of capital markets which were a core topic in almost all my modules. This enabled me to gain immense
knowledge about the topic and develop a passion for my research. I appreciated that providing answers to the question I earlier developed could be a stimulus to improved productivity in the Ugandan economy. This would help society by making their lives better.

During the research, I interviewed a number of high-profile practitioners in the field of capital markets. This enabled me to gain self-confidence as all the interviews went on smoothly and I was able to elicit the much-needed information. I greatly improved my skills in regard to interviewing especially in the area of listening and redirecting digressed interviews.

The research has enabled me to learn much more about the nuances of bond markets. The data collected from the research was sufficient to provide good answers to my earlier question and develop constructive recommendations to solve the problem.

The dissertation has helped me realise the potential vested in capital markets and the gap that exists in Uganda. With the existing gap, I have decided to start a mutual trust fund within five years to tap the potential lying within capital markets in Uganda.

In addition, I had already decided to start a company in the manufacturing sector five years from now, the dissertation has helped me realise that currently, the best capital in Uganda is from private equity firms for startups like mine.

While at DBS, I have interacted and made friends with students from all over the world. This will enable me to source for capital, expert advice, machinery, raw materials and services from all over the world to input in my manufacturing concern and the mutual trust fund I intend to start.

Overall I feel gratified with myself for a year well spent. I am proud of the findings that I have compiled and strongly feel that someday my recommendations are going to see the light of day. I hope that this will have an impact not only on the business community but on an entire nation. The knowledge and skills set that I have added on to what I already had, will surely widen my access to numerous opportunities not only in the finance and accounting sector but also in the business world in general.
References


APPENDICES
LT ONE

Interviewer

My first issue would be what is your take on the optimum capital structure in Uganda?

Interviewee

You are talking about structure in terms of businesses?

Interviewer

Yes, businesses.

Interviewee

Most businesses, you will find that they have a lot of bank debt. They are highly leveraged, have a lot of bank debt but those are companies who are there to grow, to expand. Usually, they opt for debt to fund their expansion plans.

But outside that, a big percentage actually will rely on equity, in terms of, if we put it in another way, internal funds. Meaning that someone is going to expand, they would rather wait until they have sufficient savings or retain earnings, then they use those retain earnings to expand.

So, you will find that you either have companies on one side that are have a lot of equity in their capital structure and on the other side have a lot of companies that have a lot of debt, they are highly leveraged in their capital structure.

That is also partly as a result of the design of the economy. The economy has been small and most of the expansion we had or the high economy growth we have had are not really coming from production, in terms of expansion of industry. They are mainly coming from commodities and things like trade, wholesale trade; those are the key drivers of the GDP. So, you find that there is no much impetus for a business to grow and to expand because anyway there is no so much demand for their products. Most of the products we have are imported. So, the few companies that are producing products for local demand are not so many and even then, the market is not that big in terms of; you have people’s incomes growing and are now demanding for more. So now you find its a small economy there are small
companies so there is no much impetus to grow. The much impetus to grow is mainly from; you could say mainly from multi-national who are now, who come into this market and using this market as a base to reach out the entire East African region, east and central southern Africa. So, those ones have expansion plans and they are looking at Uganda as a base to launch out, you know, even to Southern Sudan or Eastern DRC but for the indigenous companies that make up the bulk, they don’t have much impetus. That is why probably they can afford to wait, collect money, have sufficient savings and then they can buy machinery, you know. Or if they really have to, they take a risk and borrow money from the bank. Ordinarily, they could come to the Capital market but of course, we don’t have so much of the culture of market based economy while they rely more on the market rather than the banks. Yes.

So, even I must say, even for the banks to reach where they have reached where they have like 8-10 trillion outstanding credit to the private sector, it is not been like that. 10, 20 years ago, people used not to go to the banks. It is only recently the banks have begun really taking roots and expanding as people appreciate. So, we believe that in same way, to probably take a little time, for now the market to begin appreciating that for me to access money, I don’t only have to go to bank I can access directly from the investors through the capital markets. So I could say that’s a state.

**Interviewer**

**In your view, if there is a company in Uganda that is operating within the current environment, what would you advise them? How much should they go for debt and how much could they go for equity?**

**Interviewee**

Now, in our market, we are young market. It is a virgin market and there are many things that are not in place ordinarily, that a typical company would find a niche. So ideally, most companies I would say, would really operate and get some good money and good returns in this market. They should probably be skewed towards
equity because if you look at things that are needed to be done in our country, you
more less beginning from scratch and those are...... most of projects are not
bankable or they are not projects that you would easily get money from the bank.
Even to get money from the bank, then you will have, what I would call over
collateralization. The bank will really ask for so much collateral, for so much
security, you know, over and above the security they will need a guarantor because
you are undertaking a project that is emerging and there is no track record because
most of the things in Uganda have to be just be good it is not like in more developed
markets where all systems are in place and you have an established foundation,
established track record people can analyse risks, here you are looking at virgin
areas where there is even no data, that any of the models that most of these multi-
national banks have developed you can’t even put that information in their models.
So you can’t put that information in their models, they don’t even want to touch
your thing because they will ask for data and you don’t have but you know the
actual thing is needed now. That type of environment is very good for equity
because equity thrives in that environment because its risk capital. Equity is
financing, the finance growth story. What are the prospects? They are not so much
in interested in the past; they are interested in the future. The bank is interested in
the past. So, that is why I think the cost of capital is very high; because of that banks
tends to put in a lot of mark ups, trying to hedge themselves against the risk and of
course sometimes, it is, it goes really on a high end and its partly because you don’t
have data so that assumption, it is fairly a new thing also these people, guys are
doing here are fairly new, you know. So, and since they are the dominant financers,
so they have the take. So I would think, that if we had a thriving venture capital
private equity industry, first of all, what that would do, it would bring order to the
system, it would bring discipline to the companies, you know and it would begin to
provide a track record for the businesses it would begin to provide some strength
for businesses, so that now once they now go to the bank to get debt capital or get
financing from the bank or even from the capital market, they have a better
bargaining position. Currently, they don’t. Because the guy will say, “Look at your
business, look at the state of your business, I cannot give you money. But if I am
going to give you money, you need to give me so much collateral”. Currently, the collateral is around I think, 120%, 140% of the value of the money that you asked. In essence, the bank is more less giving you like 60% and they are securing that 60% with 140, meaning that they really consider this thing so risky. But once you have private equity guy who enters the system, creates a good eco-system because they build businesses from scratch. Then, they would not be justification for that 140 because the numbers will be there and the metrics will be there. So, there won’t be any justification for someone to give you a loan they ask for 140% security.

**Interviewer**

Because that is in line with actually my second question regarding cost of capital. Does that mean that Blue chip companies, multi-nationals or companies which are really well established here, can borrow at much less rates from the banks?

**Interviewee**

Yes, I was talking to a banker and he told me that for them they have decided, I think like 6 yrs ago, they decided no longer to touch a local. Because they consider them risky. Yea, Because you see our economy, one of the biggest challenges we have is lack of information. There is a lot of information asymmetry on even basics of statistics. In more developed economies, you can easily know that the market value of telecoms is this much eeeeh, and then you can confidently say that, this is my market share. It is very difficult to come across such data and authentic data in this market. So if someone is doing a business plan or projections, there are really raw, raw estimates, especially for most, even for the established industries say like telecoms it is very difficult,

o.k. For telecom now because they have a regulator, you have a few players, it is easy. So, there you can afford to test the project and the proposal and may be banking, but for the rest and another thing that the multi nationals have is that, they have the backing of their parent company. They have a backing of their parent company and in most cases, sometimes, because most of the banks we have here most of the solid solid banks we have here who account for the biggest market share of our banking industry are multi-nationals, and sometimes, even the lending is not from the local market probably from the parent company. In fact, if you look at the
statistics, the foreign denominated loans, have actually increased over the last five years. Now 40% of the loan book. Dollar denominated loans. So, the Blue chips have that in mind especially the multi-nationals. The local ones also still having a challenge, the local ones, what we call our local blue chips are having a challenge. There are some banks that no longer want to touch them,... because of those issues: Information asymmetry, governance and all those different things, there are quite challenge. So when the bank is going to give such a company money, they will have to put in a lot of provisions for all those different risks, which they perceive and those which are not perceived.

**Interviewee**

*So, what would you think should be the fair risk fee rate in Uganda before putting the risk premium?*

**Interviewee**

Uganda is actually not very risky if you look at it. Of course you would want to use the government rates, as the risk free but also the government because currently the government goes at 18% but also think that’s way much as high, at least should probably be reaching at 10% 11%, at least 10% because inflation is around 7%. So, ordinarily, you should think like 3% is a good mark up. And do you why am saying that the market is not as risky as sometimes the banks make it seem to look like, because when you look at the non performing loans, they are hovering around 3% 2 when they go to 4% that is, very high. But most of them are around 2%, 3%, 1%. That means that those guys are paying. If non performing loans were like 20% of the loan book or 30% you could say, yea, these guys are justified in charging this because the rate of default is high because you need to cover yourself. But they are not. Most of the guys are paying, meaning that, the lack of information, the lack of information is .......the bank actually are hiding behind the lack of information to be able to charge high rates and its very difficult to challenge it because you don’t have information.

**Interviewer**

*What would be your thinking why a government can issue bonds in its currency at a higher rate than a private company in the same country?*
Interviewee

No the challenge with government is that one is a market structure issue. We have a primary dealer system where its mainly like 5 or 6 commercial banks that are allowed to participate in the primary auction and I think out of those six you have like probably 2 or 3 who are active in the market. Now, meaning that if government doesn’t have money, they are at the mercy of those two, three big guys. Those banks have a huge bargaining position to be able to determine the rates. So, it is part of the structural issue but the other thing is that the government, much as up to now they had really managed their fiscal position, but increasingly their fiscal position is really getting out of hand and increasing the borrowing from the market meaning that the now the ones who are supplying the funds, have more leverage. Before the interest rates on government treasury and government bonds used to hover around 8 to 12%. 10 years around 12% lower end from 9 or 8%. Recently, the government had increased borrowing. Now when you increase borrowing you have a few small capital market, definitely you are going to have a rate that will be way beyond the fundamentals. And if I can get 20% from government, am not worried about the small businessman, a corporate because government i know what am dealing with, There is sufficient information to help me analyse whether government is going to default or not, government even has sovereign credit rating which analyses the credit worthiness. Most of these corporate guys don’t have credit ratings.

Now if am seated in Johannesburg or London, and you ask me, whom should I lend? Government, where you have all the information and have the latest sovereign credits ratings from Moody’s or Fitch and then you have a Mulwana here who is selling milk. And not even sure that the profits they reporting are the right ones. And there is no independent assessment too. But government here, you have an independent assessment from Fitch or Moody’s.

So, unless am really a local banker, who knows Mulwana and I probably go with him and have nice tea in the evening, I have been to his factory, I know his daughter. I would know, Even if I don’t have all the information that I can put in the model. I have already that local knowledge. Unfortunately, we don’t have many of those
banks in Uganda. Most of the banks are owned by multi-nationals and decisions are not made in Uganda. They are made outside Uganda.

**Interviewer**

That brings me to the gist of our interview? In your view, what factors do you think would make or, impede a company from issuing corporate bonds in the Ugandan environment? This is a business somewhere in Uganda. Why are they shunning the bond market? Not to issue?

**Interviewee**

The primary one is knowledge. Very few entrepreneurs even finance executives appreciate the bond market. So it is still a steep learning curve for most of them. We are beginning to see a change because now most of the finance courses in the Universities are beginning to look at capital markets, so, finance executives we are getting are beginning now to appreciate, but very few. The other thing we have is even the intermediaries who would structure these transactions. We don’t have a lot of, don’t have a strong competence in fixed income. We don’t have. Most of the competences we have are in equity don’t have and that goes to the investment bankers as well as the legal experts. Very few people will appreciate and understand fixed income.

Now, putting that aside, in terms of awareness, the other one is in the scale of the businesses, the scale of businesses I could say, it’s a challenge because, if you are going to raise money in the corporate bond market, the regulations or guidelines require that you shouldn’t borrow less than five hundred million, five hundred million. And from my experience, to be, to make business sense you must be at least borrowing 10 billion. Cause 10 billion, your cost will come to around 1 to 2% or even less. This is fairly reasonable. That would cover everything from the transaction, marketing, everything will be covered. So, meaning that, you will ask yourself in Uganda, how many businesses can actually absorb 10 billion? You must have serious growth plans and expansion plans for you to be able to absorb 10 billion and people to service this kind of money. Yes. you could be absorbing but you must also be having a very good business plan, for people to service. Having a good business
wouldn’t really be a problem because so many needs in this country. So well designed businesses would definitely make lot of money. But the question is that how many businesses have that scale? We don’t have many and most of them are actually multi-national. And most of them are multi-national and the thing with multi-national, in the last years, some few years most of them have been able to access cheaper capital from foreign international markets and Uganda, given that we have a fully free liberalized capital account where there are no restrictions on foreign exchange, can bring in dollars and take out your dollars and there is no limit to how much you can bring in or how much you can take out, meaning that I can as well access cheaper capital and bring in dollars and can also take them out. So, scale is a very critical issue.

The other critical issue is the requirements. If you are going to issue a bond, the disclosure requirements are quite, can be quite onerous to a business, especially if you are not accustomed to a lot of disclosure. The only time most of our businesses ever get closer to disclosure is when they are paying tax, but also the tax man is not so much interested in those audited financial accounts, IFRS. No. The financial man, the tax man is interested in how much money came in, what were the costs? is not interested in whether you have a good return on your capital. No problem. He doesn’t need all that. In fact, am told that ……because companies were having challenges with audited accounts, the URA has come up with a system, on line system where you enter in your figures, sales, at how much you sold everything, and then they are able to calculate your tax liability. So, that is the closest they come. Now ask him that I need international financial reporting standards that means that you need to get a certified public accountant who understands IFRS and they do that report and they need to disclose twice a year. And you don’t only ask them about the financials but you are asking them to disclose about their management, the prospects, you know, if there is any material information that could affect the pricing of their bonds, the trading of their bonds, that needs to be released to the public such that investors can make a decision to hold those bonds, or they can either increase the price or reduce the price in the secondary market. Now, that
would bring in a lot of discipline in businesses which most guys don’t have. So, for some businesses it will be a real paradigm shift. Whereas, if I am dealing with a bank, they would probably ask me the same information, they will ask me the same information, but they may not be so hard and fast on whether it has to be IFRS, but the banks will look at their risks and then they will ask you for those specific parameters and issues.

So you don’t have necessarily to produce IFRS accounts by Certified Public Accountant but they will have their conditionalities, like 6 or 7 which they monitor on a regular basis..... and you are working with them and the thing with the bank is that it is a sort of relationship, they manage you, whereas in the capital markets, you are left to the whims ..... you are left to the discipline of the market. The discipline of the market, the market has no time to sit down with you and discuss. If they see that your business is not being run properly, they will cut their losses and dump your bonds or they will just increase the costs of your bonds and this is happening, actually, we are talking about corporate bonds but actually, it is happening to sovereign bonds. In the past you have been monitoring, how these different African countries who went and borrowed money from international markets at very good rates, The Zambias and the Ghanas of this world , like everyone one thought these guys. When they started having issues with their government, they started having fiscal issues. Those guys are suffocating because of the price of their instruments have gone so high and can’t go back to the market that mirrors at corporate level

So the guy you may be giving him the same amount of money at 14% even less when he looks at what he actually has to do and how much he has to structure his business, the costs moves high. The opportunity costs goes high because you will not only be looking at the fees he has to pay, but you are looking at the system he has to put in place, the staff he has to employ, probably at the moment, even if it is a 10 billion, 1 billion, 5 billion revenue business, he just has a cashier whose role is just to receive the money and take to the bank. They don’t need books of accounts; they just need a book or just a basic accountant who can operate QuickBooks putting in sales. That is it. Because, that is what really URA wants. So, that’s another thing the
requirements and the structuring of the business in that would take to be able to come to the market.

That is why I was saying earlier on that, if you can have a private equity type of financing, if its to develop. its able to deal with all those different things and put out businesses on track and you have heard some stories of private local business that have been taken on by private equity and those business have totally been transferred in terms of systems and income boards xx transformed boards on what family two to three guys e who never met and have a private equity firm comes on board available meeting on a regular board meetings in a regular reports whatever, different things By the time these guys leave after seven years, the business is so different is so different, in fact, what usually happens, most of these private equity firms just do a trade sale. After 7 years another private equity firm comes in. We’ve had businesses which have been totally transformed like Quality Chemicals, Quality chemicals, they used to do drugs on sort of a wholesale, or how you import drugs and anything, but they got a private equity guy they got partner Cipla, now it’s a totally different business.

The same thing with Biyinzika; these guys bring in order in the business. Now if you don’t have that, you don’t come on the market it can be a challenge the other thing actually That thing actually where even requirement become very critical, is that even the process of getting approval can become very lengthy because, going through this business, yes they say they have been making revenue of 10 billion and probably profits 4 billion. but you, don’t have audited accounts and yet they require and at least 5 years and at least 3 profitable at least require 5 years of audited accounts I have been profitable for the last ten years and now the accountant literally has to work backwards to recreate those statements and that can take a lot of management’s time, which this guy may not be ready for. Because you have to get those receipts to create these accounts to fit international standards, and you may find that actually in the process of recreating, you will find that the 10 billion you are talking about is actually not there. So, that has been a challenge, if I would give an example, we had a project that was funded by USAID and in the early 2000, around 2003. This was fully funded by USAID they were
looking for potential companies that would come to the capital markets. They would come and do diligence at no cost to the company but some companies didn’t like it because of the time. Because it’s more than an audit, in looking at guy who has not been keeping these books no systems you are creating them from scratch which is very different from the US or U.K from the word go from day one, the guy has proper books of accounts he reports, does regular basis, so it’s a no brainer but here you have to work backwards. So that is why up to now most of the issues in the corporate bond market were banks. So because banks are mainly regulated, file quarterly reports, if you ask them for by earning They are already following international reporting standards. So that is the problem. That is why we are beginning to appreciate that probably local guy is not yet there. It is not really cut for the market and we are thinking that if the capital markets or the bond markets were transformed in the wholesale markets, where financial institution could be a bank or could be any financial institution that already has systems is able to access that market get cheap capital and they can be to onlend to the small guys because most times, those financial institutions their model can accommodate the local guy, because more of a relationship. So the investor in the capital market deals with this big guy who can absorb the amount of money he has in this capital market.

The other thing actually, I want to bring out is that, we they will what you would consider the investors in a corporate market probably in NSSF and some foreign institutional investors both in the region and outside the region. For an investor like NSSF their minimum investment threshold probably can be 5bn or 2bn. But a foreign investor it may actually be 10bn.

so meaning that even if you had a very good small issuer and you wanted to borrow 500 million, it will not be cost effective for the institutional investors it would not be cost effective. So, here because even small issues don’t provide enough liquidity, Yes. They don’t have enough liquidity because if I buy 1 billion and I want to sell it, it would probably be very costly and very difficult for me to find a buyer in a market where you don’t have a retail segment in bonds, if you had a retail segments in bonds, you could buy 1000,000 like the equity.
You could easily buy 2 billion and you know that in the secondary market you could have smaller buyers they can provide the market however small the issue is, but the market where you have many institutional investors, who have big ticket sizes, it is very difficult most of our business are so low.

**Interviewer**

So far, you have talked about knowledge, but when I look at knowledge, we do have quite a number of big companies in Uganda where we have brought in lots of certified accountants most of the adverts you see are requiring things like CPA or ACCA and now since such investors have that knowledge of capital markets. Have they really tried or stopped by their boards who don't have the exposure?

**Interviewee**

No, he may have studied probably did a course unit in these instruments, but they don't when I say competence they don't have the working knowledge. Yes. What they have is head knowledge that they are bonds but if you sat down with him and said how does it work? or if they had a financial need and the board was asking them give us options, it would hard for them to explain and make a differentiation between raising money from a corporate market and the bank.

Now we are solving that because we didn't have a certification programme, we are now partnering with the chartered institute of securities and investments UK to develop a certification programme. And this is more like a professional course, like ACCA now that one now goes into details in terms of how security markets work, how the different segments work, how equity works, fixed income derivatives, commodities how they work, like be able to know practically how it works and of course knowing that this is an option but now going into details in terms how do you raise money, what are the options, what are the differences between debt and equity, the relatives how do they come in those details. We have CFA is another professional course, certified financial Analyst which is taking root in Uganda. But we have very few. The Last time we had a function they had 10 charter holders compared to South Africa which has 2000. CFA goes into the minute details of how the thing works. If a guy does CFA and they are a finance manager, and the
company is trying to figure out how they can have an optimum capital structure, he can ably figure out what to have for equity and debt. Most of them are employed by fund managers who are on the investment side and not even the companies.

Interviewer

You talked of scale, the size of the business, we do have a lot of need which would require lots of money but our businesses are so small. Can that be attributed to lack of animal spirit, desire to take on big projects?

Interviewee

Yeah it is, one they are many factors, one of them is the culture. Much as you may not put figures to that, it is a big obstacle, because it is very difficult to quantify. But most people who start businesses don’t start with a mindset of expansion, most people start businesses to meet their needs. They are driven by necessity. They start businesses as a job. Just like someone goes to look for a job, that business is his job if it meets his family needs, then that’s it.

If there is some good money in the bank that can cater for family needs, he is comfortable. That’s why the guy is not in a hurry to expand. He says nonono….. am making 500m every month more that what I need, I don’t need to expand, get into new products. So you find a successful business but it’s been small for the last 15 years. When you talk of expansion he fears collapse. It is a big cultural thing. If you talk to any of those guys they would tell you no no I don’t want to go to the bank bring in private equity investors they are going to disturb us.

The other thing why we have perpetually small business is the eco system. The eco system I mean the different actors around this business are not fully developed to help them grow. You don’t have many people to provide business development services some countries called management consultants who would help businesses plan for scalability. Develop plans that enable business to scale up.

Most businesses do not employ professional certified accountants. You find that someone is making a lot of money but a lot of money is being lost because you don’t have proper controls, systems, what you make is lost so you can’t expand. There are lot of leakages because you don’t have a professional accountant.
The other thing is even the lawyers, you know, to advise on the best structure of business to be able to scale up. They would just advise, please when you are starting your equity should be more than 2 million to avoid stamp duty. You find a business making 200 million but equity is 2m, have a lot of debt, equity is 2m but the debt is way high.

The other eco system is business support from government in terms of marketing for businesses, having proper infrastructure. In a nutshell the ecosystem is not so favourable in facilitating a local indigenous guy to be able, for instance we don’t have a proper mechanism to encourage startups. Even where there is money or funding for startups you don’t have a support theme to mentor the entrepreneurs, they just give them money.

And yet if you look at the developed countries when you look at a person like Google he is developing his concept but his vision is worldwide right from the word go the scale in the business is quite high. Right form the word go, he has all the different possibilities of financing on their table and keep churning them at every stage of the business.

There is culture and the ecosystem and then also the market is so small not in the sense that we don’t have needs to be met but the competition from foreign products and competition wouldn’t be a problem if again our business people hand a mind building businesses with scale, or providing scalability in their businesses. Because a person with this in mind will have competition under their radar.

I was talking to friends of mine importing children clothes from China, we have a young population with potential to make money from the young market. These guys are comfortable with going to China doing at least 4-5 trips a year, make quite a lot of money. Tried to interest them about doing their own franchise build a factory in Uganda and start doing your brand in Uganda, They didn’t want to know. They will not expand, they will remain small.

**Interviewer**

You talked about disclosure being an impediment both the time involved, capacity and the willingness. We do have companies which are already issuing
shares on the stock exchange, these ones already have to disclose on the equity side why wouldn’t they do the same on the bond side

Interviewee
We have had one issue of bonds, STANBIC its listed and also issued bonds.

Interviewer
But like Uganda Clays

Interviewee
Uganda Clays, I think the……the….listed companies ideally you could say are good candidates of corporate bonds, but I think that one comes down to strategy. An example is New vision. They are investors who say that New vision would have been far bigger if they had increased their leverage. Investors claim they are too conservative, they have a lot of equity in their capital structure, they are risk averse. And yet if they take on more debt thy would have more tax savings and do much more than they are doing. One would say that their industry is saturated there is nothing more they could do in the media and printing . One would argue that they would diversify outside the media industry to become more relevant.

For listed companies its more of strategy. For the case of vision, they opted for a rights issue and raised 20bn. For the broadcasting equipment for the radio and TV even Uganda Clays did a rights issues to expand to build a new factory in Kamonkoli.

Interviewer
In Uganda as we speak equity might be cheaper than debt. By the time you do a rights issue, this is a person you have been with in the past, it means you have satisfied him and also you are comfortable not go else where.

Interviewee
In fact we have had three companies going for a rights issue New vision, Uganda Clays and NIC

The other thing is how much money you are looking for, for instance UMEME is listed but just after their listing they did 400m dollars by way of a syndicated loan. One would argue that UMEME is unique, because their revenue is pegged on the dollar. People who buy power from UMEME, you could say they pay in dollars, so
meaning that UMEME is better off borrowing in dollars, by the time they borrowed, rates were like 1%, 2%. So they could have borrowed at 4% instead of borrowing at 15% in the bond market. So for listed companies its more of corporate strategy.

Interviewer

But I think that the internal corporate strategy is driven by something behind, by the you decide that lets go for this strategy there is must be something pushing you

Interviewee

The other thing, Government is projecting debt serving to increase from 1.6tr to 2 tr. Meaning they are going to increase borrowing then cost of borrowing will go up. Since the government rate is the bench mark the rates will definitely go high. If my income and my revenue is in dollars I go to international markets and borrow much cheaper. Rather than borrow from local markets.

Interviewer

When I look at Government of Uganda, their leverage is not so bad compared to their GDP, right now they haven’t reached 50% compared to other Governments in the world are way above 100% and they still capable to borrow at lower rates.

Interviewee

Yes the Government may not be very leveraged but the higher rates are partly because of the structure of the primary dealership and the market itself is not very efficient, it is an over the counter market.

But also most of the money Government borrows is for public consumption, they have really improved their tax revenues but it still too low. So if you have a Government that is continuously expanding for consumption, the risks increase, because consumption will not bring any return. If am lending you money for consumption then I better charge a higher rate, because am not so sure that you are going down the right route. You may be at 20% but if you go at this rate you may not be able to.

The other day Government had to borrow from PTA bank to cushion themselves from foreign exchange depreciation. If you borrowing to manage foreign exchange
depreciation that’s a problem then you are not generating enough to generate enough reserves.

But if you are borrowing to invest in infrastructure, its likely now that your probability of paying is higher it will not be difficult to pay.

That’s another thing why the cost to Government is high. If they are to improve on their fiscal management, work on the structure of the markets that would bring down their rates.

**Interviewer**

Do you think of any other factor that is impeding a finance director or a board to say lets go for a bond and not other sources of funds

**Interviewee**

Boards is more of knowledge, they not so sophisticated, some local ones don’t even have boards. Except for some who have their children who are now exposed, so the next generation probably would be more bond savvy.

**Interviewer**

Finally where do see the bond market for the future in Uganda

**Interviewee**

I would frankly tell you for so long as the rates on Government borrowing are still very high, its really going to be a challenge for the bond market to take off. Unless we have a crop of local industries that are export oriented getting most of their money in foreign exchange and they can therefore be able to issue foreign denominated bonds using foreign Governments as their benchmarks. Then there you can side track the Government yield curve.

Or if you have the oil come in and our challenge becomes more of an appreciating shilling, it becomes more economical issuing foreign bonds, Government would not be borrowing because it will be in surplus. There the local guys can have a go

The other thing is that the corporate bond market will only grow with the maturity of the private sector. The private sector has to reach a level where they have exhausted funds in the banks and have to go to the capital markets.

The Equity side and public bonds have taken off but the corporate side is not
Any prudent fiancé manager would say that if I need to realign my capital structure, I need some debt to be efficient. So until that time it will very difficult for us, unless may be from banks. Currently banks have reached 80% credit to deposits meaning that they are almost maxing out their deposits and have to come to the bond market. What’s going to happen, if you have many banks, deposits are going to become very costly, you have to spend a lot of money to attract deposits. And yet in the corporate bond market you are dealing with a few institutional investors who don’t need a lot of advertising, just arrange for a meeting. Like Standard Chartered bank just had a meeting with NSSF to get 40bn, paid 1% to all the intermediaries. But to get the same 40bn in deposits you have to do a lot, you have to pay a lot of staff do a lot of operations and most of the money is short term.

As the economy grows people need houses, people are getting more income, can take up 30 year mortgages. Financing those mortgages using commercial deposits will become very expensive and difficult and you find that in the short to medium term the bond market will be driven by financial institutions.

It’s really an issue of knowledge and why not, why do they have to go to a bank

Housing Finance has done that, they did a bond which was oversubscribed.

Interviewer

If Hosing Finance has done that the only factors that impede Hossana real estates would be lack of knowledge, scale

Interviewee

Probably in the long term you may begin having the big guys coming in. Like in the US their commercial paper, which is short term loans form the capital markets is 10 times their corporate bonds. But you see that the big companies issue commercial paper to cater for their working capital instead of overdrafts. That will only come in the long term when we have large business of scale.

Like Equity bank did a share swaps, swapped 20% of their shares to buy a bank in DRC, they have a vison of opening up 100million accounts across Africa, that’s a very hungry and thirsty business that cannot be sustained by local deposits.

Interviewer
Thank you very much for your time.

END

WP FOUR

Interviewer

My first issue is, what is your thought regarding the optimum capital structure of a company operating in Uganda?

Interviewee

I think …companies operating in Uganda have one …..private companies not public companies. Private companies have one largest weakness is a lot of them are family owned and the family owned are two ways, and that’s how am going to explain the capital, either they inherited the company from the parents or they have grown organically by saying I started as a small shop then later on I go to a bank and when I borrow and then I can mortgage. Most of the structures that they have right now are either in terms of loans from banks, commercial banks or overdrafts from commercial banks. That is the funding that I have seen from most of them.

I have seen a lot of them comfortable to borrow from a bank than to raise or float shares. That is my experience even the largest companies like Mukwaano, like Madhvani, they would rather borrow from a bank or from an institution than float shares. They believe that if the float shares they dilute their control of a company, that is what I would say and I have sat down and talked to a number of them and asked them that it is not diluting your shares; It is looking at the shares that you have with your company value what its worth and instead of paying the cost of raising money from the banks, you can actually offer some shares remain a majority holder but offer some shares if you don’t want to offer some shares, look at things like the corporate bond. But the key thing came out is the governance around the corporate bond. The cost is prohibitive. Actually, one of it, there was a time when I
was in Stanbic Bank, I actually did an analysis, between what is the cost of raising money via corporate bond and the cost of coming to bank and borrowing?. The cost of coming to bank was much cheaper than the cost of raising a corporate bond. The process you have to go through, the approvals you have to go through, it was, I remember that time there was almost a difference of close to 100-200 thousand dollars, Just raising. And we were working on the MTN corporate bond at that time. I remember the privately listed corporate bond. So, most of them, they are facing with ownership not ready to let go and not looking at shares or corporate bonds as a means of reducing the cost of capital and expanding the company. The only company that has done something close to shares is Roofings. It is a very good study. Roofings has partnered with Japanese to build the Namanve Plant which was close to between 100-124 thousand million dollars to 150 million dollars. And You can see what is happening have taken over the steel market. So he looked at it differently. He said ok I will retain what I have in Lubowa but for the new project, let me partner with the Japanese and still he didn’t go to raise a corporate bond. He went for shares and borrowed from the banks.

So what the Japanese did they gave their guarantee for the loan but he went to 3 different banks and borrowed the money. That is what I saw. So if you ask me about the structure that is what I would have told you. In Uganda you have this family owned, that if it feels that it wants to enlarge, they will have to go to a bank. They don’t want to look at diluting the shares. You can see it even with the commercial banks, a lot of them as long as the majority share holder like Crane bank they don’t want to let go. They will try to find ways, of keeping it within.

**Interviewer**

*So ultimately you are saying most of the companies in Uganda are probably 90% equity and very small percentage of debt and the equity is a family owned.*

**Interviewee**

No, It is actually the other way round. Because a lot of them what they have done, is they have geared up to debt from banks and a small portion is equity. What they
have done is that they have used the equity to ramp up the debt. Let me give you a very good example, Mukwaano, Acacia Mall, 40 million dollars. None of it was his. So what did he do? He used the assets of Mukwano to acquire this debt. So most of them have used the existing framework and filled up the capital by borrowing from the bank. They have not gone to a bank and say let me issue a corporate bond or let me issue shares. They have not. They’ve just gone and borrowed straight debt.

**Interviewer**

**Do you think that would be the best for Ugandan companies given the prevailing situation?**

**Interviewee**

No. That is why they are suffering with high interest rates.

If you sat down and ask Mukwano today and he decided to say let me float a corporate bond, I will bet you, he will get close to Treasury bill rate of close to 16%. Right now he is around the 18% to 20% in the banks. Other clients are around 25% 24%. Now they don’t see this in terms of the financial cost. Because if you borrowing at 25% for 10 yrs, effectively, how much have you paid? And the only way we decided to convince Mukwano and the rest to come back and borrow longer term was when we showed them that the cost of borrowing money using short term funds. It was quite high. And I remember that time I sat down with them and asked them why don’t you float a bond? And they said the cost is high but the governance around it, is something that they don’t want to deal with. Ya. I think that is the biggest thing, the governance bureaucracy, I think companies feel more independent, only accounting to the tax man and the banks, than now going up and opening up for the public because they then tend to think that they can be held hostage. I think it is lack of knowledge and its a lack of appreciation and the last thing is the high costs that the banks would require or brokers to list a company. Because I think when you look at listing, the cost of listing a corporate bond, they are high. I sat down and really looked at it and said we are only looking at the rate. But what about the fees? It is ridiculous, pretty high.
Interviewer
So, in your view, what do you think about cost of debt financing in Uganda?

Interviewee
Its is very high. Like I mentioned, the average loan in commercial banks is about 25. Now with GDP growth of about 6%, 7%. I wanted you to, tell me how much is their return equity that is enabling them to pay the 25%? And that is all what they have done and creatively is to ask at times to for overdraft facilities, such that, although they have a loan of 2 billion and as long as they put it on overdraft, they can fluctuate. What the banks have done, they are very smart. What they do, they put the 1 billion on a separate account and credit the money onto the current account of a client. So the client remains with the fixed cost of 1 billion you understand, he is not paid on the current account balance. So one of the things that I advise is that the customers can be a little bit creative. If it is a working capital, that is short term, they could look at overdraft facilitative. If it is more of long term investment, corporate bond, term loans, shares, would bring down the cost by almost 10%. Now over a period of 5 to 10 yrs we are talking about 50 to 100% reduction in cost to a company. That is one. Number two is that, a lot of banks prefer doing bullet payments. Customers do not understand that a bullet payment is a disadvantage to you because it is not in line with the development of the business or the trend of the business. So what it tends to do is it ties you, your exposure is left fixed until the term limit. It means, the banks will tend to collect more from you than they should because as the business picks up so does the cash flow and as the cash flow improves, then the cost of your debt should actually come down because you don’t need that money. So, that is why I said that the structure of the debt creates a problem. That is number one.
Not aligning the debt to the business in terms of repayments and flows increases, so you have a customer who wants to pay commitment fees, arrangement fees, and then interest rates then the quarterly, so by the time he is done, almost 5% goes in fees, in fees, then he has to deal with interest of 25%. He is talking about roughly 30%. Which is very high and right now there is strain that you are seeing on the
market is because of the high cost of debt. The NPO’s have now just shrumped up we are talking about 6% 7% and I think they will even go higher probably close to 9%. Because if you have an economy slowing down from 5.5 to 4.6, takes a deep sigh………..

Interviewer
So with that kind of cost of debt finance, do you think it could push companies in Uganda to have more equity because the return on equity wouldn’t go as high as 30%, so you would rather have more equity rather than having more debt? You only borrow debt when it is the last resort.

Interviewee
I think banks are going to be caught in a very tight position. They benefit more by debts but they are also exposed to NPL. So they will have to swallow one bullet to decide of a financing companies, decide that. Either, a portion of their clients, they would encourage them to issue to restructure their debts or they have to write it off. You can’t realize value in such a market where the prices have slumped and yet, you want to continue earning from that client. The business is doing well but it is not able to service the debt because it is too high. 30% is too high. and I always tell people .. think closely when the rates of the government securities were 25% what did the government do, cut down the 15 year bond. Why? Because it also looked at its cost and said If I pay people 25% for 15 years, its a lot of money. But Clients are willing to pay. That is one so Its lack of knowledge. It is the banks really competitively coming out to………, then the market itself does not have sufficient players with muscle to bring down this cost of borrowing. So you have 4,or 3 banks who are enjoying monopoly exactly and its a monopoly kind of arrangement and that is where I say the small banks have a lot of room to grow because if they become smart on how they pay the deposits and how they pay the assets and managing their operating costs, they can actually eat into the share holding, I mean the business share of the big banks.

Interviewer
If a small bank came up and said, we are offering loans at 15% and deposit may be at 10% or 5%, yes or 5% and just get 10% which covers their operating costs and then the loan portfolio will really grow.

**Interviewee**

It will grow. And not only that the small bank has an ability to look at the client and tie his debts to the kind of business that they do.

People talk about creating an agricultural bank. It will not solve the problem. An agricultural bank is required because the debts are not aligned to the trends of agriculture. All you need to do is to just align the debts to the trend of agriculture. Like a school, it does not get money every month. Cash flows should be termly.

So that’s what you should plan. They ask and understand what is the rate of return of that particular business? Can they pay our interest, today. If tomorrow you had a shock or a rise in interest rates of 5% can that business still absorb?

I think that is something that to me is going to……. the rise in NPL’s is a blessing because it is going to encourage all the lenders to rethink the strategy in which they want to do it.

Then another aspect that is coming in which we have encouraged here, is the Islamic banking. It is going to fundamentally change this market the way people think. Because there you are sharing in the profits.

Now, it will go back to the first point that I mentioned. Are the share holders willing to let go some of the control in exchange for having reduced cost of funding but also increased governance requirements? Because people want to know how the companies are performing. So, that is what I think. This is what will happen. So, it is going to re-evolve into a situation where by people have to step back and rethink.

**Interviewer**

Where do you see that happening? Is it likely to happen in short term or medium term?

**Interviewee**

I think, with continued stress that we are seeing in the banks, I think in the medium term. Two to three years we should see a fundamental shift in the way banks are
funded and in the way customers are borrowing, because the awareness has started to take root. People are now looking at the cost of borrowing; they are looking at how people have collapsed, what have been the causes of collapsing? not hedging themselves by saying o.k, today I have to, like the bank is giving me 20% that is a definitely good rate but they have not gone backwards and say how much am I earning? And will the rates remain at 20%. Do I want it to leave it fluctuating or I want to protect myself against the changing rates? They knowledge has to change. So, to me, there has to be a fundamental........ as cost of funding becomes a problem, as indicated in the rising of NPL’s, so will the businesses have to adopt or get wiped out. Its two ways, either you adopt or you fall out.

Interviewer
So we now come to the gist of our actual discussion. The factors that are impeding Ugandan companies from issuing bonds. They want the finance but they are not themselves coming out to say we have an issue and its floated and it is not subscribed to I haven’t seen that kind of thing.

Interviewee
I think a lot of things, let me start with the basic thing. Do we have the legal framework and structure, where by one can confidently know that security is actually secure. I think that is the major point. If you look at issues that have raised investors from taking equity, they’ve had concerns of how the security can be perfected and how truthful and easy it is. So, issues of land, issues of transfer, issues of ownership, issues of actually getting the investor to feel protected have to be addressed.

Interviewer
That is on the side of the investor but the side of the company,

Interviewee
That is where it comes because if a company wakes up and says I want to float a corporate bond, for example, what will the investors say? In case you don’t pay me back, what is my fall back position? That’s where the problem comes. So, in terms of a company, they have to sit back and ask themselves, do we want to change this structure in which the currently sitting? They have to make a decision either to float
shares, to issue bonds. To me that is what I would do, or to restructure the business in such a way that they tie their flows to their debt. Those are the two cases.

But you ask me a question, what is your question again?

**Interviewer**

We are looking at the fact that impeding Ugandan companies from issuing corporate bonds.

**Interviewee**

Cost of corporate bonds. The banks cost of issuing bonds is high. The fees are quite high. The number of banks that can issue corporate bonds are limited. The limited advisors to companies in terms of how to issue the corporate bond, how to assess it, they are very few in Uganda and if you go out of Uganda and say let me get a Kenyan advisor, it comes with a price tag. The cost comes much higher. That is one of the issues that I think.

Number two, there is no incentive. There is no incentive, why someone should go and issue a corporate bond, visavis borrow from the banks. So, If you had a tax incentive, for example, an investor who is investing in a corporate bond as a tax break or something, then you would definitely see a build up. There is no incentive. That is what I have seen.

Then the other thing is also from the regulatory point of view. If we limit or put in place regulations, that require that after above a certain amount, a company should seek to borrow outside, either corporate or shares, then we could definitely see........ So the regulations do not encourage or prevent someone from just going and raising debts throughout the bank.

**Interviewer**

You are talking about regulation on the side of the banks? Yes. If you want to borrow from the bank, there is a ceiling. Beyond this amount, it goes to the market.

That is missing.

**Interviewer**
Is it somewhere, is there a country?

*Interviewee*

I think some countries have. Yes.

Even during UAE, they have a way of controlling the share holding. If you are borrowing or you are lending or you are investing, if you are not a citizen, you cannot own more than 50% of or something like that. Ya. Thats what it should have been.

In Nigeria it took off because the cost of borrowing was high and what they did, they opened what we call a corporate bond market. Here we don’t have it where you can sell the paper to any one, So the lack of Corporate bond market is also is an impediment, because if you have what they used to call the corporate paper, corporate certificate, corporate deposit slips or something that they used to trade. So, the lack of a corporate bond market is something because you need to have a yield curve of a corporate bond markets which will act as a bench mark. That is one.

There is also lack of a rating agency, a local rating agency to rate the locals is also an issue because how do I know what Mukwano looks like? or how do I know what Mulwana looks like? or how do I know what Nice looks like? People want assurance and normally the rating agency to rate corporates will be something. So, in the regulations if you say, to lend a company they have to have a rating. What we have done as a central bank, we have introduced what we call the credit reference bureau to give a person a comfort but it is only looking backwards. It does not look forwards. Just looks at your previous history and defaulted anywhere. The history does not predict the future.

Those are the key things that I can mention. Is lack of incentives, regulation to support, the listing for example, if you came up and said, banks anything above 50% of your shareholdings has to be floated or has to be raised. Or any amount that exceeds a certain amount of portion of your capital has to be out, So, there has to be an environment that promotes this kind of behaviour There has to be a market that is created and how will the market be created? That is a question you are going to ask.
It comes by, the more you encourage, then you develop a yield curve, based on the rating of a company. If you are rated AA then everyone expects that your credit default rate should be lower. If you are high risk of depending on the sector you are in, then the spread over and above the government security. So, that is one. Then the lack of pricing loans against government security is a very big impediment to raising corporate bonds because now banks just wake up and say I have increased to 30% have increased 20% but they are not referencing to the government rates and the base rates has no angle to the government security rates or to the CBR. So, until you have the loans being issued referenced to a market determined rate, your risk is so much so we add be 2% exactly. Yes. That is what is preventing people.

**Interviewer**

*But a lot of the issues you have talked about: the advisors, the cost, credit reference, we do have multi-national companies here or the Blue chip companies, I wouldn't think would have problem with any of these. Why haven't they issued?*

**Interviewee**

Because there is no incentive. The first thing I started with, there is no incentive. It is cheaper to go a bank than to go to a corporate bond because you will need an advisor, that will cost money. You will need an arranger that will cost money. You will have to go into the market. That costs money. Why do I do all these three things yet I can go to the bank and all ask, do a syndicated loan, without an advisor? The banks just do it for you. The advisors are few and so are quite expensive. That explains a lot. That is it.

A lot of it comes from there and the banks don’t have an incentive. The banks should have been promoting it. They are still enjoying monopoly. So if you enjoy monopoly if you look at the other banks, all banks have 25 billion but its just becoming interesting when banks, when the volumes are big. So, no one has come up and say o.k. Yes, I don’t want to look at a client, or the number of clients who are borrowing quite high but I can look at a sector. When you start seeing, sector borrowing then
you are going to see where people are now pricing based on the sector, So, if, for an example, it is agriculture, what is the premium on agriculture? If it is oil, what is the premium? That is lacking also, in terms of segregating the market and pricing it; according to that relevant risk of the sector they are not doing that.  o.k.
With no incentive for the bank and no incentive for the clients, can't move.

The cost of funding..... we did an analysis, the cost of funding from a bank from a straight loan, although looks high, is much cheaper than if you went to a corporate bond.

**Interviewer**

Does that have anything to do with the amounts being floated?

**Interviewee**

No. it has something to do with the way the structure of charging for corporate bonds is here. It is very primitive because you pay an adviser, pay of an arranger, you pay quarterly fee, pay commitment fee, you pay, I don’t know whether they have a certain other figure they pay. By the time you are done as I told you. You could have lost 5%. It is quite high. Even if I was borrowing 1m, the time to go to arrange these things, by the time I finish, you are better off going to the bank. O.k.

**Interviewer**

When you look at the government yield curve, for the government borrowing: bonds and treasury bills, is it reflecting of what is in the market? Like in terms of the yield curve as in the Government borrowing at certain rate which is considered to be the risk free rate. Is it reflecting of what is in the market?

**Interviewee**

Right now, I would say, in terms of relating it to the borrowing of clients, banks more use it as a bench mark to price their prime rates or base rates. But after they have priced their base rates, then the margin that they charge a client is over and above that base rates. So, I would say, it is reflective where the investors feel that government should borrow. It is very reflective. However, it is not being used as a
tool to price deposits, or to price loans. So, yes, an investor says I like Uganda government, I think I should invest at 16%, but the bank that sits there is not applying this to the lending in the market. So, you find that, no lending that have seen so far, has been turned matched to the government security as per now. If that was the case, then it means, either the government debt is being mispriced or the loans and deposits have been mispriced. Then we go and look at what we call real exchange rate. We look at the rate of inflation vis a vis, the rate at which we are lending for a local investor, so, you will find that if you have inflation at 5% and you have government security at 15%, it means real rate of return is 10%, is quite high. So you find that its govt securities are not in line with what you see as the inflation. So, there is premium the government is paying over and above the inflation rate. Which is pretty big. It is 10% am telling you. Real interest rate. At one time it was 15% other governments are borrowing at 2%. to one person, so it is high. If you look real rate of return, Uganda is quite high.

**Interviewer**

**Could that have an impact on the corporate bond market?**

**Interviewee**

100%. It means if the real rate of return on government securities is 10%, any corporate asset cannot have a real rate of less than 10%. Then it doesn’t make sense. That is why you will find that they are pushing the rates much higher than the real rates.

So, you find a bank having a real rate of return of 20 and that is why you see that the borrowing has been constrained because the cost is very prohibitive. So if you ask me about whether it is reflective of the market, it is reflecting of where market thinks where government should borrow. But if you step back and look at the rate of inflation, government should be borrowing around 8% or 9%.

**Interviewer**

**How does the yield curve in Uganda compare with the EA region?**

**Interviewee**
It is much higher than that of EA region. If you look at Nairobi, Kenya, is right now we have as 16%, 17%. Look at Nairobi they are about 10%, 12%. Look at Tanzania, they are around the same, 12% 13%. So, generally we have tended to be, in my opinion 3%, 5% higher than the rest of EA.

But something that is interesting in Kenya they don't have tax. Their tax on government security is applied at the beginning. Ours, as you keep on earning it is 20% and ours is not synchronized with EA. I think Kenya is 15 and ours is 20. I don't think whether Tanzania has government security. So that is one of the itms. ya.

**Interviewer**

Any other factor you would think could be impeding?

**Interviewee**

I think lack of knowledge. Knowledge could also be an issue. Serious knowledge gap is a very big issue. Knowledge in order to have properly auditable accounts and use these as a basis to display the health of an institution or the issues the institution is having. Lack of knowledge in understanding, what type of debt structure a company needs for specific projects. they don't have it. The lack of knowledge of how to apply the cost of funding to the market rates, they don't. Someone just come in, and says, I just need the money. Is doesnot make sense. ya. I just need the money. Someone still not looking and says as a bank, you pay me zero on my deposit, but you are charging me 25. So pay me on the deposit or reduce my cost of borrowing. No one does that. Probably they are too small to have an impact on the bank. I think they are very big. If Stanbic has average cost of deposit of 3%, and on the average lending rate of 25%, That is 22%. Who is paying? He is using the money that is paying 3% to pay/earn 25%. So, when people look at this and when they look, that is why I said, it is lack of knowledge. When you look at Stanbic balance sheet or any other bank and you look at it and say, where do they earn their revenue? It is in fees and interest rate income. How much are you paying me? Should be a question. They don't ask that question. I do it, to be honest with you if you go to my account, I invest. I don't give them money, I invest I know the securities are 18% because I can’t invest in securities because I control them. so, I will only invest in fixed deposits. You understand what I say.
I push them I earn between 16% to 18% just slightly below the treasury bills rate, because that very money they pick from you, tomorrow they will buy treasury bonds Because am aware, treasure bills are higher, why are you paying me less? So, I try as much as possible for negotiating close to the treasury bills rate to fixed. I have done it for a long time and now am very happy, and advantage, is fixed deposits have a tax of 15% treasury bills have a rate of 20.

At the end of the day you are at par. Actually, it is like more than people treasury bills, people are not aware. Lack of knowledge. When you put knowledge, you grade it. Knowledge in product, Knowledge in understanding, knowledge in importance of having properly accountable books. They don’t know. Yes, if you have the knowledge in properly accounting books, you will be able to see where your cost is coming and if you are borrowing that is where you have a problem. If I use my own personal experience, what I do, because I participate a lot in real estate, am very strict not to borrow from the bank for real estate because the cost is prohibitive. But not because the commitment and rate of return from real estate is low. ya. and if you go out to borrow, the cost is high. So, net rate yes, you can have the best building but it is actually giving you a negative return because you have a salary they are deducting, you don’t feel it. but if you put it in perspective and say, let this building pay for itself, it can’t and very many people don’t do that math and yet for me I look at it differently and I say, spread your wings, have some fixed deposit, have some assets and real estate everyone looks at it and they wonder, why do Ugandans? Are they crazy? It is not earning. It comes from history of security. They feel comfortable if they have a building than if they have cash. Because there is one day you will come and devalue but you won’t devalue the building. They cant.

Interviewer

So finally, what do you think would be the results positive or negative of the booming corporate market in Uganda?

Interviewee

The market will grow. In Uganda, if you see the number of people who have bank accounts and who borrow, they are less than 5million. Against a total population of about 38. Now, I wanted you to imagine and these one don’t all borrow, So of that 5
million who have bank accounts, you might find that only 100,000 are borrowing. Now a lot of capital is locked out in buildings in assets, because of what I told you about security. Someone just says, let me keep, when I want I will sell, now let me keep the building, so you find that a lot of Ugandans use cash to invest. The culture of borrowing is very low because of the high cost that is involved. People feel, I will lose my building, and rightfully so 25% interest you are going lose it. So if the interest rates were to drop hypothetically, lets say down to 15%, it will let out capital. This economy will become a two digits and GDP growth because agriculture will produce… everyone. But now we have a lot of capital locked out in buildings. If a person had two buildings, fully cash paid, he could own 4 buildings. So, in my opinion, that is something that they need to relate to the capital, visa vis the potential to make more out of this capital. They don’t look at it. When he finishes paying the loan, he just gets his title and puts it in the drawer. says, Now I am done. Not knowing when he looks at that building he could have actually had two buildings all bringing in money one servicing one not serving. At the end of 10 years, you have two buildings. The value has gained. In my view, is that, I think the prospect for corporate bonds is very high, but there is a lot of education that has to be done, a lot of assurances that have to be done, the infrastructure has to be developed in such a way that it is easy to transfer ownership to and from. Then you have a different size of corporate market, because it is booming but nothing, people are just trading with their money. No one is looking at investing. Am telling you, I would not be surprised if the GDP triples. If people just decided if the 4m people with bank account, decided to go out and borrow, how much capital do you think would be let out?

It is significant, yes, and with all these infrastructure projects, I think the light seems to be there. If they are structured in such a way that they encourage people to invest in some of these projects, that could encourage awareness. When Stanbic first floated, you saw everyone was running. When Safaricom, came, every Ugandan was saying Safaricom, even they did not know how to spell the name they just say, please I have to buy shares. So if the structure of the infrastructure projects are structured in such a way that they promote people to invest, So, the company that is
probably going out to build a refinery comes and says am floating a bond. I should be able to see. So the future is there but it has to be triggered by a market driven demand where by anyone doing this infrastructure project, goes out to source for money either in terms of shares, in terms corporate bond. The light is, am very optimistic that it will definitely pick up. Am very optimistic. I can tell you that 2 years from now, you and me will be smiling and saying I told you so. 2 years is not a long time, No. not a long time, I am now convinced that two years is a very short time. That is for sure. Ya, So thank you very much. You are welcome. I think that answers all my questions. If there is anything else that comes to you, and you let me know, I will definitely share with you. but that is my opinion,

Interviewer

Very informative and very helpful,

Interviewee

any time and if you remember something, please, let me know.
Interviewer

So, I have a few questions for this interview which you are given your experience, I expect you to give as wide a response as possible not probably limited to this company but from a general perspective of the Ugandan business sector.

So, in your view what do you think would be the best capital structure for a company operating in Uganda?

Interviewee

I think that looks at mostly the shareholding of your company and for the private sector you would be looking more at equity and debt. That goes also a little into the companies which are owned by government. It’s also equity and debt if you look at the costing of each of that, equity might be seen to be cheaper and in the long run possibly it might be more expensive depending on the expectations of the shareholders.

But we believe debt currently is expensive in Uganda. Because we are talking of rates of 15% for the low risk debt to even up to 30%. So it is quite high. So possibly equity takes a big share of most of the companies.

Interviewer

So because historically, it’s been, most academics have had that argument that there should be a balance between debt and equity and they encourage you to be geared as much as possible to have debt almost to the extent of 70, 30 or 60, 40 so are you saying it is a reverse in Uganda?

Interviewee
It’s fairly reverse in Uganda you see many companies using more of equity and possibly that is why they are not developing because you see companies that are stagnated and debt because of the cost of the debts it tends to distress most of the companies, but if you look at, like our company the housing industry there is no way you can avoid debt. So it is actually possible to have debt even higher than equity by 60% debt and 40% equity.

Interviewer

Yes you might have a 40, 60 do you think it is optimal is it a heavy burden? Do companies fail because of that debt?

Interviewee

I don’t think we have many companies that actually sit down to look down at their capital structure. So most of it is more of project driven need than looking at the overall picture of whether I am efficient with which percentage to take, so I don’t think structure is very critical here it is more of what do you want to do and that drives your need for financing.

Interviewer

So it is about availability.

Interviewee

It’s really about availability. I would actually say in Uganda you will find very few companies that have tried to look for the optimal mix of their finances.

Interviewer

They end up by whatever percentage by accident.

Then given that background, what’s your take on the cost of debt finance in Uganda?

Interviewee
Debt finance is quite high, driven more by the bank rate which is equally high, because the bank rate we are talking of 15%. if you put the risk and the margins you are talking of debt minimum being 20%. So borrowing at 20% is quite high and affects the pricing of projects. So it’s not sustainable in the long run, though it is what is available to use today. And that would explain why most organisation do not survive when the banking sector is actually booming. And I want to believe the absence of long term debt affects this pricing because most organisations borrow short term to finance long term needs and that mismatch means that you are borrowing long term at short term high rates and affects the achievement of your objectives of the project.

**Interviewer**

*If you look at your company and you look at the returns, do you have returns which really match this cost of debt?*

**Interviewee**

No if you are looking at my company the highest return on investment we have registered is something like 5%. The cost of debt is 25% so that is why I was saying that it is not sustainable at all.

**Interviewer**

*So the return on investment of 5% doesn’t include debt finance?*

**Interviewee**

No it doesn’t include debt finance. That would actually be the return on equity.

So you will find that equity if you take that to be the price of equity certainly becomes cheaper but it is eroded if you look at the inflation rate of about 7, 8% the return is actually lower than the debt and the erosion of that margin I believe is the cost of financing itself.

So debt is taking a bigger share of the profitability of the organisation. Which affects the bottom line of the price of equity.
Interviewer

If we come to the gist of this interview, which is the main factor, what factors do you think are impeding companies from issuing corporate bonds?

Interviewee

The major issue is knowledge. I think there are very few companies that understand clearly how you can approach corporate bonds and it because it is a young market the capital market authority is young. The stock exchange is quite young and there not much trading of bonds in stock exchange, so many companies are not looking at it as one way of quickly getting money.

And the other factor is that the agents, when you look at it the cost itself of structuring if you are going to start a process, and this process is going to cost you 2% 3% of debt before you acquire it, it is also quite high,

There is the cost itself of structuring, then there is the preparation for that corporate bond, very few companies have really worked towards preparing yourself for it. Because for you to list it is has the same requirement as actually listing equity. The three years of profitability, 3 years of unqualified accounts, so you will find that organisations do not prepare themselves for those 3 years for compliance so that affects them.

There is the other factor that most of the companies that would be going for corporate bonds don’t see much difference between the prices for them and price for debts-bank loans

If you look at the cost of bond now an average of 15%, okay if you compare it with the loan, the commercial bank loan of around 20% you will find that you look at that spread of 5 as actually also being taken up in the structuring process. So you ask yourself whether you need to prepare the company for the 3 years or 4 years only wait to get margins that are smaller so if possibly that difference between the cost of the corporate bond and the cost of loan was big, then possibly companies would start being managed to attract that.
Then the other is the projects that are bankable to support those corporate bonds because we have very few projects that would attract that type of financing, if you look at the companies that have succeed I think it is only Kakira, housing finance, EADB, MTN I don’t know which other bonds we have. Those are the only ones that have actually gone for that and if you look at their characteristics they are actually not locally owned so you would think that the knowledge gap I have talked about the exposure to these opportunities, the cost, the preparation

Then if you look at some of the companies which were inherited from government a company like mine, then they are also restrictions to how you can access these corporate bonds. The approval processes is for the government type of companies.

Then those which were sold they are cheaper sources of financing where the shareholders come from than the local market. So you would find that for example the multinationals, the financing in India is cheaper, in South Africa is cheaper in China is cheaper so it is easier to pick finances from these countries than picking the local finances and I think we see most of that now. So there is no interest I don’t think Standard chartered bank would look at getting finances from the corporate bond when they have the whole chain of SCB that can lend the Ugandan branch. So up to when we will build capacity for our own organisation also to absorb some of those finances and be trusted we will actually not succeed in that.

Then the other factor is that the available funds that can go into these corporate bonds is mostly the pension funds. And these pension funds have opportunity for high yield instruments like the treasury bills, the direct fixed deposit in banks, the restrictive law itself for the social security fund. So that also affects the liquidity of the bond market. If you are looking at really only one person one organisation that will take a big chunk of it then it means if that one organisation is not interested then the bond will not be successful. So if you look at the Ugandan market the person who would have interest in those bonds would be NSSF. If from the beginning NSSF does not show interest in this, you actually won’t get high subscription on it. So there is the whole of that fear that you can spend all that money in structuring it and even after spending you do not have organisations subscribing to it or when they
subscribe then it is a monopoly in pricing which will so affect the attractiveness of bonds themselves.

Interviewer

*So when you talk about projects, is it about the size or the type of the projects?*

Interviewee

The size of the project, the type and size and how you can I think if you have had successful projects it becomes easy to attract some of these bonds but if you are now working on big projects then there is the whole trust based on the history of the companies. Whether this company is able to deliver what it promises to deliver through that financing. Now if that trust if you can actually take it as trust, how trustable these companies are, how consistent they have been which also moves with the economy. If the economy has not been consistent, the parameters haven’t been consisted sometimes you ask yourself whether parameters projected for the company’s bond period will also be consistent. If you actually just take the dollar fluctuations, today you at 3000 the next month you are at 3800 how do you then price the bond is it in dollar is it in Uganda shillings. So how do you trust that your returns the bond will actually yield the returns that the organisation that has borrowed. That consistent could also be affecting it.

Interviewer

*If you are talking about the pension funds and NSSF do you involve these people even before you actually do the actual issue, do you have to talk to them before hand and if you think they are not interested then you back off?*

Interviewee

I think anything before structuring you look at how successful it is going to be, so before you structure a bond you still must talk to these major they would be buyers, the potential buyers and if you see that there is interest in it then it becomes easy for you to structure knowing that I have two or three potential buyers that can attract 3 or 4 more buyers.
And you see this also with the equity market, if you look at most of the companies which are listed, the pension fund and insurance actually have a big chunk of these equities, now that in the long run also affects the tradability of these securities because these guys are holding over a long period of time there are not eager to sell because there isn’t much that they can buy, so when they keep these instruments then the market itself becomes illiquid and does not attract other buyers. Those people who may have been interested in them, and that in the long run also affect the liquidity. And I don’t think the bond market would be that different from what is happening in equity market.

**Interviewer**

When we talk about knowledge, for a long time Uganda has had professional courses like ACCA and CPA and I believe this is involved in their curriculum, now the people in the market who you work with, have they shown good knowledge of these instruments?

**Interviewee**

Incidentally I think they study some of these things for the purposes of passing exams but the opportunity to practice, because if you look at the companies which are providing financial advisory services even for the USE I think we have had something like 5 or 6 of them for a long period of time one drops out another one comes in but there are not many that can. And if you look at the profitability of these companies I don’t think it is high considering the number of transactions that they handle. So the whole market does not provide opportunity for the practitioners, the professionals actually learn how the bond market works. Does not.

**Interviewer**

And this has largely affected knowledge?

**Interviewee**
It affects knowledge and it is not the only profession, if you look for example at the engineering profession it is not growing as much as it should grow. So much as we believe that because of the low opportunity to practice the knowledge gap widens.

**Interviewer**

So when you talk about knowledge of you leave the professionals alone, what about at the board level, do you think boards have some, if I had the idea and I sold it to the board, are they likely to buy it easily?

**Interviewee**

I think the board would buy it, if you structure it properly and convince them that this is achievable, they would buy it. If you look at the board presentation, most boards that I have seen we don’t see so many financial experts on the boards that go into the difficult things. So it is more of the management itself driving their agenda through the board, and I don’t think I would blame the board on this.

**Interviewer**

So it is a negative on the side of professional it is a positive on the side of the board, they are not having much knowledge then they easily accept things?

**Interviewee**

You would easy manipulate them to achieve anything that you want as long as you can show that actually can help you achieve the objectives, the financing that you need.

**Interviewer**

Is there any other factor you think because this is a company in Uganda, has been operating for some time is in need of debt finance and doesn’t think about bonds. Is there any other factor apart from the ones you have listed?
**Interviewee**

I think the other is the demand that would be driven from the organisations that would finance these bonds. Because if there was that demand that is where people are badly looking for where to put the money then that would drive the market. But if they are so many alternatives that give you a return that would be higher than what you would get from the bond market, then you would not actually go for something that you think is a pull effect.

Because for it to succeed well, you would be having people fighting to have some of these proposals come out. But if it has to be driven from the issuer then it becomes it is not that lucrative, it is like you are trying all the time experimenting rather than having a market that you know that exists the financing is there.

If you have many organisation providing long term financing that would be, you would say let me structure something that would attract these people, but when you know an organisation knows that I can go short term and make my money and pull out rather than risk my money long term, then that would affect the market.

So even these organisations need to see that there is an alternative to raising funds because the market is maybe available or something. But as long as it is still at its infancy then the organisations that would borrow from it.

**Interviewer**

*We have heard a big influx of funds from the western world at a very low rate and some countries have benefited from such bonds and it would still come back to Uganda. Why? if companies here issue foreign currency related bonds probably they would get them at a very low rate, is it something that has been expounded?*

**Interviewee**

Incidentally we have tried to look at it but it is not as easy as that because the country risk comes in at that point and you will find that something that one would be selling at 3% would come here at 7% because of the country risk. And this is also coming in form of foreign currency which is also affected by the exchange rate risk,
so what would come in as cheap by the time you access it, it is actually quite expensive.

If you put the volatility of the exchange rate it is worth a long term you might actually not see the benefit of this type of finance.

The other is, the market here is so liberalised and not supported by government possibly if there was a clear government support of this and maybe cushioning part of the risk either in terms of guaranteeing these bonds or things like that, then you would find that the pricing is low because they are not guaranteed then you find that that risk is also captured. So if you capture the currency risk and the country risk into this bond what you would call a cheap source of financing becomes high. Because in the absence of government guaranteeing it then you will have the bank guaranteeing it so you have still actually introducing the same risk on the market.

Interviewer

And that comes at a cost.

Interviewee

That still comes at a cost. I think those structural issues also need to be solved.

Interviewer

You were talking about the cost of debt. I was looking at government borrowing and corporate borrowing, and I’m looking at the cost of government borrowing almost being higher than the cost of corporate borrowing.

Interviewee

At how much is Govt borrowing, Govt is borrowing at 15%.

Interviewer

I think right now they are borrowing at 18%.
Interviewee

And corporate borrowing is more than 18%.

Interviewer

Some corporate are even borrowing at even 14%.

Interviewee

That would be special funds possibly, or if it was structured corporate banks it was structured when the govt borrowing was also around the same percentage.

Interviewer

So you think if properly matched.

Interviewee

I don’t think it is matched, I don’t the market is efficient here, so some of these things if you borrow at the prevailing rates and it is a fixed rate bond over time then you benefit but you also suffer if it is fluctuated. Because I don’t think today you would borrow at 14% you possibly would fix it at 18% so it moves down then you will still be affected. I don’t think our market is that efficient to start capturing those movements.

Interviewer

In your view what do you think would be the results positive or negative of a booming bond market in Uganda?

Interviewee

I think if it was booming and attracting foreign inflows, then the interest rates would significantly go down.
So the interest rate would go down then availability of money for long term projects for example if like in my industry if we stopped focusing on one project and maybe you have 6 or 7 projects that are being funded by one bond, then you would have long term stability of financing organisation and possibly which will translate into long term stability in returns.

So I believe it would create stability, it would create growth of organisation because if you have this adhoc borrowing per project it also affects the whole outlook of implementing the strategy itself but if for example had your entire strategy financed by one corporate role then you are able to grow the organisation with one facility and not in the market all the time. Then certainly the other is growing the financial market, because if you had these bonds there then possibly you would see more activity in our finance markets.

**Interviewer**

*With increased finance activity, lower interest rates and more availability of funds, that definitely would translate into more economic activity.*

**Interviewee**

Yes, more economic activity.

**Interviewer**

*But do you think banks would be on the losing side?*

**Interviewee**

Short term yes, long term I don’t think. I want to believe long term as the market grows the banks grow with it; and two I believe they would restructure their systems also to tap into this markets and benefit from it. For me I think it would create new business for the bank rather than actually compete with the banks, because they are now handling a small percentage of the savings, when you have a high performing bond market it introduced new products, it introduced new money, it introduces new opportunity for banks. So I just want to believe that the banks
would actually growth. You can easily find some few of them being affected, short term but long term they also have the stability and of how they work and also a bigger opportunity for the banks themselves to grow because if you look at the like local banks which have no opportunity to attract some these financing, their growth has kept low. if you look at housing finance with some few million dollars in capitalisation, post bank with some few million dollars in capitalisation, Centenary bank with high deposit rate but possibly would be growing faster if it had more funds to push into the market. So for me I just believe it will introduce more business than kill the finance industry.

Interviewer

So thank you very much, basically those are the issues I wanted us to discuss, except if you have anything else you have to add.

Interviewee

Nothing much but I just believed it is another opportunity that possibly if we focus on would improve the way we look at our business.

Interviewer

Thank you.
Interviewer
I think we have started.
So in your view what would be the optimum Capital structure of a company operating in Uganda?

Interviewee
Okay, the way I get it from the point of view of the corporation or you want just,

Interviewer
Even if it is the point of view of the corporation but could be generalised a little, given the experience you have.

Interviewee
I think with my experience I think a mix of equity and debt, would suffice and the equity I’m looking at the shareholding, which would be from the private sector or that is individuals or even from the public itself subscribing to some of these companies.
And Debt, looking at debt, primarily in long term debt, that some of these companies could get without the fear of actually losing control in terms of ownership.

Interviewer
So would you think in the Ugandan situation now, it is wise for a company to be highly geared or 50-50 or they should just take minimal debt?

Interviewee
I personally think it should start in small instalments in bits, because again if you get too much into it at a go and you burn your figures, that also will not be good for the market generally. But it also depends on the need but whichever scenario I think it should be in small tranches to start it, test it generate additional apatite get the experience and then go into it. That would be my thinking.

Interviewer
Regarding the debt in Uganda what is your view on the cost of debt financing in Uganda?

**Interviewee**

The debt financing, the cost at the moment is a bit high to be honest and the co. That takes on debt now if it is significant it may struggle because at the levels of 19 – 27% to get returns to service that debt might be a little bit of a struggle. So I do believe it is a bit high but again that is from a commercial bank lending. But I think even for development financing it is also bit high because the biggest player in determining this interest rate is actually government. So if they continue borrowing from the public with their bond and treasury bills expensively it makes the cost of funds to be really high.

**Interviewer**

So now it takes us to the gist of our interview today because this is the most important part that, what factors do you think have led to Ugandan companies shunning the issuing bonds, why aren’t they issuing bonds?

**Interviewee**

I personally think there is one; lack of awareness, the people who should be driving the process of getting into the issue of bonds do not understand them so much. So the financial literacy around the bond is wanting I must admit, and even to the extent that people who have done business courses you will them actually with all sorts of reservations and negativity about bonds and it is just that lack of appreciation

and also two; there are not so many examples that you could cite that so and so has issued a bond and has done ABCD so, the success stories are very few if any and those ones who have issued the bonds also, I don’t think the capital market authorities and whatever have really used it to market these products because if I issued a bond for purpose A and it matured after 5 years, I have done this, I have transformed my sector, I’ve attained this, I have repaid. The success stories are not been told. So that drives ignorance in the market
and the other reason I think why the issuing of bond is also not so common is that the shareholders do not understand and they are a little bit jittery and again it gets back to what I said first, financial literacy. Because really I don’t see why the utilities are not involved in the issuance of bonds and then the third reason why all these also did not catch fire even especially for the state corporation is when these credit crunch cropped. People thought that borrowing of whatever nature was going to be extremely risky and I do know of instances where approvals were withdrawn because of the fear of the implications of the credit crunch which fear turned out to be a little bit far fetched to be honest. Because I don’t think it would have mattered much so there was that general fear that this borrowing will cripple the economy.

And then I think the other reason I think for some people they think that if I issue a bond, it is like mortgaging the company there is going to be a lot of demand, a lot of inquiry the typical requirements that people associate with public issues, so that also drives a little bit of fear for as far as borrowing is concerned but primarily it is financial literacy and ignorance.

**Interviewer**

*With the experience you have, we have many people of ACCA, CPA, CIMA coming into the market, do you think they have contributed to increase the awareness or they are also not aware?*

**Interviewee**

I do not think that they have done much, in my own assessment and discussion, because personally I was involved in an attempt to float a bond but the kind of discussion we have and reactions we have still I think the colleagues in ACCA and CIMA they are typical accountants and they more interested in accounting but their understanding of the product is a lot of better. But I think the risk factor, the fear which to me should not be the case. Make a few of them to be a little bit conservative.
because my attempt actually ended up being shot down by people who are accountants, economics, guys who should be the know how.

I think for institutions like ACCA and CIMA traditionally the emphasis has been so much on accounting. It is actually the recent past that they have opened up a little bit in financial management so you find that the other older generation of accountants are more typical focused on accounting and there are the guys that who are now up there but I think the generation coming should appreciate this product much better.

**Interviewer**

*When I look at national water as a utility company, I am definitely sure you need finance. So if you sat here today as a top finance officer in the company, what would stop you from issuing a bond maybe next month or starting next week?*

**Interviewee**

Yes, we actually did everything to actually float a bond, we worked with the world bank, and we walked through the process of issuing the bond and understanding the bond typically and we had reached the stage where we were supposed to do a road show and we had been given actually approval by the shareholder which approval was withdrawn after one week because of the fear of the credit crunch. So to answer the question specifically as an institution as national water, we have no problem of actually issuing a bond and we already started the process.

At management and board level we have developed a framework for finance and one of the options we are looking at is actually the bond and not only that to ensure that whichever financing option we go for, is successful. We successfully convinced Government and we set up a water infrastructure facility which is a surcharge on the tariff and the whole idea is to leverage on that for market financing. So our target is that the preparatory process should take the next two years so that by 2018, we should be in position to actually float infrastructure bond for national water and Sewerage Corporation. So we are moving along that.
We are government owned and whatever we do, we have to get the final approval from the ministry of finance which I believe we should be able to get at an opportune time because the way we see the global trend we also see the amount of money that has been coming in the country over the last three four years, less and less of donations and grants are coming in, we are seeing more of concessional loans and market loans so really if you look at it the next 3-5 years, whether the country likes it or not, it has to work around and see where and how to get additional funding. I don’t see people like us running away from bonds or market finance.

**Interviewer**

Then the illiteracy that you are talking about, do you think it also spreads into boards, company boards?

**Interviewee**

Yes it does. For us in National water what we did was that the moment we got into this, actually the first category of people that we targeted was the board. So that they were brought on board to understand this particular product, including going to benchmark and see where bonds are being issued for infrastructure and they have worked successfully, and they came back having seen by their own eyes, they were excited and embraced it, so within the board there is need for that.

**Interviewer**

In your view what would you think would be the results of a booming bond market in Uganda? positive or negative.

**Interviewee**

I think if it is booming, I think one of the benefits is actually to bring the cost of funds down. Because right now the driver of the market is actually government because he is the biggest borrower and I believe the more people we have on board, that would give us the true yield curve for the interest of bond or debt the way you look at it. Because at the moment, it is government, so the booming one would be great and if we have a booming one, then I think also we would be able to start
attracting more players from outside. At the moment we have a lot of the locals, NSSF and the banks participating primarily.

**Interviewer**

*So thank you very much for your time those were the four major issues we wanted to look.*